



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Management Letter

Department of Human Services

Fiscal Year Ended June 30, 1999



MARCH 14, 2000

00-08

Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota State government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately fifty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year and one best practices review.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of Representatives and Senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

Summary

Management Letter

Department of Human Services Fiscal Year Ended June 30, 1999

Key Findings and Recommendations:

- The department did not complete the federally required MMIS II system security risk analysis in a timely manner. The department should establish and maintain a program of system risk analyses and security reviews over the MMIS II system. (Finding 1, page 3)
- The department did not adequately monitor its federal cash management procedures. The department should implement procedures to ensure that it complies with the state's cash management agreement with the federal government and related state policies. (Finding 2, page 3)
- The department did not have an adequate system of accounting for the Drug Rebate Program during fiscal year 1999. The department should continue to implement an appropriate accounting system that allows for periodic verification of billings, collections, and outstanding receivables. In addition, the department should bill drug labelers for past due balances and should charge interest on overdue amounts. (Finding 3, page 4)
- The department did not accurately allocate MAXIS computer system costs to the participating programs for a six-month period. One federal program was overcharged nearly \$1 million. Two other federal programs were undercharged. The department needs to correct the misallocation of costs. (Finding 4, page 5)
- The department's reporting on two federal food stamp reports needs to be improved. The department should make the necessary computer programming changes to ensure that it has complete and accurate information when reporting to the federal government. (Finding 5, page 5)

Management letters address internal control weaknesses and noncompliance issues found during our annual audit of the state's financial statements and federally funded programs. The scope of work in individual agencies is limited. During the fiscal year 1999 audit, our work at the Department of Human Services focused on major public assistance programs, including medical assistance, temporary assistance for needy families, and food stamps, and on other grant programs, including federal social services, community social services, and chemical dependency treatment. We reviewed cost of care revenues for the department's residential treatment centers and group homes. We also reviewed child support collections and disbursements. Finally, we performed procedures on ten federally funded programs administered by the department to determine whether the department complied with certain federal requirements. The department's response is included in the report.

Department of Human Services

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Jeanine Leifeld, CPA,CISA	Audit Manager
Michael Hassing, CPA	Auditor-in-Charge
Steve Johnson, CPA	Senior Auditor
Connie Stein	Senior Auditor
Crystal Eskridge	Staff Auditor
John Hakes, CPA	Staff Auditor
Kathy Fisher	Intern

Exit Conference

We discussed the findings and recommendations in this report with the following staff of the Department of Human Services on March 1, 2000:

Tom Moss	Deputy Commissioner
Dennis Erickson	Assistant Commissioner
Jon Darling	Director, Financial Management
Larry Woods	Director, Health Care Operations
David Ehrhardt	Director, Internal Audits



OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • **James Nobles, Legislative Auditor**

Representative Dan McElroy, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Michael O'Keefe, Commissioner
Department of Human Services

We have performed certain audit procedures at the Department of Human Services as part of our audit of the financial statements of the State of Minnesota as of and for the year ended June 30, 1999. We have also audited certain federal financial assistance programs administered by the Department of Human Services as part of our audit of the state's compliance with the requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement*. We emphasize that this has not been a comprehensive audit of the Department of Human Services.

Table 1 identifies the financial activities within the Department of Human Services that were material to the state's financial statements. We performed certain audit procedures on these programs as part of our objective to obtain reasonable assurance about whether the State of Minnesota's financial statements for the year ended June 30, 1999, were free of material misstatement.

Table 1
Programs Material to the State's Financial Statements
Fiscal Year 1999 (in thousands)

	<u>Amount</u>
Revenue Areas:	
Child Support Enforcement	\$456,183
Residential Treatment Center Cost of Care	87,519
State Operated Community Services Cost of Care	35,979
Chemical Dependency Cost of Care	13,465
Expenditure Areas:	
Medical Assistance	\$3,487,283
Family Support (TANF and Food Stamps)	488,338
Child Support Enforcement	451,229
Consolidated Chemical Dependency Treatment	65,654
Community Social Services	54,445
Social Services Block Grant	32,647

Note: We also audited certain statutory transfers from the Health Care Access Fund and other administrative aids and transfers.

Source: State of Minnesota Comprehensive Annual Financial Report and Minnesota Accounting and Procurement System (MAPS) for fiscal year 1999.

Department of Human Services

Table 2 identifies the State of Minnesota's major federal programs administered by the Department of Human Services. We performed certain audit procedures on these programs as part of our objective to obtain reasonable assurance about whether the State of Minnesota complied with the requirements that are applicable to each of its major federal programs.

Table 2
Major Federal Programs Administered by the Department of Human Services
Fiscal Year 1999
(in thousands)

<u>Program Name</u>	<u>CFDA #</u>	<u>Federal</u>
Medical Assistance	93.778	\$1,718,727
Temporary Aid for Needy Families (TANF)	93.558	182,315
Food Stamps Cluster: (1)		
Food Stamps	10.551	171,321
Food Stamps Administration	10.561	34,017
Foster Care IV-E	93.658	64,454
Child Support Enforcement	93.563	63,210
Social Services Block Grant (Title XX)	93.667	41,464
Aging Cluster:		
Special Programs for the Aging – IIIB	93.044	6,876
Special Programs for the Aging – IIIC	93.045	7,771
Nutrition Program for the Elderly	10.570	2,860

(1) The value of the Food Stamp inventory on hand at June 30, 1999, totaled \$28,023,650.

Note: We also audited the department's cash management practices and other general compliance requirements related to federal assistance.

Source: Minnesota Accounting and Procurement System (MAPS) for fiscal year 1999.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Conclusions

Our December 1, 1999, report included an unqualified opinion on the general purpose financial statements included in the State of Minnesota's Comprehensive Annual Financial Report for fiscal year 1999. In accordance with *Government Auditing Standards*, we have also issued our report, dated December 1, 1999, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. At a later date, we will issue our report on compliance with requirements applicable to each major federal program and internal control over compliance in accordance with OMB Circular A-133.

Department of Human Services

As a result of our procedures, we identified the following weaknesses in internal control or instances of noncompliance with finance-related legal provisions or program requirements at the Department of Human Services.

1. The department did not complete the MMIS II system security risk analysis in a timely manner.

The department did not complete a security review over the Medicaid Management Information System (MMIS II) during fiscal year 1999. MMIS II is the state's main computer system for managing medical assistance claims and payments, which totaled over \$3 billion in fiscal year 1999. Federal regulations require state agencies involved in the administration of federal health and human service programs to review automated systems security, including both physical and data security elements and personnel practices, at least on a biennial basis. The last MMIS II review was done in fiscal year 1997.

Recommendation

- *The department should establish and maintain a schedule of system risk analyses and security reviews over the MMIS II system.*

2. PRIOR FINDING NOT RESOLVED: The department did not adequately monitor its federal cash management procedures.

The Department of Human Services did not implement an adequate system to track federal cash balances and the related interest owed by either the state or the federal government. The state's agreement with the United States Department of the Treasury allows the state to charge the federal government interest on funds received late and, conversely, requires the state to pay interest on funds not expended promptly. The worksheets used by the department to track interest earned or owed did not contain complete information. In addition, in some cases, the dates shown on the sheets did not correspond to the actual dates the department made payments for federal programs.

The department did not calculate the actual interest owed by either the state or the federal government according to the cash management agreement and related Department of Finance policies. The department assumed that, since it generally requested cash after disbursements were made, it would not owe the federal government any interest. Therefore, the department did not complete the required interest calculation. The department did not consider the effects of late draws, delays in the availability of federal program awards, or amounts to be returned to the federal government in determining any interest obligations.

Finally, the department has not always requested federal cash in a timely manner. The department has made a decision to never draw federal funds early. Generally, the

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department made cash requests the same day or within one day of the disbursement of funds. However, in 8 of 25 samples we tested, either the draw was later than the time allowed by the cash management agreement, or there was insufficient data to determine whether the draw was done in a timely manner. Delaying the requests for federal cash after legitimate disbursements have occurred unnecessarily shifts the cash flow burden for federal programs to the state.

Recommendations

- *The department should implement procedures to track federal cash draws and determine actual amounts of interest due from or owed to the federal government in compliance with the state's cash management agreement with the federal government and the state Department of Finance policies.*
- *The department should request federal cash in a timely manner, in accordance with the applicable cash management regulations.*

3. PRIOR FINDING NOT RESOLVED: The department did not have an adequate system of accounting for the Drug Rebate Program during fiscal year 1999.

The drug rebate record keeping system did not adequately account for all functions of the drug rebate program in fiscal year 1999. The federal Medicaid program requires drug labelers to rebate a portion of the drug retail price to the state for drugs purchased through the Medical Assistance Program. The federal government calculates the rebate amounts on a per unit basis from information supplied to the federal government by drug labelers. The state received rebates totaling \$43,211,137 during fiscal year 1999.

During fiscal year 1999, the drug rebate unit maintained spreadsheets to accumulate drug rebate financial data. Department staff adjusted the spreadsheets to reflect retroactive rebate changes. This system of accounting did not provide adequate control over the drug rebate program. It did not allow the department to readily track billing adjustments and payments, or to calculate interest on overdue accounts.

In addition, the department did not bill drug labelers for outstanding unpaid rebate amounts or charge interest on past due bills. The department sent quarterly bills to labelers only for the current quarter and did not include previously billed unpaid amounts. The department had outstanding unpaid rebate billings dating to 1995.

The department has been working to develop and implement a new drug rebate accounting system. The department began the process of implementing its new system and converting old data into the new system during June 1999.

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Recommendations

- *DHS should continue implementing an appropriate accounting system for the Drug Rebate Program. The system should allow for:*
 - *periodic verification of the billing and receipt transactions affecting the accounts receivable balances, and*
 - *the identification of all billings, collections, and outstanding drug rebate balances.*
- *DHS should bill drug labelers for past due balances and should charge interest on overdue amounts.*

4. The department did not accurately allocate MAXIS computer system costs to the participating programs for a six-month period.

The department inaccurately allocated the costs of maintaining the MAXIS computer system among three participating federal programs during the period from January through June 1998. The department overcharged the food stamp program nearly \$1 million while undercharging both the medical assistance and temporary assistance to needy families (TANF) programs. Federal regulations require the department to identify and allocate the costs of operating the MAXIS system to all of the programs that use the system. The department completes this allocation quarterly according to a federally approved cost allocation plan.

The department incorrectly calculated the MAXIS cost allocation for the last two quarters of fiscal year 1998. The department did not successfully fix the misallocation during fiscal year 1999. The department needs to correct the allocation to finalize fiscal year 1998 program expenditures.

Recommendation

- *The department needs to correct the allocation of fiscal year 1998 MAXIS costs to the affected programs.*

5. The department's reporting on two federal food stamp reports needs to be improved.

The department submitted potentially inaccurate reports to the federal government for electronic benefit transfer food stamp issuances and claims against households for fiscal year 1999. The source of information included on both of these reports is the MAXIS computer system. Each month, the department must report the amount of food stamps issued through electronic benefits transfer on federal report FNS-46. The department

Department of Human Services

used an internal financial management database to track these issuances. However, the total issuances calculated by the internal database each month differed from the totals produced from MAXIS. The department did not resolve the differences and used the MAXIS amounts when reporting to the federal government. However, it needs to determine the correct amount and use the proper figure to report to the federal government.

Additionally, the MAXIS system also cannot currently produce all necessary data for the federal food stamp claims report FNS-209. The department must report to the federal government each month a cumulative claims amount due to be recovered against households that received food stamps erroneously. The MAXIS system cannot currently produce the data in the necessary categories required for the federal claims report. The department manually adjusted the MAXIS data by using an adjustment line on the report. The federal government conducted a Claims Management System review in fiscal year 1998 and identified this issue. Since that review, the department has been working on the necessary programming changes within MAXIS to produce complete data for the report. However, as of the end of fiscal year 1999, these changes had not been completed.

Recommendation

- *The department should make the necessary programming changes to ensure that its systems report complete and accurate information for the food stamp program.*

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Human Services. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 14, 2000.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: January 28, 2000

Report Signed On: March 9, 2000

Status of Prior Audit Issues As of January 28, 2000

March 12, 1999, Legislative Audit Report 99-17 examined the Department of Human Services activities and programs material to the State of Minnesota's Annual Financial Report or the Single Audit for the year ended June 30, 1998. The scope included the administration of the state's Medical Assistance and other health care programs, the various income maintenance programs, and other federal and state programs. The report contained seven findings.

We reported that the department did not have a sufficient system to account for the drug rebate program. While we acknowledge the department's progress toward implementing a new drug rebate accounting system, the new system was not operational in fiscal year 1999. We repeated the issue in the current report as Finding 3.

We noted weaknesses in the department's reporting of food stamps in the 1998 report. The department implemented our recommendation by correcting and resubmitting the food stamp reports. However, we noted other reporting deficiencies in the current audit (see current Finding 5). Finally, we reported that the department had not accurately calculated outstanding interest on federal cash. The department made some changes in its management of federal cash. However, we cite examples of noncompliance with policies in our current report (see current Finding 2).

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota, any quasi-state organizations, such as metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.



Minnesota Department of **Human Services**

March 8, 2000

James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
Centennial Office Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

The enclosed material is the Department of Human Services response to the findings and recommendations included in the draft audit report of the financial and compliance audit conducted by your office for the year ended June 30, 1999. It is our understanding that our response will be published in the Office of the Legislative Auditor's final audit report.

The Department of Human Services policy is to follow-up on all audit findings to evaluate the progress being made to resolve them. Progress is monitored until full resolution has occurred. If you have any further questions, please contact David Ehrhardt, Internal Audit Director, at (651) 282-9996.

Sincerely,

/s/ Thomas Moss, Deputy Commissioner, for

Michael O'Keefe
Commissioner

Enclosure

cc: Jeanine Leifeld
Michael Hassing

**Department of Human Services
Responses to the Legislative Audit Report
For the Year Ended June 30, 1999**

Audit Finding #1

The department did not complete the MMIS II system security risk analysis in a timely manner.

Audit Recommendation #1

The department should establish and maintain a schedule of system risk analysis and security reviews over the MMIS II system.

Department Response #1

We agree with the recommendation. The department's Internal Audits Office is currently reviewing MMIS II security policies and procedures. In the future, the department will combine all the federal security reporting requirements for MAXIS, MMIS II, and EBT into a single department report for the 2001 review process.

Person Responsible: Larry Woods, Director, Health Care Operations Division

Estimated Completion Date: The security review will be completed by June 30, 2000.

Audit Finding #2

PRIOR FINDING NOT RESOLVED: The department did not adequately monitor its federal cash management procedures.

Audit Recommendation #2-1

The department should implement procedures to track cash draws and determine actual amounts of interest due from or owed to the federal government in compliance with the state's cash management agreement with the federal government and the state Department of Finance policies.

Department Response #2-1

The department does have procedures to track federal cash draws and we are committed to improved monitoring of cash draws. Any interest calculation is immaterial because the federal government will only pay interest to states in situations where the federal government failed to provide a grant award in a timely manner and the states used their own funds. The Cash Management Improvement Act (CMIA)

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has achieved its original intent of improving the timeliness of federal agencies issuing awards to states. We will work with the Department of Finance on this issue and will follow their recommendation.

Person Responsible: Jon Darling, Director, Financial Management Division

Estimated Completion Date: May 1, 2000

Audit Recommendation #2-2

The department should request federal cash in a timely manner, in accordance with the applicable cash management regulations.

Department Response #2-2

The department agrees that it should and will strive to further improve the timing of draws. The department will improve its monitoring of draws to be sure they are being made timely. The new federal funds management system, implemented in November 1999, includes additional reporting capabilities for monitoring purposes. Training sessions have been held and program accountants are already providing the additional data necessary for monitoring. Cash management staff conduct daily reviews of draw request data. A complete review of draw data for accuracy and timeliness compliance will be done with each program accountant every quarter.

The finding suggests the department could further speed up some draws by a day or two. For internal accounting control and operational efficiencies, payment functions must be separated from receipting functions. It is therefore not possible to perfectly time the actual payment with the respective cash draw each and every time. However, we agree we can do better and have already implemented improved procedures.

Person Responsible: Jon Darling, Director, Financial Management Division

Estimated Completion Date: May 1, 2000

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Audit Finding #3

PRIOR FINDING NOT RESOLVED: The department did not have an adequate system of accounting for the Drug Rebate Program during fiscal year 1999.

Audit Recommendation #3-1

The DHS should continue implementing an accounting appropriate system for the Drug Rebate Program. The system should allow for periodic verification of the billing and receipt transactions affecting the accounts receivable balances and the identification of all outstanding drug rebate billings and collected amounts.

Department Response #3-1

The department acknowledges the recommendation and agrees that continued implementation of the drug rebate accounting system is critical. To accomplish this solution, DHS explored available options for administration of the drug rebate program, and concluded that development of a client based server application provided flexibility and scalability needed for administration of drug rebate for Medical Assistance and for future state-only drug rebate programs. Implemented in June 1999, the department's new system is calculating and issuing invoices to pharmaceutical manufacturers, and will provide full accounting functions after financial data converted from MMIS is verified as accurate for accounting purposes.

The study process also identified that the state of Montana needed to procure a solution to drug rebate administration, which led to joint procurement of a common technology platform, that meets the unique needs of both state Medicaid agencies. This innovative, unprecedented joint procurement by agencies in different states required that partnering states overcome the obstacles of designing a common system to meet the needs of each partner, and of effecting the purchase through two separate state administrative procurement systems. The benefit of this partnership was purchasing a system that allowed states to operate a drug rebate accounting system that had high integrity and meets federal requirements. States were able to acquire a system that met their needs at 60% of the cost of a single state procurement. An additional benefit was realized in working closely with our federal partner to ensure the new system met their standards for a system enhancement, which resulted in states receiving a 90% federal match for the procurement. Applying both benefits meant that Minnesota paid \$58,675 for a drug rebate management systems that cost \$850,714. The resulting system has been nominated for a Partnership Minnesota 2000 Cooperative Public Service Award.

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Person Responsible: Larry Woods, Director, Health Care Operations Division

Estimated Completion Date: June 1, 2000

Audit Recommendation #3-2

The DHS should bill drug labelers for past due balances and should charge interest on overdue amounts.

Department Response #3-2

The department acknowledges the recommendation, with the understanding that federal regulations prohibit billing and charging interest on unpaid amounts that are associated with disputes filed by drug manufacturers. DHS can only bill and charge interest on past due amounts that are delinquent, and not related to a dispute. The new drug rebate management system will provide full capability to bill past due amounts. Since its inception, the drug rebate program had invoiced \$230,852,005.86 through fiscal year 1999. As of June 30, 1999, the delinquent, unpaid balance was \$16,578.05.

Person Responsible: Larry Woods, Director, Health Care Operations Division

Estimated Completion Date: June 1, 2000

Audit Finding #4

The department did not accurately allocate MAXIS computer system costs to the participating programs for a six month period.

Audit Recommendation #4

The department needs to correct the allocation of fiscal year 1998 MAXIS costs to the affected programs.

Department Response #4

The department agrees with the recommendation and acknowledges that an error was made in computing the costs allocated to MAXIS for the quarters ended 3/31/98 and 6/30/98. The error was

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precipitated by a change in the cost allocation process mandated by the federal government. The department found, diagnosed, and attempted to correct the error in the quarter ended 9/30/98. Unfortunately, the department's attempt to correct the error was incomplete. The department will process prior quarter adjustments to correct the errors and report them on the federal reports for the quarter ending 3/31/2000.

The department would like to clarify that the "nearly \$1 million" mentioned in the finding is total costs. The necessary corrections to the federal programs' Federal Financial Participation (FFP) is smaller.

Person Responsible: Jon Darling, Director, Financial Management Division

Estimated Completion Date: March 31, 2000

Audit Finding #5

The department's reporting on two federal food stamp reports needs to be improved.

Audit Recommendation #5

The department should make the necessary programming changes to ensure that its systems report complete and accurate information for the food stamp program.

Department Response #5

The audit report contains two separate audit findings concerning federal reports submitted to the federal government's Food and Nutrition Service (FNS).

FNS-46 (Issuance Reconciliation Report)

The first issue addresses the accuracy of figures reported on the FNS-46 report. The department contends that the figures reported on the FNS-46 report are accurate, even though they may not reconcile to the penny to the amounts applied by our Electronic Benefit Transfer (EBT) processor, Deluxe Data Systems, to client level accounts for the same time period. The amounts reported on the FNS-46 comply with FNS instructions and reconcile to data contained in MAXIS.

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FNS staff instructed the department to report using the issuance amounts from MAXIS instead of the amounts applied to client accounts. Since FNS is the authority on this issue, we complied with the federal government's instructions.

We acknowledge that there are currently small differences in issuance numbers reported between the MAXIS System and the application of benefits to client level accounts on the Deluxe Data System reports. Therefore, we agree to investigate the reason for the differences by June 30, 2000. We also agree to consult with FNS to clarify this issue with their report instructions. MAXIS System resources will determine the implementation of any programming changes that may be needed.

FNS 209(Status of Claims Against Households)

The audit report also identifies a problem with the MAXIS computer system. MAXIS could not produce a complete version of the FNS-209 report during fiscal year 1999. Although the department agrees that MAXIS did not produce the entire FNS-209 report during fiscal year 1999, MAXIS did produce the majority of the data contained in the FNS-209 report with the remaining data being manually produced. Using both sources of information, a complete and accurate FNS-209 report was compiled and submitted to FNS during fiscal year 1999.

The department has been working toward producing an automated version of the FNS-209 that is produced entirely by MAXIS. We anticipate that the required programming will be complete in time for MAXIS to produce the entire FNS-209 report for the quarter ending June 30, 2000.

Person Responsible: Jon Darling, Director, Financial Management Division

Estimated Completion Date: June 30, 2000