NORTH CAROLINA
DEPARTMENT OF STATE TREASURER
STATE AND LOCAL GOVERNMENT FINANCE DIVISION
AND THE LOCAL GOVERNMENT COMMISSION

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Memorandum # 2014-03

To: **Local Management Entities – Managed Care Organizations' Financial Officials and their Independent Auditors**

From: **Sharon Edmundson, Director, Fiscal Management Section**

Subject: **Reporting Medicaid 1915(b)(c) Waiver in Audited Financial Reports as of June 30, 2013**

Date: **August 8, 2013**

Recent changes in the operational and funding structure for mental health services provided by local governments in North Carolina have prompted us to review the financial reporting format for Local Management Entities and Managed Care Organizations (LME-MCOs). Beginning in the fiscal year that ended June 30, 2013, LME-MCOs received a predominate amount of their funding for Division of Mental Health, Developmental Disability, Substance Abuse Services (DMHDDSAS) programs from the Medicaid Waiver program. As a result, specific questions are being raised - should the LME-MCOs continue to report operations under modified accrual basis of accounting as they have traditionally done or as a business-type activity and full-accrual basis of accounting due to the risk in managing the delivery of MHDDSAS services within the financial framework of the Medicaid capitation rate?

As a result of this review, LME-MCO entities will be required to report their operations as a Business-Type activity on the full accrual basis of accounting in the basic financial statements beginning in the year ended June 30, 2013. Units should report one fund that includes both the services funded by the Medicaid 1915(b)(c) Waiver program and the services funded by the federal and State financial assistance, county appropriations, and other fees and charges. The financial report will include:

<u>Basic financial statements</u>:
- a statement of net position,
- statement of revenues, expenses, and changes in net position,
- statement of cash flows

<u>Supplementary information</u>:
- balance sheet
- budgetary comparison statements

The balance sheet and budgetary schedules reported as supplementary information should be reported using the modified accrual basis of accounting and should be presented in accordance with generally accepted accounting principles. The NC Department of Health and Human

Services (DHHS) - Division of Mental Health, Developmental Disability, Substance Abuse Services (DMHDDSAS) has requested that the modified accrual balance sheet be included to allow them the ability to monitor the fund balances of the LME-MCOs and provide that information to the General Assembly.

In making this decision we consulted with DHHS-Division of Medical Assistance (DMA) and DHHS-DMHDDSAS, finance officers of various LME-MCOs, and independent auditors with LME-MCOs as clients. Guidance found in Governmental Accounting Standards Board (GASB) Statement No. 34, paragraph 67, states that a government's activity *must* be accounted for as an enterprise fund if there is a pricing policy that fees and charges be set to recover costs, including capital costs. We believe that this is consistent with the intent of the Medicaid Waiver program as a way to control and more accurately budget for the costs of MHDDSAS programs. The NC Prepaid Inpatient Health Plans (PIHP) Financial Reporting Guide Instructions (section 1.03) published by The Division of Medical Assistance of NC DHHS requires that the LME-MCOs monthly reports of all revenues and expenses of the Medicaid Waiver program be prepared using the full accrual basis of accounting. DMA believes that because the interim reports must be made using full accrual accounting, the annual report should be completed using the same basis of reporting.

Traditionally, LMEs have reported on the modified accrual basis of accounting. The predominant sources of funding have been cost-reimbursement contracts, direct State appropriations, and Federal awards passed-through the State, all which are considered financial assistance. Other funding sources included county appropriations and patient fees and charges. The funding varied depending on the particular unit, but our calculations, which were based on the three LMEs-MCOs that reported Medicaid Waiver funding during the fiscal year ended June 30, 2012, showed that traditional funding is less than twenty percent of total revenues. As a result we do not believe it is necessary to account for the funding sources in separate funds.

Sub-recipient or Vendor?

We have received inquiries regarding whether Medicaid Waiver payments received by the LME-MCOs are financial assistance and as such are subject to Single Audit requirements. After considering OMB Circular A-133 *Audits of State, Local Governments, and Non-Profit Organizations*, §___.205(i), we are of the opinion that Medicaid Waiver payments are not financial assistance. DHHS is in agreement.

Before a LME-MCO enters into a contract with private or public providers of mental health services that are to be paid with federal or State financial assistance, the unit must determine the nature of the relationship between the provider and the LME-MCO. Specifically, will the provider perform services or provide substantive, programmatic work for the LME-MCO? This vendor vs. sub-recipient relationship will have a major impact on the audit of the LME-MCO. Therefore, the nature of the LME-MCO/provider relationship should be communicated to the LME-MCO's auditor before the audit engagement. We recommend that the auditor have an understanding of the relationship prior to entering into a contract to audit the LME-MCO.

In a vendor relationship, a program's compliance requirements normally do not automatically pass to vendors. However, the LME-MCO is still responsible for establishing procedures to ensure that either the vendor is responsible for program compliance or that the LME-MCO will review the vendor records for compliance. The auditor should determine if transactions that are material to the major program of the LMC-MCO are in compliance with the laws, regulations, and the provisions of the contracts or grant agreements. If compliance cannot be determined by the auditor by reviewing the LME-MCO records, the auditor should report a deficiency in internal control over compliance. In order to determine compliance, additional procedures may be required such as reviewing the vendor's records. If the auditor determines that the vendor has not been compliant with program requirements, the auditor should report a finding in the compliance reports for the LME-MCO.

A sub-recipient relationship between a LME-MCO and provider requires the auditor to determine if the LME-MCO is monitoring the sub-recipient, via site visits or other means, to ensure that the financial assistance is being used for authorized purposes in compliance with the laws, regulations, and the provisions of the contracts or grant agreements and that performance goals are being met. If a sub-recipient is a non-profit organization (NPO), the sub-recipient is subject to federal audit requirements found in Circular A-133. We requires that NPO sub-recipients that receive State financial assistance directly from a local government or public authority, such as a LME-MCO, have State Single Audits if the amount of expenditures of State awards is $500,000 or more during the fiscal year. It is the LME-MCO's responsibility for ensuring that an audit is performed by the NPO since we do not have oversight over NPOs, do not review their audit reports, and are not a party to their audit contracts. This understanding should be communicated to the sub-recipient provider by the LME-MCO prior to approving a contract.

There are questionnaires and checklists available to assist you in determining if a provider is a sub-recipient or a vendor. The awarding agency should be of assistance to you in making this determination. For additional information, please refer to the AICPA's *Audit Guide: Governmental Auditing Standards and* OMB's *Circular A-133 Audits*.

Budgetary Comparison in the Audit Report: Contracted Services

In our reviews of LME-MCOs audited financials, we have noticed that "contracted services" is commonly reported as a line item the mandatory budgetary comparison in the basic financial statements and/or the budget to actual comparisons in the supplementary information. The expenditures can represent as much as eighty percent of total expenditures. General Statues (§159-13(a)) and generally accepted accounting principles (GAAP) require that appropriations be budgeted by department, function (program), or project. The supplemental schedule, which can be reported in more detail than the basic financials, does not need to list the providers but it should reflect the type of program service.

Should you have any questions concerning this memorandum, please contact Manasa Cooper at (919) 807-2390 or James Burke at (919) 807-2389 or via e-mail at manasa.cooper@nctreasurer.com or james.burke@nctreasurer.com.