

Audit Report

Manistee-Benzie Community Mental Health

October 1, 2005 – September 30, 2006



Office of Audit
Central Regional Office
April 2011



RICK SNYDER
GOVERNOR

STATE OF MICHIGAN
DEPARTMENT OF COMMUNITY HEALTH
OFFICE OF AUDIT
400 S. PINE; LANSING, MI 48933

OLGA DAZZO
DIRECTOR

April 7, 2011

Don Smeltzer, Board Chair
Manistee-Benzie Community Mental Health Services
310 N. Glocheski Drive
Manistee, Michigan 49660

Joseph "Chip" Johnston, Executive Director
Manistee-Benzie Community Mental Health Services
310 N. Glocheski Drive
Manistee, Michigan 49660

Olga Dazzo, Director
Department of Community Health
Capitol View Building – 7th Floor
Lansing, Michigan 48913

Dear Mr. Smeltzer, Mr. Johnston, and Ms. Dazzo:

This is the final report from the Michigan Department of Community Health (MDCH) audit of Manistee-Benzie Community Mental Health for the period October 1, 2005 through September 30, 2006 and selected areas prior to October 1, 2005.

The final report contains the following: description of agency; funding methodology; purpose; objectives; scope and methodology; conclusions, findings and recommendations; Audit Adjustments by Fiscal Year and Funding Source Table; Impact of Audit Adjustments Table; and Corrective Action Plans. The conclusions, findings, and recommendations are organized by audit objective. The corrective action plans include the agency's paraphrased response to the Preliminary Analysis, and the Office of Audit's response to those comments where necessary.

If the agency disagrees with the MDCH audit findings, the agency must use the appeal process specified in the agency's contract with MDCH. The adjustments presented in this final report are an adverse action as defined by MAC R 400.3401. If disputing the adverse action, the agency must submit a request for the Medicaid Provider Reviews and Hearings Process pursuant to MCL 400.1 et seq. and MAC R 400.3401, et seq. within 30 days of the receipt of this letter. Requests must identify the specific audit adjustment(s) under dispute, explain the reason(s) for the disagreement, and state the dollar amount(s) involved, if any. The request must also include any substantive documentary evidence to support the position. Requests must specifically identify whether the agency is seeking a preliminary conference, a bureau conference or an

Mr. Smeltzer, Mr. Johnston, Ms. Dazzo
Page 2
April 7, 2011

administrative hearing. If the agency does not appeal this adverse action within 30 days of receipt of this notice, this letter will constitute MDCH's Final Determination Notice according to MAC R 400.3405, and MDCH will implement the audit adjustments.

A request for the Medicaid Provider Reviews and Hearings Process must be sent within 30 days of receipt of this letter to:

Administrative Tribunal & Appeals Division
Michigan Department of Community Health
1033 S. Washington
P.O. Box 30763
Lansing, Michigan 48909

For any audit finding and adjustment not in dispute, the agency must submit any resulting amounts due to MDCH within 30 days of receipt of this letter to:

Lisa Halverson, Manager
Revenue Operations Section
Bureau of Finance (Accounting Division)
Michigan Department of Community Health
P.O. Box 30437
Lansing, Michigan 48909

Thank you for the cooperation extended throughout this audit process.

Sincerely,



Debra S. Hallenbeck, Manager
Quality Assurance and Review Section
Office of Audit

TABLE OF CONTENTS

	Page
Description of Agency	1
Funding Methodology.....	1
Purpose and Objectives.....	2
Scope and Methodology	3
<u>Conclusions, Findings and Recommendations</u>	
Contract and Best Practice Guidelines Compliance	4
Financial Reporting.....	4
1. Proprietary Fund Charges Exceeded Allowable Amounts	5
2. Unallowable Bad Debt Expense	8
3. Phone Equipment Not Properly Capitalized.....	9
4. Computer Software and Hardware Never Received Improperly Expensed	10
MDCH's and CEI's Shares of Cost and Balance Due.....	11
Audit Adjustments by Fiscal Year and Funding Source Table.....	12
Impact of Audit Adjustments Table.....	12
Corrective Action Plans	13

DESCRIPTION OF AGENCY

Manistee County Community Mental Health was established in 1972. In 1992, the Manistee County and Benzie County Boards of Commissioners organized Manistee-Benzie Community Mental Health (Manistee-Benzie CMH) under the Urban Cooperation Act. Manistee-Benzie CMH operates under the provisions of the Mental Health Code, Sections 330.1001 – 330.2106 of the Michigan Compiled Laws. Manistee-Benzie CMH is subject to oversight by the Michigan Department of Community Health (MDCH).

Manistee-Benzie CMH provides services to three population groups within Manistee and Benzie Counties: children and adolescents with emotional disturbances, adults with mental illnesses, and children and adolescents with developmental disabilities.

Manistee-Benzie CMH's administrative office is located in the City of Manistee. The Manistee-Benzie CMH Board is comprised of 12 members who reside in either Manistee County or Benzie County and are appointed according to the "Agreement for the Community Mental Health Board of Manistee and Benzie Counties."

FUNDING METHODOLOGY

Manistee-Benzie CMH contracted with MDCH under a Managed Mental Health Supports and Services Contract (MMHSSC) for fiscal year end (FYE) 2006. This provided State General Funds (GF) for mental health and developmental disability supports and services to individuals with serious mental illness, serious emotional disturbances, or developmental disabilities as described in Section 208 of the Mental Health Code. Manistee-Benzie CMH received approximately \$1.3 million of GF funding for FYE 2006. Manistee-Benzie CMH reported their GF expenditures to MDCH on a Financial Status Report (FSR) at the end of the fiscal year, and a settlement occurred between MDCH and Manistee-Benzie CMH.

Manistee-Benzie CMH received special and/or designated funds and fee for services funds under special contractual arrangements with MDCH. Each agreement specifies the funding methodologies. MICHild is a non-Medicaid program designed to provide certain medical and mental health services for uninsured children of Michigan working families. The Adult Benefit Waiver (ABW) Program is a plan that provides basic medical care to low income childless adults who do not qualify for Medicaid. MDCH provided the funding for the MICHild and ABW programs by capitated payments based on a Per Eligible Per Month (PEPM) methodology for covered services. Children's Waiver Services is a community living supports services program reimbursed by MDCH through a fee-for-service (FFS) payment system.

Manistee-Benzie CMH received their Medicaid dollars through the Community Mental Health Authority of Clinton, Eaton and Ingham Counties (CEI). CEI contracted with MDCH for Medicaid funding under a Medicaid Managed Specialty Supports and Services Contract (MMSSSC) for FYE 2006. MDCH provided both the state and federal share of Medicaid funds as capitated payments based on a PEPM methodology to CEI. CEI then passed the Medicaid funds on to Manistee-Benzie CMH based on their individual PEPM determination under the terms of the Medicaid Subcontracting Agreement (MSA). Under the MSA, Manistee-Benzie CMH is subject to the terms and conditions of the MMSSSC, Mental Health Code, and applicable state and federal laws. Manistee-Benzie CMH received approximately \$9.2 million of Medicaid funding from CEI in FYE 2006. Manistee-Benzie CMH reported their Medicaid expenditures related to the MSA to CEI, and a settlement occurred between Manistee-Benzie CMH and CEI. Manistee-Benzie CMH also reported their Medicaid expenditures related to the MSA as an Earned Contract on their FSR with MDCH for information purposes only as no settlement occurred between Manistee-Benzie CMH and MDCH relating to the Medicaid funds.

PURPOSE AND OBJECTIVES

The purpose of the limited review was to assess the agency's performance relative to certain requirements and best practice guidelines set forth in the contracts; to determine whether the agency properly reported certain revenues and expenditures in accordance with generally

accepted accounting principles and contractual requirements; and to determine MDCH's and CEI's shares of cost in accordance with applicable requirements and agreements as a result of any financial adjustments related to this limited review. The following were the specific objectives of this review:

Objectives

1. CONTRACT AND BEST PRACTICE GUIDELINES COMPLIANCE

To assess Manistee-Benzie CMH's effectiveness and efficiency in establishing and implementing select policies and procedures in compliance with the MSA, MMHSSC, and MMSSSC requirements and best practice guidelines.

2. FINANCIAL REPORTING

To assess Manistee-Benzie CMH's effectiveness and efficiency in reporting select revenues and expenditures in accordance with the MSA, MMHSSC, and the MMSSSC requirements; applicable federal, state, and local statutory requirements; Medicaid regulations; and applicable accounting standards.

3. MDCH'S AND CEI'S SHARES OF COST AND BALANCE DUE

To determine MDCH's and CEI's shares of cost in accordance with applicable requirements and agreements, and to identify any balance due to or from Manistee-Benzie CMH as a result of any financial adjustments related to this limited review.

SCOPE AND METHODOLOGY

We examined a portion of Manistee-Benzie CMH's records and activities for the period October 1, 2005 through September 30, 2006. We completed an Internal Control Questionnaire and reviewed internal controls relating to accounting for revenues and expenditures, procurement, reporting, claims management, and risk financing. We interviewed Manistee-Benzie CMH's executive, financial, and administrative staff. We reviewed Manistee-Benzie CMH's policies, procedures and board minutes. We summarized and analyzed various revenue

and expenditure account balances to determine if they were properly reported on the FSR in compliance with the MSA, MMHSSC, and MMSSSC reporting requirements and applicable accounting standards. During the review, we found a material exception relating to proprietary funds that resulted in an expansion of the review scope in this area to fiscal year ends 2000 through 2005.

CONCLUSIONS, FINDINGS AND RECOMMENDATIONS

CONTRACT AND BEST PRACTICE GUIDELINES COMPLIANCE

Objective 1: To assess Manistee-Benzie CMH's effectiveness and efficiency in establishing and implementing select policies and procedures in compliance with the MSA, MMHSSC, and MMSSSC requirements and best practice guidelines.

Conclusion: Manistee-Benzie CMH was generally effective and efficient in establishing and implementing the select policies and procedures in compliance with the MSA, MMHSSC, and the MMSSSC requirements and best practice guidelines. However, our assessment disclosed exceptions with financial reporting (Findings 1, 2, 3, and 4) with Finding 1 considered material.

FINANCIAL REPORTING

Objective 2: To assess Manistee-Benzie CMH's effectiveness and efficiency in reporting select revenues and expenditures in accordance with the MSA, MMHSSC, and the MMSSSC requirements; applicable federal, state, and local statutory requirements; Medicaid regulations; and applicable accounting standards.

Conclusion: Manistee-Benzie CMH was not effective and efficient in reporting select revenues and expenditures in accordance with the MSA, MMHSSC, and MMSSSC requirements;

applicable federal, state, and local statutory requirements; Medicaid regulations; and applicable accounting standards. We found a material exception related to proprietary fund charges (Finding 1); and exceptions related to reporting unallowable bad debt expense (Finding 2), expensing capital assets (Finding 3), and reporting expenditures for computer software and hardware never received (Finding 4).

Finding

1. Proprietary Fund Charges Exceeded Allowable Amounts

Manistee-Benzie CMH reported expenditures for buildings, vehicles, and health care on FSRs that exceeded allowable amounts in violation of OMB Circular A-87.

Manistee-Benzie CMH uses three separate “proprietary funds” (funds) to account for financial transactions associated with buildings, vehicles, and health care. These funds are accounted for within Manistee-Benzie CMH’s common general ledger system and are separated by different fund centers. Transfers from the general operating fund to the three separate funds provide the resources to operate the funds. The transfers have been reported by Manistee-Benzie CMH to MDCH as expenditures on FSRs.

The cumulative transfers to each of the funds over several years have exceeded the cumulative expenditures resulting in positive fund balances in each of the three separate funds. As of 9/30/2006, the funds had the following net asset values, which represent the amount of transfers into the funds that exceeded the actual expenditures of the funds:

Building Fund	\$1,215,924
Motor Pool Fund	198,860
Health Fund	<u>396,520</u>
Total	<u>\$1,811,304</u>

By contract, Manistee-Benzie CMH must use the principles and standards of OMB Circular A-87 for determining all costs reported on the FSRs. OMB Circular A-87 (located at 2 CFR Part 225) requires that costs be necessary, reasonable, allocable, and adequately documented to be allowable under Federal awards. Furthermore, OMB Circular A-87 requires a comparison of the

revenue generated by the transfers to actual allowable costs at least annually with an adjustment for the difference between the revenue and the allowable costs. The transfers, which have been reported by Manistee-Benzie CMH to MDCH as expenditures on FSRs, exceeded actual, necessary, reasonable and allocable costs by the cumulative amounts stated above. Annual adjustments for transfers (amounts reported on FSRs) to allowable costs have not occurred resulting in significant fund balances. For the period 10/1/1999 through 9/30/2006, the funds' balances increased a total of \$948,556, which represents the amount of transfers into the funds (amounts reported on FSRs) that exceeded the actual expenditures of the funds.

Following are the applicable references from OMB Circular A-87 relating to allowable costs and required adjustments:

Appendix A, General Principles for Determining Allowable Costs

Section C. Basic Guidelines.

1. *Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:*
 - a. *Be necessary and reasonable for proper and efficient performance and administration of Federal awards.*
 - b. *Be allocable to Federal awards under the provisions of 2 CFR 225...*
 - j. *Be adequately documented...*
3. *Allocable costs.*
 - a. *A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received...*
 - d. *Where an accumulation of indirect costs will ultimately result in charges to a Federal award, a cost allocation plan will be required as described in Appendices C, D, and E to this part.*

Appendix C, State/Local-Wide Central Service Cost Allocation Plans

Section A. General.

1. *Most governmental units provide certain services, such as motor pools, computer centers, purchasing, accounting, etc., to operating agencies on a centralized basis. Since federally-supported awards are performed within the individual operating agencies, there needs to be a process whereby these central service costs can be identified and assigned to benefited activities on a reasonable and consistent basis. The central service cost allocation plan provides that process. All costs and other data used to distribute the costs included in the plan should be supported by formal accounting and other records that will support the propriety of the costs assigned to Federal awards.*

Section G. Other Policies.

4. *Adjustments of billed central services. Billing rates used to charge Federal awards shall be based on the estimated costs of providing the services, including an estimate of the allocable central service costs. A comparison of the revenue generated by each billed service to the actual allowable costs of the service will be made at least annually, and an adjustment will be made for the difference between the revenue and the allowable costs.*

In addition to the full recovery of actual costs that are necessary, reasonable, allocable, and adequately documented, OMB Circular A-87 allows for the establishment and maintenance of a reserve for internal service funds for normal operating purposes as stated in Appendix C, Section G. Other Policies as follows:

2. *Working capital reserves. Internal service funds are dependent upon a reasonable level of working capital reserve to operate from one billing cycle to the next. Charges by an internal service activity to provide for the establishment and maintenance of a reasonable level of working capital reserve, in addition to the full recovery of costs, are allowable. A working capital reserve as **part of retained earnings** of up to 60 days **cash expenses** for normal operating purposes is considered reasonable. (emphasis added)*

Accordingly, in addition to the actual costs Manistee-Benzie CMH incurred for buildings, vehicles, and health care, Manistee-Benzie CMH may establish and maintain a reserve as part of retained earnings of up to 60 days of cash expenses (cash expenses excludes depreciation expense). Following are calculated allowable reserve amounts for each fund for FYE 2006 based on the prior 3-year average of **cash** expenditures:

Building Fund	\$8,521
Motor Pool Fund	11,262
Health Fund	<u>188,988</u>
Total	<u>\$208,773</u>

The fund balances are the cumulative net effect of multiple years of overcharges and undercharges. Accordingly, we expanded our analysis as far back as FYE 2000 in an attempt to assign overcharges and undercharges to applicable fiscal years. After considering beginning fund balances as of October 1, 2009, changes in fund balances due to transfers (FSR charges) above or below actual expenditures, and allowable reserves based on average cash expenses, we determined that the FSR had the following undercharges or (overcharges) for each year:

FSR Charges (Above) or Below Allowable Amounts by Year by Fund

FYE	Building Fund	Motor Pool Fund	Health Fund	Total
2000	\$(100,835)	\$0	\$(46,176)	\$(147,011)
2001	(123,902)	0	101,123	(22,779)
2002	(169,361)	0	2,693	(166,668)
2003	(158,337)	0	212,516	54,179
2004	(129,732)	0	(159,917)	(289,649)
2005	(75,732)	0	(238,391)	(314,123)
2006	(54,916)	(23,821)	(79,379)	(158,116)
Total	\$(812,815)	\$(23,821)	\$(207,531)	\$(1,044,167)

Recommendation

We recommend that Manistee-Benzie CMH implement policies and procedures to ensure that reported expenditures for buildings, vehicles, and health care on FSRs are limited to allowable amounts in accordance with OMB Circular A-87. We also recommend that Manistee-Benzie submit revised FSRs to MDCH that properly represent actual and allowable expenditures for buildings, vehicles, and health care costs for FYE 2007 forward.

Finding

2. Unallowable Bad Debt Expense

Manistee-Benzie CMH reported unallowable bad debt expense on the FSR which is in violation of contract provisions and OMB Circular A-87.

In FYE 2006, Manistee-Benzie CMH reported \$13,103 of estimated bad debt expense on the FSR.

OMB Circular A-87, Appendix B, Section 5 states,

Bad debts. Bad debts, including losses (whether actual or estimated) arising from uncollectible accounts and other claims, related collection costs, and related legal costs, are unallowable.

The adjustment to decrease expenses by \$13,103 is shown on the Audit Adjustments by Fiscal Year and Funding Source Table on Page 12 of this report.

Recommendation

We recommend that Manistee-Benzie CMH implement policies and procedures to ensure that the FSR does not include expenses that are unallowable according to OMB Circular A-87.

Finding

3. Phone Equipment Not Properly Capitalized

Manistee-Benzie CMH did not properly capitalize and depreciate phone equipment as required by OMB Circular A-87.

In September 2003, Manistee-Benzie CMH signed an agreement for the purchase of \$135,186 in phone equipment over a 60 month period. Rather than capitalizing and depreciated the phone equipment over its useful life (typically 120 months), Manistee-Benzie expensed each payment. Consequently, the expense was recorded over a shortened 60 month period rather than a 120 month period as it should have been.

OMB Circular A-87, Appendix B, Subsection 15. Equipment and other capital expenditures, states,

- a. (1) "Capital Expenditures" means expenditures for the acquisition cost of capital assets (equipment, buildings, land),...*
- a. (2) "Equipment" means an article of nonexpendable, tangible personal property having a useful life of more than one year and an acquisition cost which equals or exceeds the lesser of the capitalization level established by the governmental unit for financial statement purposes, or \$5,000.*
- b. (1) Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges, except where approved in advance by the awarding agency.*

Subsection 11. Depreciation and use allowances, states,

- a. Depreciation and use allowances are means of allocating the cost of fixed assets to periods benefiting from asset use.*

Due to the immateriality of the adjustment amounts that would be required in every year since 2003 to properly record the expense for the phone equipment, financial adjustments will not be required.

Recommendation

We recommend that Manistee-Benzie CMH implement policies and procedures to ensure that capital assets are properly capitalized and depreciated as required by contract provisions and OMB Circular A-87.

Finding

4. Computer Software and Hardware Never Received Improperly Expensed

Manistee-Benzie CMH reported expenditures on the FSR for software, hardware, and support services never received or placed into service in violation of contract terms and OMB Circular A-87.

In September 2006, Manistee-Benzie CMH paid \$35,443 for software, hardware, and support services, which were never received or placed into service, and reported this expenditure on the FSR. The third party vendor that was contracted to supply the software, hardware, and support services went bankrupt.

OMB Circular A-87, Appendix A, Section C. Basic Guidelines, states,

2. *Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:*
 - a. *Be necessary and reasonable for proper and efficient performance and administration of Federal awards.*
3. *Reasonable costs. A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost.*

In this instance, no value was received, so the amount expensed of \$35,443 for software, hardware, and support services not received is considered not necessary and not reasonable, and is therefore unallowable.

An adjustment to decrease expenses by \$35,443 is shown on the Audit Adjustments by Fiscal Year and Funding Source Table on Page 12 of this report.

Recommendation

We recommend that Manistee-Benzie CMH implement policies and procedures to ensure that the FSR does not include expenses that are unallowable according to OMB Circular A-87.

MDCH'S AND CEI'S SHARES OF COST AND BALANCE DUE

Objective 3: To determine MDCH's and CEI's shares of cost in accordance with applicable requirements and agreements, and to identify any balance due to or from Manistee-Benzie CMH as a result of any financial adjustments related to this limited review.

Conclusion: As a result of the financial adjustments related to this limited review for FYEs 2000 through 2006, Manistee-Benzie CMH owes MDCH a balance of \$251,561 (\$228,876 for FYE 2000 through FYE 2002 Medicaid, \$13,120 for FYE 2002 General Fund, and \$9,565 for other MDCH contracts); and Manistee-Benzie CMH owes CEI a balance of \$630,794 as shown on the Impact of Audit Adjustments Table on page 12 of this report.

Audit Adjustments by Fiscal Year and Funding Source

FYE	Total Adjustment		Medicaid	General Fund	Childrens Waiver	MI Child	ABW	Other Items
2000	\$(147,011)	(1)	\$(102,871)	\$(19,079)	\$0	\$(43)	\$0	\$(25,018)
2001	(22,779)	(1)	(2,241)	1,198	(14)	4	0	(21,728)
2002	(166,668)	(1)	(110,344)	(22,290)	(294)	(68)	0	(33,671)
2003	54,179	(1)	41,044	11,088	28	98	0	1,921
2004	(289,649)	(1)	(236,559)	(25,578)	(366)	(163)	(3,217)	(23,766)
2005	(314,123)	(1)	(265,528)	(22,047)	(474)	(943)	(4,043)	(21,089)
2006	(206,662)	(2)	(169,751)	(23,797)	(461)	(365)	(2,695)	(9,594)
Totals	\$(1,092,713)		\$(846,250)	\$(100,505)	\$(1,581)	\$(1,480)	\$(9,955)	\$(132,945)

- (1) Proprietary Fund Adjustment (Finding 1)
- (2) Proprietary Fund Adjustment (Finding 1) \$(158,116)
 - Bad Debt Expense Adjustment (Finding 2) (13,103)
 - Computer Software Adjustment (Finding 4) (35,443)

Impact of Audit Adjustments

FYE	Total Adjustment	Medicaid	GF Carry-Forward (Up)/Dn	Due (To)/From MDCH	MDCH Earned Contracts	Local Risk	Local Match	MIChild/ ABW/ Childrens Waiver (Non-GF)	Non-MDCH Items
2000	\$(147,011)	\$0	\$0	\$(116,291)	\$(866)	\$0	\$(5,660)	\$(43)	\$(24,152)
2001	(22,779)	0	0	(2,241)	688	1,048	150	(10)	(22,416)
2002	(166,668)	0	(6,998)	(123,464)	(1,061)	0	(2,172)	(362)	(32,610)
2003	54,179	41,044	6,998	0	1,860	3,697	393	126	61
2004	(289,649)	(236,559)	(23,224)	0	(2,762)	0	(2,533)	(3,568)	(21,004)
2005	(314,123)	(265,528)	(22,617)	0	(3,550)	0	(4,490)	(400)	(17,539)
2006	(206,662)	(169,751)	45,841	0	(3,874)	(65,821)	(6,945)	(393)	(5,720)
Totals	\$(1,092,713)	\$(630,794)	\$0	\$(241,996)	\$(9,565)	\$(61,076)	\$(21,257)	\$(4,650)	\$(123,380)

Corrective Action Plan

Finding Number: 1

Page Reference: 5

Finding: **Proprietary Fund Charges Exceeded Allowable Amounts**

Manistee-Benzie CMH reported expenditures for buildings, vehicles, and health care on FSRs that exceeded allowable amounts in violation of OMB Circular A-87.

Recommendation: Implement policies and procedures to ensure that reported expenditures for buildings, vehicles, and health care on FSRs are limited to allowable amounts in accordance with OMB Circular A-87. Also, submit revised FSRs to MDCH that properly represent actual and allowable expenditures for buildings, vehicles, and health care costs for FYE 2007 forward.

**MBCMH
Comments:**

MBCMH agrees that the Motor Pool Fund had an excessive fund balance at FYE 2006 in the amount of \$23,821, and the Building Fund had an excessive fund balance at FYE 2006 in the amount of \$812,815; and agrees with the audit adjustment amounts and has implemented changes in how expenses for these funds are reported on the FSR. However, MBCMH does not believe that the Health Fund was excessive, and believes that it was justified and in accordance with OMB Circular A-87. MBCMH states that the Health Fund balance was intended to mitigate the risk of health fund claims for which the agency was liable; however, they did not receive a detailed risk analysis from Unicare (the administrator of the fund), and the balance was determined using their best estimate of liability for unpaid claims. MBCMH states that the audit adjustment in the amount of \$207,531 for the Health Fund should not be required as the actual claims supported the fund balance, and upon suspension of the fund, the balance was approximately \$52,000. Also, the application of the \$207,531 adjustment will create a deficiency in the fund in the subsequent years. Alternatively, rather than an audit adjustment of \$207,531, MBCMH requests the adjustment be changed to \$52,000.

Corrective Action: MBCMH eliminated the Health Fund in 2010 and purchased a fully funded traditional BCBS plan for their employees. For the Motor Pool Fund and Building Fund, MBCMH will make adjustments annually for the differences between the revenue and the allowable expenses to ensure accurate FSR expenditure reporting in accordance with OMB Circular A-87.

Anticipated Completion Date: Completed.

MDCH Response: MDCH acknowledges that activity in the Health Fund subsequent to the audit period reduced the Health Fund balance to \$56,200 at FYE 2009. However, according to the provisions of OMB Circular A-87, comparisons of the revenue generated (expenditure amounts reported on FSRs) to the actual allowable costs of the service are to be made at least annually with adjustments made for the difference between the revenue and the allowable costs. Furthermore, given the unique funding characteristics of this program that include Medicaid savings, General Fund carryforward and risk sharing, it is critical to report actual allowable expenditures in the years incurred. Accordingly, annual adjustments must be made to properly report costs.

The audit adjustment removing \$207,531 in reported expenditures for the Health Fund is the net impact of both addition adjustments and subtraction adjustments for FYEs 2000 through 2006 as shown on Page 8 of the Audit Report. MDCH proposes further adjustments for FYEs 2007 through 2009 for a net *addition* to reported expenditures of \$151,392 to properly adjust for allowable costs in each year as follows:

FYE 2007	(\$116,214)
FYE 2008	101,213
FYE 2009	<u>166,393</u>
	<u>\$151,392</u>

The above adjustments result in the elimination of the Health Fund at FYE 2009, and ensure Health Fund related expenditures are properly reported in each applicable year. The net impact of all adjustments is a disallowance of \$56,139 (which is only slightly more than the amount conceded by MBCMH in their reply to the Preliminary Analysis). This amount reconciles with the beginning Health Fund balance plus/minus any over/under-charges to the Health Fund for FYEs 2000 through 2009.

Corrective Action Plan

Finding Number: 2

Page Reference: 8

Finding: **Unallowable Bad Debt Expense**

Manistee-Benzie CMH reported unallowable bad debt expense on the FSR which is in violation of contract provisions and OMB Circular A-87.

Recommendation: Implement policies and procedures to ensure that the FSR does not include expenses that are unallowable according to OMB Circular A-87.

MBCMH

Comments: MBCMH does not disagree with this finding.

Corrective Action: In FY 2007 MBCMH implemented the elimination of accruals for third party payers. Revenues are recognized when the payment for services is received. At the close of the fiscal year, accounts receivable for services provided during the reporting fiscal year are included in the financial statements for payments received within 90 days of the close of the fiscal year. There is no bad debt expense.

Anticipated

Completion Date: Completed.

MDCH Response: None.

Corrective Action Plan

Finding Number: 3

Page Reference: 9

Finding: Phone Equipment Not Properly Capitalized

Manistee-Benzie CMH did not properly capitalize and depreciate phone equipment as required by OMB Circular A-87.

Recommendation: Implement policies and procedures to ensure that capital assets are properly capitalized and depreciated as required by contract provisions and OMB Circular A-87.

MBCMH

Comments: MBCMH does not disagree with this finding.

Corrective Action: MBCMH implemented policies and procedures to properly capitalize and depreciate capital assets as required by OMB Circular A-87.

Anticipated

Completion Date: Completed.

MDCH Response: None.

Corrective Action Plan

Finding Number: 4

Page Reference: 10

Finding: Computer Software and Hardware Never Received Improperly Expensed

Manistee-Benzie CMH reported expenditures on the FSR for software, hardware, and support services never received or placed into service in violation of contract terms and OMB Circular A-87.

Recommendation: Implement policies and procedures to ensure that the FSR does not include expenses that are unallowable according to OMB Circular A-87.

MBCMH

Comments: MBCMH does not disagree with this finding.

Corrective Action: MBCMH implemented policies and procedures to ensure that expenses are not included in the FSR that are unallowable as required by OMB Circular A-87.

Anticipated

Completion Date: Completed.

MDCH Response: None.