



**EXAMINATION OF POLICIES,
PROCEDURES, AND FINANCIAL ACTIVITY IN
THE FIDUCIARY AND GUARDIANSHIP SECTIONS OF
THE CABINET FOR FAMILIES AND CHILDREN**

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**DIVISION OF EXAMINATION AND
INFORMATION TECHNOLOGY**
Briefing Report
October 14, 2002

Briefing Report on the Examination of Policies, Procedures, and Financial Activity in the Fiduciary and Guardianship Sections of the Cabinet for Families and Children

Background

The Cabinet for Families & Children (CFC) serves as the court-appointed fiduciary for thousands of persons. As guardian or conservator, the Cabinet is responsible for protecting and managing the financial resources of some, and/or for controlling the personal affairs of others.

Summary

CFC does not effectively safeguard, monitor, or manage the assets of its wards, thereby violating its fiduciary duty to those persons. CFC's deficiencies clearly increase the risk of undetected fraud.

Audit Findings

Policy and control deficiencies prevent the safeguarding of assets

- CFC does not reconcile bank and investment accounts to its accounting system. On April 30, 2002, the commercial checking account containing all liquid fiduciary assets held almost \$5 million. However, CFC's computerized accounting and record keeping system (GFS) was short more than \$265,000.
- GFS has limited capabilities and is not suitable for its intended purpose because it does not have an adequate accounting module, which makes appropriate safeguarding, monitoring, and managing of assets impossible.
- Weak GFS controls include:
 - Allowing personnel to both initiate and approve check requests;
 - Failing to record the approver of a check request; and,
 - Allowing check information to be changed and deleted without any record.
- CFC does not control check distribution, allowing checks to be given to the employee requesting the disbursement, rather than being mailed to the payee.
- CFC's accounts payable process routinely grants final approval and processes checks without receiving or reviewing supporting documentation.
- Disbursement controls are inconsistently observed. We identified more than \$110,000 in disbursements lacking supporting documentation and, in some cases,

violating the records retention requirements of the Social Security Administration.

- The combination for a safe holding negotiable instruments worth more than \$184,000 was not kept confidential.
- Bank money market accounts were allowed to exceed the Federal Deposit Insurance Corporation (FDIC) coverage limits without additional security, in violation of KRS 386.020(1)(k).

Assets are not recorded or monitored

- Investment assets are not accurately enrolled in GFS.
 - Twenty-three persons had investment assets totaling more than \$224,000 unrecorded in GFS. \$21,000 of these assets belonged to 17 persons who receive or have received Medicaid benefits, which could lead to incorrect eligibility determinations.
 - Investment assets recorded in GFS were often several months out of date. Unrecorded investment transactions caused GFS asset accounts to be overstated by more than \$2 million.
- Refunds due are not recorded, monitored, or pursued to ensure receipt. We examined letters written by CFC requesting refunds totaling nearly \$128,000 and found that less than \$49,000 of that amount was collected.
- Pre-paid burial arrangements are not accurately enrolled in GFS, allowing in at least one instance, a person having pre-paid burial arrangements at two funeral homes.

Assets are not properly administered

- CFC had not distributed over \$92,000 belonging to 44 persons to successor guardians or conservators, going back as far as March 1999.
- CFC had not distributed over \$114,000 belonging to the estates of 19 persons who had died as early as December 1997.
- Pre-paid burial arrangements were routinely purchased without selecting specific goods and services, which offers no protection from price increases and provide no assurance that funds set aside are sufficient. Family members are not consulted at the time the burial contract is negotiated.

- CFC does not ensure that all pre-paid burial arrangements have been applied before disbursing additional funds to funeral homes. In four cases, the Fiduciary Section overpaid funeral homes by nearly \$1,800.
- Insurance policies have not been administered properly. We identified three unclaimed life insurance benefits totaling more than \$10,000 and one unclaimed hospitalization income insurance benefit of at least \$1,200. One life insurance policy with a face value of more than \$2,000 was allowed to lapse, despite notification from the insurance company of premiums due.
- Other management failures include paying the expenses of one person with another's funds, charging inconsistent or excessive guardianship fees, and failing to notify benefit providers of the deaths of persons. The latter resulted in excess benefits received of more than \$35,000, including Social Security payments nearly two years after one death.

Observations and Concerns

Our findings raise the issue of improper Medicaid payments.

- Persons may have received Medicaid benefits during periods when they were ineligible.
- CFC's "spend down" practice may have resulted in intentional Medicaid program violations.
- Potential estate recoveries for Medicaid have been overlooked.

Since these concerns are beyond the scope of our examination, we will refer the information we gathered to the Cabinet for Health Services for further consideration.

We are also concerned that CFC may be unable to resolve the fiduciary issues raised in this report. Accordingly, we recommend the Judicial Branch evaluate appointment and fiduciary monitoring practices in order to protect the interests of these persons.

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EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS

October 14, 2002

Dr. Viola Miller, Secretary
Cabinet for Families and Children
275 East Main Street, 4W-A
Frankfort, Kentucky 40621

RE: Auditors' Report on Fiduciary and Guardianship Sections Examination

Dear Dr. Miller:

We have performed an examination of selected practices and financial transactions of the Fiduciary and Guardianship Sections of the Department for Community Based Services within the Cabinet for Families and Children (CFC). Our examination was initiated as a result of a concern brought to our attention by a citizen. Our objective was to determine whether funds belonging to the Fiduciary and Guardianship Sections' clients (Clients) had been misappropriated or had been subjected to unacceptable risk of loss.

We interviewed Guardianship and Fiduciary Sections' employees and vendors, and examined Guardianship and Fiduciary Sections' records, as well as the documentation of transaction details. While we did not detect fraud, a number of asset safeguard issues were identified that significantly increased the risk of undetected fraud. We also identified a number of issues related to the monitoring and management of Client assets and Medicaid compliance.

The findings noted during our examination are presented in the attached executive summary and report. We wish to thank Fiduciary and Guardianship Sections' personnel, as well as all other parties involved, for the cooperation extended to us during the course of our work.

Very truly yours,

A handwritten signature in black ink, appearing to read "Edward B. Hatchett".

Edward B. Hatchett, Jr.
Auditor of Public Accounts

EBHJr:kct



The Fiduciary and Guardianship Sections serve more than 2,300 persons.

The Fiduciary Section and Guardianship Section reside within the Department for Community Based Services of the Cabinet for Families and Children (CFC). Together, these sections manage the assets of more than 2,300 persons (Clients) found by a District Court to be disabled and in some sense incapable of managing their own affairs. This stewardship takes various legal forms set forth in KRS 387.590. CFC, may be appointed as

- *Guardian* in cases where the Client has been found to have a full disability that prevents managing financial resources and personal affairs;
- *Limited Guardian* in cases where the Client has been found to have a partial disability in managing financial resources and personal affairs;
- *Conservator* in cases where the Client has been found to have a full disability that prevents managing financial resources; or,
- *Limited Conservator* in cases where the Client has been found to have a partial disability in managing financial resources.

The Fiduciary Section, with a staff of eight, manages Clients' financial resources. This includes services such as applying for benefits, receiving income and benefits, managing investment, real estate, and personal assets, paying expenses, and filing income tax returns.

The Guardianship Section, with a staff of 54, manages Clients' personal affairs. This includes decision-making on living arrangements and medical treatments, assisting with daily activities such as visiting a physician or obtaining groceries, and generally monitoring the Client's well being.

Findings and Recommendations

Client assets are not safeguarded because of policy and control deficiencies.

We identified the following safeguarding issues at CFC:

- persistent, long-term failure to reconcile Clients' bank and investment accounts;
- weaknesses in the internal controls;
- inconsistently applied control procedures;
- insecure physical storage of negotiable instruments; and,
- uninsured Client deposits in financial institutions.

Millions in bank and investment accounts have not been reconciled in years.

The commercial checking account (Master Bank Account) into which all checkable funds are deposited had a balance of \$4,979,350 as of April 30, 2002. The Master Bank Account is not reconciled to the Cabinet's computerized accounting and recordkeeping system known as the Guardianship Fiduciary System (GFS).

Fiduciary Section personnel told us that reconciliation has not been attempted since GFS was implemented in 1996 because GFS is not programmed to produce a consolidated book balance of all Clients' checkable funds.

GFS is not suitable for its intended purpose because it does not contain an accounting module. The absence of an accounting module makes safeguarding, monitoring, and managing Client assets impossible because it deprives CFC of an industry standard for fiduciaries – a double entry accounting system. Likewise, investment accounts have not been reconciled to investment statements and current statements have not been maintained in Client files.

There is a \$265,000 unexplained difference between GFS and bank balances.

At our request, personnel from CFC's Office for Technology Services were able to quickly modify an existing GFS report, resulting in a report listing every Client's checking balance. We attempted to reconcile the GFS total on this modified report to the Master Bank Account as of April 30, 2002. When all known reconciling items are taken into account, the bank balance is \$265,436 less than the total reflected in GFS.

This unreconciled difference could be attributable to undetected fraud or errors. We tested for fraud by examining a sample of checks paid by the bank during six judgmentally selected months. This sample did not contain any paid checks that were not recorded in GFS. We also examined a sample of deposits from six judgmentally selected months. This sample did not contain any deposits recorded in GFS that were not reflected in the Master Bank Account.

Control weaknesses in GFS increase the risk that fraud or errors may occur undetected.

GFS has significant control weaknesses. According to Fiduciary Section management, GFS allows personnel to both initiate and approve check requests, two functions that must be segregated if the risk of errors or fraud is to be effectively reduced.

GFS cannot identify the approver of a check request, depriving the system of a key element of an audit trail. Finally, GFS allows check information to be changed and the record of the check to be deleted after printing without logging such actions, eliminating another important audit trail document.

We identified a \$3,500 check that was written in February 1998 to pre-pay a Client's burial expenses. This check cleared the bank and the pre-paid burial arrangement is on file. GFS does not, however, contain any record of this check. As a result, the pre-paid burial arrangement was not reported in two successive mandatory biennial District Court filings.

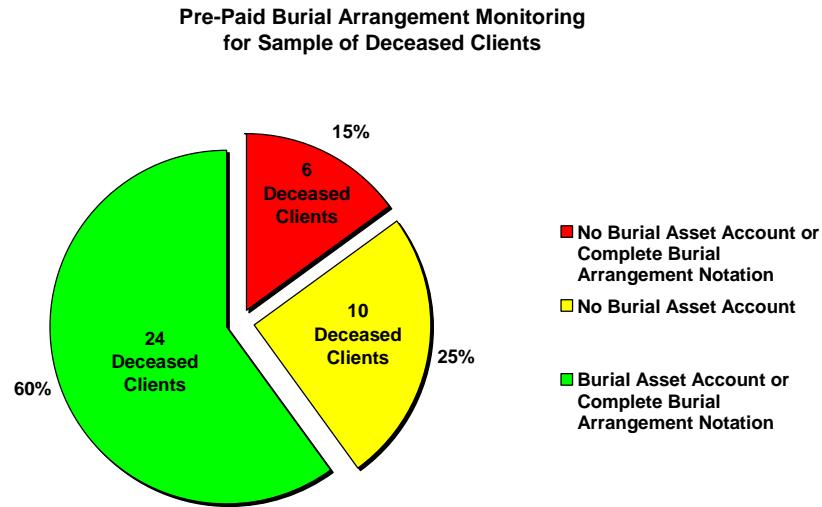
Certain practices constitute control weaknesses.

The Fiduciary Section does not control the distribution of checks. Some checks, notably those for pre-paid burial arrangements, are given to the requesting Guardianship Section fieldworker, instead of being sent directly to the payee. The Fiduciary Section grants final approval for all disbursements of Clients' funds. In most cases, this approval is given without the Fiduciary Section reviewing or receiving the supporting documentation.

Fiduciary and Guardianship Sections personnel have not consistently observed disbursement controls.

Fiduciary Section personnel said that Guardianship Section personnel are responsible for maintaining documentation supporting disbursements. The Fiduciary Section has a policy regarding pre-paid burial arrangement disbursements that requires a copy of the policy or contract be provided to the Fiduciary Section before the disbursement is processed.

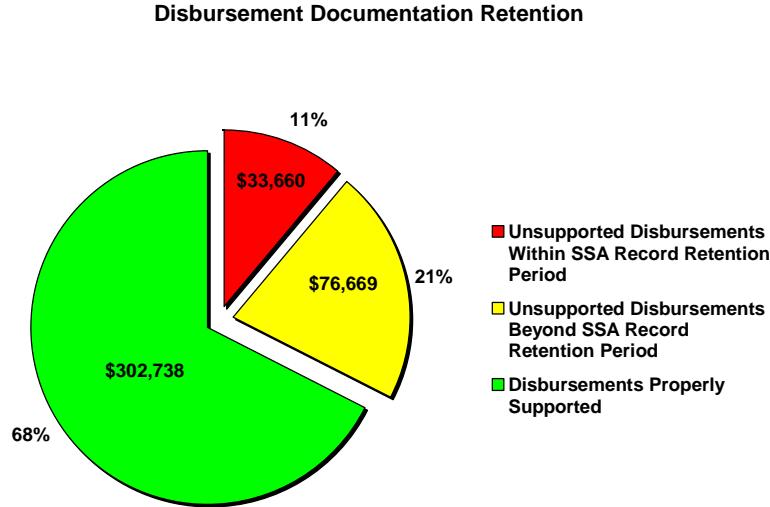
In examining Fiduciary Section records for 40 deceased Clients, however, we found 13 disbursements for pre-paid burial arrangements with no supporting documentation. We located documentation in the Guardianship Section file for only five of these cases. Testing results are illustrated in the graph below:



Disbursement records do not meet SSA requirements.

We examined an additional 206 disbursements of various types totaling \$413,067. We found no supporting documentation for 66 of these disbursements totaling \$110,329.

The Social Security Administration (SSA) Guide for Representative Payees, *Publication 05-10076*, states that: “[a]s a representative payee, you should keep records showing how much you received in benefits and how the money was used. You should keep these records for two years from the time you complete a Representative Payee Report.” We found that 23 of the unsupported disbursements totaling \$33,660 had occurred within the mandatory documentation timeframe, resulting in non-compliance with SSA record retention requirements. Testing results are illustrated in the graph below:



The Fiduciary Section is not properly safeguarding over \$184,000 in negotiable instruments in its custody.

The Fiduciary Section stores negotiable instruments in a combination safe, but does not maintain an inventory of such instruments nor a log of additions and withdrawals. We inventoried the safe on April 5, 2002, and found it contained stock certificates, savings bonds, and certificates of deposit worth \$184,405. Additionally, five of these negotiable instruments were already endorsed by the owners.

The safe's combination is not changed when combination-entrusted personnel leave the section, violating a basic internal control.

The Fiduciary Section failed to comply with statutes requiring the security of bank deposits.

KRS 386.020(1)(k) allows the Fiduciary Section to invest the assets of a Client with any bank having a main office in Kentucky, but requires that any portion of such investments that is not insured by the Federal Deposit Insurance Corporation (FDIC) shall be fully secured by:

1. An irrevocable letter of credit issued by the United States of America or by an agency or instrumentality thereof;
2. A pledge of securities named in this subsection as collateral;
3. A surety bond; or
4. A combination of such irrevocable letters of credit, securities, and surety bonds.

Generally, when Clients have significant assets, the Fiduciary Section opens a money market checking account in order to earn interest. Three Clients at times have had money market balances exceeding the \$100,000 FDIC coverage limit. One of these Clients has a balance in excess of \$400,000. According to Fiduciary Section personnel, no steps were taken to secure Clients' funds not covered by the FDIC.

Recommendations

We recommend the Fiduciary Section:

- Adopt a double entry accounting system that provides proper financial controls including an accounting module to record Clients' financial transactions;
- Reconcile the accounting system to the bank statement regularly and in a timely manner;
- Resolve the \$265,436 difference between GFS and the Master Bank Account;
- Maintain current statements for investment assets and reconcile the accounting system to these statements in a timely manner;
- Implement a policy requiring checks to be sent directly to payees;
- Implement procedures in which all accounting functions are performed by Fiduciary Section personnel;
- Ensure disbursement does not occur until supporting documentation is obtained and maintained in Fiduciary Section files;
- Rent a safety deposit box at a financial institution for storing Clients' physical valuables and negotiable instruments;
- Implement a procedure in which dual access is required for the safety deposit box and a log is kept which details initial contents and all additions and withdrawals;
- Implement a policy to convert physical stock certificates to electronic ownership;
- Implement a policy to either liquidate or re-issue endorsed negotiable instruments; and,
- Invest Clients' funds in accordance with KRS 386.020.

CFC has not adequately recorded or monitored assets.

The Fiduciary Section did not record more than \$224,000 of investment assets and misstated recorded assets by more than \$2 million.

The Fiduciary Section did not record or monitor nearly \$128,000 refunds requested for Clients.

Client burial accounts are not properly posted in GFS.

We identified a number of issues involving the recording and monitoring of assets. These issues include unrecorded and misstated investment assets, unrecorded refunds receivable, and unrecorded pre-paid burial arrangements.

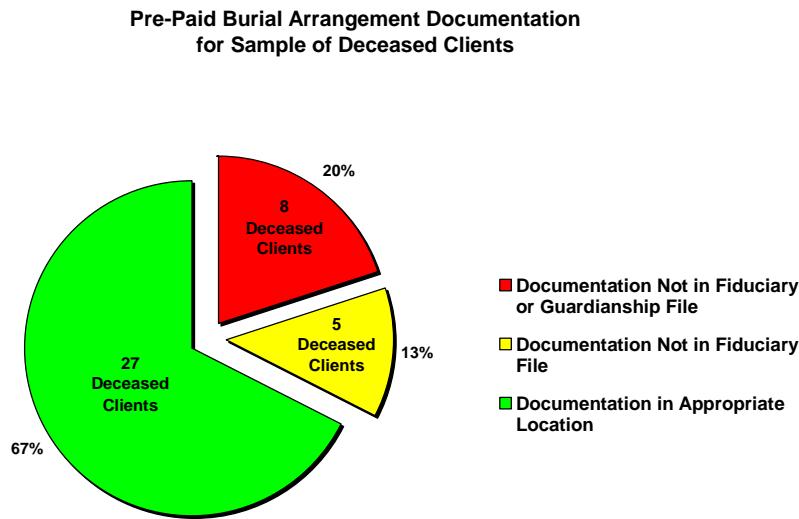
We identified 61 Clients who have assets in addition to their funds held in the Master Bank Account. These additional assets currently controlled by the Fiduciary Section are worth more than \$2.2 million. We identified unrecorded investment assets totaling \$224,662. Of these unrecorded assets, \$21,455 belonged to 17 Clients who receive or have received Medicaid benefits. Failure to record all assets could lead to incorrect eligibility determinations. We also found unrecorded investment transactions that caused GFS asset accounts to be overstated by \$2,274,054 because these accounts were often several months out of date.

Most care facilities require the Fiduciary Section to pay room and board expenses for Clients at the beginning of the month. When Clients move or die during the month, the Clients or their estates are often entitled to refunds from the care facilities. Fiduciary Section personnel identify such situations and request refunds.

Copies of the refund requests are retained, but there is no process for tracking the receipt of these refunds. Fiduciary Section personnel said they do not have time to monitor such refunds. Since January 1, 2000, the Fiduciary Section has sent letters requesting refunds totaling \$127,900 to care facilities. We found that only \$48,989 had been received in response to these requests, leaving \$78,911 (62 percent) uncollected.

We examined the records of 40 deceased Clients and found that 16 had pre-paid burial arrangements without any record being made in GFS burial asset accounts by the Fiduciary Section. It is more difficult to monitor the pre-paid burial arrangements and accurately report to District Courts.

To monitor the assets in these cases, Fiduciary Section personnel have to rely on notations made in other areas of GFS by Guardianship Section personnel. However, for six of the 16 deceased Clients missing burial asset accounts, there were no notations in GFS or incomplete notations. In at least one instance, this resulted in the Client having pre-paid burial arrangements with two funeral homes. Testing results are illustrated in the graph below:



Recommendations

We recommend the Fiduciary Section

- Implement procedures to ensure all known assets and transactions associated with those assets are recorded in the System;
 - Automate the process of identifying refunds due;
 - Record refunds receivable and credit subsequent receipts against these receivables; and,
 - Pursue the payment of receivables due Clients.
-

CFC does not properly administer assets.

District Court may relieve CFC of its duties by appointing a successor or by restoring the Client's rights. The Fiduciary Section designates such Clients as resigned. There are a number of issues concerning resigned and deceased Clients. These include

- asset distributions;
- procurement of pre-paid burial arrangements;
- payment of final burial expenses;
- administration of insurance policies;
- deficit Client balances;
- charging guardianship commissions; and,
- notifying entities paying benefits that Clients have died.

In violation of KRS 387.710(3) the Fiduciary Section had not distributed at least \$125,000 to court appointed individuals on behalf of Clients who had resigned or died as early as November 1999.

In a sample of 20 resigned Clients, the Fiduciary Section was improperly holding assets totaling \$74,057 belonging to 13 Clients who had a successor guardian or conservator appointed as early as October 2000. Withholding these funds violated KRS 387.710(3) that states, “[u]pon the resignation, removal, or death of a limited conservator or conservator, or on the termination of the conservatorship, the limited conservator or conservator, or his personal representative, shall forthwith submit a final report and account to the court and to the former ward and to the successor limited conservator or conservator, or, if the ward is deceased, to his personal representative and shall pay over the trust estate to the person entitled thereto.”

In nine of these cases, assets were partially distributed, while no distributions whatsoever took place in the remaining four cases. Additionally, 31 other Clients who resigned as early as March 1999 also have remaining balances in their checking accounts totaling \$18,013.

In a sample of 40 deceased Clients, the Fiduciary Section was holding assets totaling \$33,227 belonging to the estates of five Clients who had died as early as November 1999, and whose estates had a court appointed administrator. Again, withholding these funds violated KRS 387.710(3) as stated above.

Additionally, the Fiduciary Section was holding assets totaling \$81,028 belonging to the estates of 14 other Clients who had died as early as December 1997. The Fiduciary Section has information necessary to contact family members who are potential administrators of the estates of these 14 Clients. However, Fiduciary Section records do not document any attempts to contact these potential administrators. Fiduciary Section personnel said they try to contact family members about remaining assets when time constraints permit.

Pre-paid burial arrangements have been purchased for Clients without full consideration of Clients' interests.

Eleven of the 40 deceased Clients had pre-paid burial arrangements in excess of a thousand dollars that had been purchased without selecting specific goods and services. Purchases made in this manner do not offer Clients price protection, nor do they provide assurance that sufficient funds have been set aside to cover burial expenses.

One Guardianship Section fieldworker said that purchases are made in this manner as a matter of policy, and that selection of goods and services is left to family members to decide at the time of death. A better policy would appear to be consulting family members at the time the burial contract is negotiated rather than after the Client's death.

Personnel from the Cabinet for Health Services' Department for Medicaid Services (DMS) said that specific goods and services should always be selected when making these arrangements for Clients. DMS reviews burial trusts above \$10,000 and typically rejects those that do not detail specific goods and services.

Funeral homes have been overpaid.

The Fiduciary Section also made payments for services other than pre-paid contracts in 16 of the 40 deceased Client records we examined. Funeral homes were overcompensated a total of \$1,792 for four of these Clients because the Fiduciary Section paid the funeral homes without first checking to see if all pre-paid funds had been applied toward the final expenses.

A funeral home was overpaid in another instance because no one ensured that the Client received the goods and services provided for in the pre-paid burial arrangements. The Guardianship Section arranged for, and the Fiduciary Section purchased, a pre-paid burial contract for this Client in 1994 in which specific goods and services were selected and prices guaranteed. In 1996, a \$500 burial insurance policy was obtained to provide the Client with a "memorial." However, comparison of the final burial invoice with the 1994 contract revealed that the only item the Client received in addition to the goods and services included in the 1994 contract was acknowledgement cards costing \$30. The funeral home did collect \$803 from the 1996 burial insurance policy, which paid for the acknowledgement cards, and also refunded \$67 to a member of the Client's family, resulting in an overpayment of \$706.

The Fiduciary Section does not properly administer insurance policies.

The Fiduciary Section has an informal policy of notifying the funeral home or administrator of the estate if insurance may be claimed for a deceased Client. However, not all insurance benefits are assigned to funeral homes and estate administrators are not always appointed. Three deceased Clients had unclaimed life insurance policies totaling \$10,630. In addition, the Fiduciary Section paid hospitalization income insurance policy premiums for five years for one Client. Despite the fact that this Client had at least 24 qualifying days in the hospital during that time, no claims were ever made against the policy. This policy would have paid the Client at least \$50 per hospital day, or \$1,200.

One deceased Client had a \$2,020 life insurance policy in force when CFC was appointed as his limited conservator. Despite having received a notice of premium due July 28, 2000, the Fiduciary Section sent a letter to the insurance company on August 14, 2000, stating “[i]f there is a premium being paid please send that information to this office so we can begin paying the premium.” The Fiduciary Section again received the premium information from the insurance company on September 18, 2000, but no action was ever taken or premiums ever paid. The insurance company confirmed that the policy was never reinstated.

This policy does not appear to have been allowed to lapse due to insufficient funds. Although this Client had no funds immediately available, other routine expenses such as a cable television bill were still paid in anticipation of the sale of this Client’s home. At the time of testing, more than a year after the Client’s death, his home still had not been sold and he had a \$4,201.76 deficit checking balance in GFS.

157 Clients had deficit checking balances totaling over \$161,000.

A number of Clients were allowed to carry deficit balances in their checking accounts. Since all Clients’ checking funds are kept in the Master Bank Account, a deficit balance results in one Client’s expenses being paid with other Clients’ funds.

As of April 17, 2002, there were 157 Clients with deficit balances totaling \$137,853. While some of these deficit balances may be temporary, this does not appear to be the case for many Clients. One hundred and twenty-five of these 157 Clients still had deficit balances on June 28, 2002, when the combined deficit balance rose to \$161,341 for 156 Clients. The timing difference between income received and the due date for an expense requires at times that expenses be paid for Clients that do not have the resources to pay them. However, these funds should not be borrowed from other Clients.

Clients' checkable funds do not earn interest in the Master Bank Account. CFC has agreed to forego interest income and the bank has agreed to waive service charges in return. This practice is a violation of CFC's fiduciary duty to the Client to conserve and, whenever possible, augment the trust corpus.

CFC violated KRS 386.180 by not accurately calculating commissions.

KRS 387.760 allows CFC to be compensated for acting as a Client's guardian or conservator, but such compensation may not exceed the limits set in KRS 386.180. KRS 386.180(1) limits this compensation to

- “a commission of six percent (6%) of the income collected by them, payable as the income is collected;” and,
- “an annual commission of three-tenths of one percent (.3%) of the fair value of the real and personal estate in the care of the fiduciary, or at the option of the fiduciary and in lieu of the annual commission on principal, a commission which shall not exceed six percent (6%) of the fair value of the principal distributed, payable at the time the principal is distributed.”

The Fiduciary Section chose to receive commissions at the time of distribution, instead of an annual commission.

CFC does not account separately for principal and income; therefore its calculation of compensation does not comport with KRS 386.180, and the deduction of the commission from Clients' accounts violates both CFC's fiduciary duty to the Client and the mandates of Kentucky's Uniform Principal and Income Act (UPIA) at KRS 386.215, et. seq.

The Fiduciary Section did not uniformly charge commissions to Clients.

Clients with similar financial circumstances did not pay the same commissions. The Fiduciary Section has an informal policy of not charging commissions of Clients who receive Medicaid and do not have burial arrangements due to hardship, and Clients who receive Veterans Administration (VA) benefits. The VA allows for commissions to be charged of its beneficiaries when specific reporting requirements are met. According to Fiduciary Section management, GFS does not allow for these reporting requirements to be met. CFC plans to collect commissions from veteran Clients once these reporting requirements can be met.

We compared the commissions charged on income for 14 Clients and found that five of these Clients were not charged any commissions on income collected. Each of these five individuals had been a Client for more than two years and none of them met the exemption criteria. The other nine Clients were charged commissions at varying rates (see Exhibit A).

We also compared the commissions charged on distributions for 20 Clients and found that 13 of these Clients were not charged any commissions and did not meet the exemption criteria. Each of these 13 individuals had been a Client for well over a year with a few having been Clients for decades. The other seven Clients, one of whom had been a Client for less than a year, were charged commissions at varying rates (see Exhibit B).

Additional efforts are necessary to accurately calculate commissions because of deficient GFS records.

The Fiduciary Section does not calculate the commission on distributions in accordance with KRS 386.180(1) as illustrated below:

Example of Computation:

Funds Available for Distribution	\$10,000
Less Commission (0.06 x 10,000)	(600)
Less Distribution Amount	<u>(9,400)</u>
Funds Remaining After Distribution	-

Example of Statutory Computation:

Funds Available for Distribution	\$10,000.00
Less Commission (0.06 x 9,433.96)	(566.04)
Less Distribution Amount	<u>(9,433.96)</u>
Funds Remaining After Distribution	-

The UPIA KRS 386.195 states that, “[a] trust shall be administered with due regard to the respective interests of income beneficiaries and remaindermen. A trust shall be so administered with respect to the allocation of receipts and expenditures if a receipt is credited or an expenditure is charged to income or principal ...” However, GFS does not differentiate between principal and income receipts. As a result, additional efforts are necessary to accurately calculate commissions. The Fiduciary Section does not know when funds are distributed whether these funds are entirely composed of principal that has not yet been charged a commission. If a Client has had more income than expenses, a portion of the funds distributed may represent income that has already been subject to a commission.

CFC has under-billed commissions by at least \$57,000.

Due to inconsistently applying commission rates the Fiduciary Section charged the Clients in our commission comparison sample \$36,417 less than the maximum allowed under KRS 386.180(1). Additionally, we examined the commissions that could have been charged to eight Clients we identified from our deceased and resigned Client samples who received VA benefits. We found that the inability to meet VA reporting criteria that precludes the Fiduciary Section from charging commissions to Clients receiving VA benefits resulted in lost commissions of \$21,416 since GFS was implemented in 1996.

The Fiduciary Section did not notify entities paying benefits that Clients had died.

As guardian or conservator, CFC receives benefits on behalf of its Clients from numerous public and private entities. When a Client dies, the Fiduciary Section is responsible for notifying these entities to cease benefit payments. Seven of the 40 deceased Clients whose records were examined had received benefits totaling \$35,290 from private trusts and public agencies after death. There were no documented attempts to notify these entities for five of the seven Clients. One of these Clients had died in July 2000, but was still receiving SSA benefits as late as June 2002 in the cumulative amount of \$9,568.

Recommendations

We recommend that the Fiduciary Section implement procedures to ensure

- Remaining assets are timely distributed to successor guardians, conservators, or estate administrators;
- Potential estate administrators are contacted about appointment whenever remaining assets exceed an established threshold;

- The full value of pre-paid contracts is applied toward burial expenses before disbursing additional funds to the funeral home;
- Insurance policies are not allowed to lapse inadvertently and that appropriate claims are made on all policies;
- Client deficit balances are minimized, and unavoidable deficit balances are covered with funds other than those belonging to other Clients;
- Deposit Client checkable funds in an interest bearing account with each Client receiving the appropriate interest earned as required by UPIA;
- Client financial transactions are recorded in sufficient detail to ensure compliance with the UPIA and allow calculating and charging accurate commissions;
- Commissions are charged of veteran Clients in compliance with VA reporting requirements;
- Statutory commissions are charged uniformly; and,
- Entities paying benefits for Clients are timely notified of Client deaths.

We also recommend that the Guardianship Section consult families of Clients on the selection of goods and services when negotiating pre-paid burial arrangements.

Client Medicaid eligibility may be questionable.

Some Clients received Medicaid benefits when they may have been ineligible. One deceased Client was the beneficiary of a trust created by her mother's will. The principal and interest were to be used to provide for the Client's lifetime maintenance and care at the trustee's discretion. The trust is currently worth \$46,000.

A representative for the trustee indicated that trust statements have been sent to the Guardianship Section since at least January 1999, but that no distributions were made for this Client's care because funds were never requested by the Fiduciary Section. The Fiduciary Section did not record the trust account as an asset in GFS until May 30, 2001, several months after the Client died. DMS records indicate that this Client received \$21,282 in Medicaid benefits from 1996 until her death in August 2000, all of which could potentially be recovered from the Client's trust.

CFC observes the practice of “spending down” Client assets to bring resources below the Medicaid eligibility limit.

Another area of concern is the practice of the Fiduciary and Guardianship Sections of “spending down” assets in order to reduce Clients’ funds below Medicaid eligibility requirements. We noted instances in which “spending down” was not a responsible use of Clients’ funds. One example involves a Medicaid and Medicare Client whose funds were paid to a care facility without regard to whether they were needed, what they were spent on, or whether they were spent at all.

An entry appearing in the Client’s GFS case notes documents that the Fiduciary Section sent an e-mail to the Guardianship Section fieldworker on June 11, 2001, which stated “[w]e have a PA-1A due on [Client] and she is way over the resource limit. We need to spend at least \$3,000 on her as soon as possible. Please let me know what you are buying and how much you are spending. I have to return the PA-1A to Family Support by 6/25/01.”

The PA-1A form is used to report financial resources for Medicaid eligibility determination. The Fiduciary Section is required by 907 KAR 1:605 to submit a PA-1A to the CFC Division of Family Support (Family Support), where Medicaid eligibility is determined, annually or within ten days of any change in circumstances that may effect eligibility. The June 27, 2001, response from the fieldworker was: “[w]e are spending \$850 for opening of grave & marker for [Client]. \$1,000 for clothing; \$200 shoes; \$450 television; \$100 VCR; \$75 cot; \$75 glamour shots; \$200 stereo; \$200 for camera and accessories for a total of \$3,150.”

The PA-1A for this Client was received by Family Support on June 29, 2001. This filing included a GFS checking statement dated June 6, 2001, which showed an ending balance of \$5,638.69. Three disbursements totaling \$3,650 were handwritten on the statement to bring the ending balance below the \$2,000 Medicaid resource limit used by the Fiduciary Section as a target resource level.

Approximately \$1,800 of funds the Fiduciary Section sent to a care facility to purchase personal items for a Client had not been spent nearly a year later.

The Fiduciary Section disbursed two checks from this Client's funds on June 28, 2001. An \$850 check was sent to a funeral home and a \$4,100 check was sent to the Client's care facility. We requested documentation from the Guardianship Section supporting the purchases made with the \$4,100. The Guardianship Section did not have this documentation and had to request copies from the care facility. The care facility provided a memo dated June 19, 2002, stating that they had spent \$2,411.88 of that \$4,100, though the memo was only accompanied by copies of receipts totaling \$600.12. The care facility also included a statement of the Client's patient escrow account as of June 18, 2002, reflecting a \$1,809 balance.

The Fiduciary Section filed a PA-1A for this Client with Family Support on June 17, 2002. This filing included a GFS checking statement dated June 14, 2002, which showed an ending balance of \$2,983.69. One disbursement for \$1,100 was handwritten on the statement to bring the ending balance down to \$1,883.69. The Fiduciary Section did not disclose the significant amount of funds in the patient's escrow account on the PA-1A.

Fiduciary and Guardianship Sections “parked” Client funds at a care facility to avoid reporting the resource when determining Medicaid eligibility.

Despite the fact that the care facility still had \$1,809 in this Client's patient escrow account, the Fiduciary Section still disbursed \$1,100 to the care facility on June 17, 2002, bringing the Client's patient escrow balance up to \$2,909. This sequence of events suggests that the Fiduciary and Guardianship Sections are “parking” Clients' funds at care facilities to avoid reporting the resources to Family Support for the purpose of maintaining uninterrupted Medicaid eligibility. If Clients have been “inappropriately obtaining a covered service” due to the “spending down” practice and this has resulted in financial losses to the Medicaid program, it could constitute a Medicaid intentional program violation under 907 KAR 1:675 Section 2.

A second “spending down” example involves another Client who receives Medicaid and Medicare benefits. This Client’s mother purchased a comprehensive pre-paid burial contract in 1987, in which specific goods and services were selected. CFC was appointed this Client’s conservator in 1992. A Guardianship Section fieldworker sent a memo on August 26, 1996, to their Site Supervisor stating: “[i]n reviewing our accounts, I found that [Client] has \$2,304 in her account and does not have a burial. She is at [care facility] on Medicaid. We need to purchase a burial in order to get her under the resource limit.”

Fiduciary and Guardianship Sections made unnecessary pre-paid burial arrangements to reduce Client resources under the Medicaid eligibility limit.

The Guardianship Section Site Supervisor replied on September 3, 1996: “[c]ontacted [funeral home] and learned that [Client] has a \$2,500 contract purchased on 4-23-87. Nevertheless, we will add some monies to the contract to bring her under the resource limit.” Though the 1987 contract included services of the funeral director and staff, the Fiduciary Section disbursed \$500 on September 6, 1996, to purchase a life insurance policy assigned to the funeral home and allocated to pay for services of the funeral director and staff.

The Fiduciary Section disbursed an additional \$1,750 of this Client’s funds on January 25, 2001, to purchase another life insurance policy through the same funeral home. This disbursement brought the Client’s GFS checking balance down to \$1,800.

When asked why additional pre-paid burial arrangements were necessary, the Guardianship Section fieldworker stated that he had requested the funds to purchase the 2001 policy because both GFS and the latest biennial report indicated that this Client had less than \$700 put aside for burial. No burial account has been set up in GFS and the Guardianship Section notations mention only the 1996 policy. We noted that the biennial report submitted to District Court for the period ending April 30, 2000, only includes the 1996 policy.

CFC appears to have overlooked at least \$78,000 in potential Medicaid estate recoveries.

A final area of concern relates to Medicaid estate recoveries. As required by 907 KAR 1:585, Medicaid benefits paid on behalf of an institutionalized individual should be recovered from that individual's estate, subject to a number of limitations. We noted at least five Clients who have received a total of \$277,345 in Medicaid benefits since July 1996. Each of these five Clients has assets that appear to qualify for estate recovery under 907 KAR 1:585. The potential estate recovery for these five Clients totals \$78,009. CFC administered the estate recovery process for DMS through June 30, 2002, at which time DMS resumed administrative responsibility. We asked Family Support personnel involved in estate recovery and were told that they had no information regarding any potential estate recovery for these five Clients.

Recommendations

We recommend that the Fiduciary Section implement procedures to ensure

- All known assets are recorded in the accounting system; and,
- Clients' funds are not spent irresponsibly simply to maintain Medicaid eligibility.

We also recommend that DMS determine

- Whether Clients have received Medicaid benefits when they were actually ineligible;
 - Whether "spending down" by the Fiduciary and Guardianship Sections is an intentional Medicaid violation; and,
 - Whether potential Medicaid estate recoveries have been overlooked.
-

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EXHIBITS

EXHIBIT A

Summary of Income Guardianship Fee Analysis

Client Ref #	Days Serviced As of 6/28/02	Date Guardianship Fee Charged	Income Guardianship Fee Charged	Income To Date Since Appointment or Last Fee	Income Commission Percentage	Statutory Maximum Income Commission	Waived/ (Excess) Fees
1	1,003	N/A	-	\$ 45,191.90	-	\$ 2,711.51	\$ 2,711.51
2	1,074	N/A	-	63,775.55	-	3,826.53	3,826.53
3	1,159	N/A	-	26,909.85	-	1,614.59	1,614.59
4	886	N/A	-	118,453.21	-	7,107.19	7,107.19
5	862	N/A	-	41,584.68	-	2,495.08	2,495.08
6	1,101	28-Jun-2001	\$ 882.00	16,739.34	5.27%	1,004.36	122.36
7	3,872	7-Sep-2000 19-Dec-2001	1,149.00 1,204.00	25,004.00 12,696.00	4.60% 9.48%	1,500.24 761.76	351.24 (442.24)
8 ^A	1,492	23-Jun-2000	240.00	10,528.48	2.28%	631.71	391.71
9	1,659	15-Mar-2000	5,362.92	102,975.79	5.21%	6,178.55	815.63
10	1,103	28-Jun-2001	240.00	100,214.36	0.24%	6,012.86	5,772.86
11	2,105	3-Jul-2000 23-Apr-1998	2,033.67 2,194.25	39,387.04 36,671.26	5.16% 5.98%	2,363.22 2,200.28	329.55 6.03
12	2,135	27-Sep-2000	4,924.00	113,357.30	4.34%	6,801.44	1,877.44
13	2,902	1-Sep-1998 1-Sep-2000	1,574.00 1,635.00	25,218.00 28,446.00	6.24% 5.75%	1,513.08 1,706.76	(60.92) 71.76
14	6,898	21-Sep-2000	240.00	31,893.93	0.75%	1,913.64	1,673.64
					Net	\$ 28,663.96	

^A Client receives Medicaid benefits and has no record of pre-paid burial arrangements in GFS.

EXHIBIT B

Summary of Distribution Guardianship Fee Analysis

Client Ref #	Days Serviced	Date(s) of Distribution	Distribution Guardianship Fee Charged	Amount Distributed	Distribution Commission Percentage	Statutory Maximum Distribution Commission	Waived/(Excess) Fees
1	534	5-Dec-1999, 10-Mar-2000, 4-Apr-2000, 13-Nov-2000	-	\$ 70,216.82	-	\$ 4,213.01	\$ 4,213.01
2	1,074	3-Jan-2002	-	7,881.08	-	472.86	472.86
3	2,268	27-Jul-1999	-	19,131.33	-	1,147.88	1,147.88
4	9,907	12-Apr-2001	-	1,583.94	-	95.04	95.04
5	1,659	4-Oct-2001, 23-Oct-2001	-	13,695.03	-	821.70	821.70
6	1,694	16-Apr-2001, 14-Jun-2001	-	2,043.95	-	122.64	122.64
7	11,346	27-Nov-2001	-	1,830.53	-	109.83	109.83
8	2,322	14-Dec-2001	-	3,000.00	-	180.00	180.00
9	2,660	31-Jan-2002	-	1,758.67	-	105.52	105.52
10	10,233	22-Jun-2001, 28-Jan-2002	-	3,980.84	-	238.85	238.85
11	569	23-Aug-2001	-	1,525.02	-	91.50	91.50
12	3,897	30-Mar-2001	-	5,000.00	-	300.00	300.00
13	459	16-Feb-2001	-	1,269.59	-	76.18	76.18
14	1,941	6-Feb-2001, 1-Mar-2001	\$ 859.18	13,460.53	6.4%	807.63	(51.55)
15	3,448	18-Oct-2001	3,323.29	52,064.84	6.4%	3,123.89	(199.40)
16	2,728	29-Mar-2001	290.85	4,556.60	6.4%	273.40	(17.45)
17	1,406	24-Jan-2002, 12-Feb-2002	130.29	4,041.15	3.2%	242.47	112.18
18	1,115	10-Jan-2002	159.60	2,500.35	6.4%	150.02	(9.58)
19	3,600	21-Feb-2001, 5-Mar-2001	151.42	1,965.35	7.7%	117.92	(33.50)
20	304	2-Jun-2000	350.73	5,494.73	6.4%	329.68	(21.05)
					Net	\$ 7,754.66	

CABINET FOR FAMILIES AND CHILDREN EXAMINATION RESPONSE



PAUL E. PATTON
GOVERNOR

THE SECRETARY FOR FAMILIES AND CHILDREN
COMMONWEALTH OF KENTUCKY
275 EAST MAIN STREET
FRANKFORT 40621-0001
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VIOLA P. MILLER, ED. D.
SECRETARY

October 11, 2002

Mr. Edward B. Hatchett, Jr.
Auditor of Public Accounts
Capitol Annex, Suite 144
Frankfort, Kentucky 40601

Dear Mr. Hatchett:

Thank you for the opportunity to respond to the recommendations set forth in the Draft Report of the Cabinet's Fiduciary responsibilities. As you are aware, the Cabinet takes its responsibilities as fiduciary and guardian for its wards very seriously. Your draft report captures issues that we, as an agency, are very concerned about correcting immediately. To that end, we promptly created a work group that has been working very diligently to address the issues raised in your draft. The work group has developed action steps which I have previously shared with you to address the recommendations in your draft report. We have already been successful in accomplishing many of these goals and continue to update and revise the action steps to remain current on what further steps need to be taken to achieve the goal of improved service to our clients.

Representatives of the work group met with the Finance and Administration Cabinet within 2 days of receipt of the draft to obtain Finance's input on how we can better accomplish these goals. All agreed that we could better serve our clients through contracting with an outside financial institution or non-profit agency whose employees have the expertise and technological capacity to better manage our clients' assets and income. CFC staff and Finance and Administration representatives have already begun to prepare an RFP for these services. While we are eager to make this transition, we believe that it is very important to approach this task in as careful and methodical a manner as possible.

In addition, we recognize that until that process is complete, short term measures must be taken to ensure that client assets and funds are protected. As mentioned in the following response, discrepancies between the GFS and the Master Account are being investigated and upon its completion a work paper will be provided resolving those



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discrepancies. By creation of a reconciliation report in the GFS we have already been able to identify well over half of the discrepancy amount. In addition, we have identified Standards of Practice ("SOP") or protocols that need to be implemented to establish best practices. As you can see from the attached response, we already have a draft for most of these items and intend to have the SOPs completed by the end of this month.

The Cabinet also understands that we need to make timely technological changes to ensure further stability of our current GFS system until the RFP is in place. In furthering this objective, the Office of Technological Services ("OTS") has been included in the work group. OTS has already been able to make significant improvements in the system and will continue to work diligently to address those systemic issues that can reasonably be addressed prior to the contract with an outside entity being secured.

Attached is the Cabinet's response pursuant to KRS 43.090(1) which sets forth a reply to each recommendation in the draft report. The Cabinet generally accepts the findings of the report with one clarification which is specifically addressed in the reply to recommendation number 28 (page 20 of the draft report). In short, the Cabinet's efforts to "spend down" clients accounts for clothing and life enhancing items is not a violation of state or federal law. The Cabinet has initiated contact with the Department of Medicaid Services to determine if amendments can be made to Medicaid laws which will permit the use of excess assets for private payment, as set forth in the attached letter from Commissioner Mike Robinson, Department of Medicaid Services.

If you have any questions regarding the Cabinet's response or action steps underway for corrections and improvements, please do not hesitate to contact me.

Sincerely,



Viola P. Miller
Secretary

RESPONSE TO RECOMMENDATIONS

Recommendations--page 7:

- (1) Adopt a double entry accounting system that provides proper financial controls including an accounting module to record Clients' financial transactions;

The Cabinet immediately began, upon issuance of the draft report, working with the Finance and Administration Cabinet to develop and issue a Request for Proposal ("RFP") to address this and other deficiencies in accounting methods and securities ownership that were identified in the draft report. The Cabinet consulted with the Finance and Administration Cabinet and the State Auditor who both recommended looking to an outside entity for assistance regarding these duties. After further discussion, the Cabinet determined that due to the highly specialized nature of these services it would be best to out-source these services to a contractor in order to better serve the Cabinet's clients. The Cabinet expects to have a contract with a financial institution or other appropriate entity by April 1, 2003.

As a short-term measure, the Office of Technology Services ("OTS") has reprogrammed the Cabinet's computerized record-keeping system, the Guardianship Fiduciary System ("GFS"), to create a report to be used in the reconciliation process and to identify duplicative accounts. These duplicative accounts will be deleted. In addition, OTS has reprogrammed the check-writing process to eliminate programming errors in the system.

- (2) Reconcile the accounting system to the bank statement regularly and in a timely manner;

OTS has reprogrammed the GFS to create reconciliation reports (as discussed in response to number 1 above). The Fiduciary staff will immediately begin work on reconciling the GFS with bank statements until such time as these duties are transferred to a contractor pursuant to the RFP.

- (3) Resolve the \$265,436 difference between GFS and the Master Bank Account;

Upon completion of the reconciliation process, a report will be provided to the State Auditor. It is anticipated that the reconciliation process will resolve the \$265,436 difference. The Fiduciary Section has already identified well over half of this amount. The Cabinet will provide a report regarding the difference to the State Auditor no later than the end of the current calendar year.

- (4) Maintain current statements for investment assets and reconcile the accounting system to these statements in a timely manner;

Given the timeline for Information Technology (“IT”) development and the impending RFP, Fiduciary will manually update and reconcile the investment asset statements. All records will be up-to-date and current by October 15, 2002. Once the records are up-to-date the Office of Program Support (“OPS”) will do a random monthly check of client accounts until such time as this function is transferred to a contractor pursuant to the RFP.

- (5) Implement a policy requiring checks to be sent directly to payees;

The Cabinet has developed a draft Standard of Practice (“SOP”) known as “The Financial Management Responsibilities SOP”, which defines a process whereby checks will be mailed directly from the Fiduciary Section to a payee other than a CFC staff person, if possible. In situations in which checks are mailed to field offices for clients who live independently the SOP will require that every effort be made to designate a payee who is an individual or outside entity other than CFC. In those instances in which outside assistance is not possible and the client comes to the field office to pick up his or her check, the CFC staff person who receives and records receipt of the check will not be the same CFC staff person who gives the check to the client. In addition, a log will be instituted to record who received and who distributed the check (to ensure they are not the same person) and will record the client’s signature or mark. If the client is unable to sign his or her name and must make a mark instead, the SOP will also require that a witness sign the log in addition to the staff person distributing the check to ensure that the client receives the check.

- (6) Implement procedures in which all accounting functions are performed by Fiduciary Section personnel;

The Cabinet has developed the draft “Financial Management Responsibilities SOP”, that requires a field worker to request disbursements from the Fiduciary Section, located in Quality Central (Frankfort). Requests for disbursements from the field worker are entered into GFS by the worker, and printed out into written form with justification for the expenditure. The hard copy must be approved by the field worker’s immediate supervisor. The hard copy shall then be faxed to the Fiduciary Section located in Frankfort. Upon receipt of the request for disbursement, the Fiduciary Section Supervisor or designee will determine whether the request for disbursement will be approved. If approved, the check will be printed and mailed to the payee (see discussion in paragraph number 5 above). Inasmuch as it is not possible to obtain receipts for the expenditures prior to disbursement, the written request will be filed and held until the receipt for expenditures, over what is usual and customary living and personal expenses as defined in the SOP, is provided by the field

worker. Upon receipt, it will be attached to the request and filed in the client's file.

The Cabinet is exploring whether OTS can reprogram the GFS to ensure that final approvals of requests for disbursements may only be made by the Fiduciary Section Supervisor or designee. Currently a field supervisor can approve an expenditure, as noted in the Report.

If reprogramming cannot be done prior to implementation of the RFP, then the SOP will ensure that the process contains three levels of approval with final approval coming from Quality Central.

- (7) Ensure disbursement does not occur until supporting documentation is obtained and maintained in Fiduciary Section files;

See Response to Number 6 above.

- (8) Rent a safety deposit box at a financial institution for storing Clients' physical valuables and negotiable instruments;

The Cabinet has developed the draft "Financial Management Responsibilities SOP", that sets forth a protocol for the inventory of, transfer to and placement of clients' assets. Safe deposit boxes have been rented at Farmers Bank in Frankfort for clients' valuables. All clients' assets have been inventoried. With the exception of firearms, all clients' assets have been moved to the safe deposit boxes at Farmers Bank. Firearms cannot be stored in the safe deposit boxes, therefore, the Cabinet is exploring whether the storage or disposition of firearms can be handled by the State Police.

- (9) Implement a procedure in which dual access is required for the safety deposit box and a log is kept which details initial contents and all additions and withdrawals;

The SOP (discussed in response number 8 above) will also require that items deposited in a safe deposit box be inventoried by two Cabinet staff persons. Access to the safe deposit box may be obtained only by the signature of two Cabinet staff persons. The Cabinet has restricted access to the safe deposit boxes to three Cabinet employees located in Quality Central.

- (10) Implement a policy to convert physical stock certificates to electronic ownership;

Conversion of stock certificates to electronic ownership would require the Cabinet to solicit another RFP for broker services. Inasmuch, as the Cabinet is obtaining an RFP with a financial institution or other non-profit agency, efforts to contract with a broker for such purposes would not be

advisable. Until the RFP (discussed in response number 1) is in place, such instruments will be kept secure in the safe deposit boxes at Farmers Bank and inventoried pursuant to the "Financial Management Responsibility SOP" (discussed in response number 8 above).

- (11) Implement a policy to either liquidate or re-issue endorsed negotiable instruments;

Until the services described in the RFP discussed above are obtained, the Fiduciary Section will liquidate all negotiable instruments as soon as practical and deposit the proceeds into the client's account. For the long term, the RFP defined in response to number 1 above will address this issue.

- (12) Invest Clients' funds in accordance with KRS 386.020.

Currently the Cabinet's Fiduciary Section does not have the financial expertise or technological capacity to invest Clients' funds in accordance with KRS 386.020 due to limitations with the GFS. The GFS is not able to distinguish between client principal and income. The Cabinet anticipates that the Clients' funds will be invested in accordance with KRS 386.020 when the RFP is implemented. The RFP will require that the contracting entity possess the ability to make this distinction so that the Revised Uniform Principal and Income Act ("RUPIA") and other relevant trust law is followed. Not only will the RFP require that the contractor deposit all client funds in interest-bearing accounts, but it will also require compliance with all applicable state and federal law.

Recommendations--page 9:

- (13) Implement procedures to ensure all known assets and transactions associated with those assets are recorded in the System;

The Cabinet has developed the draft "Financial Management Responsibilities SOP" to track assets in the GFS. The Fiduciary Section is manually recording assets and transactions related to these assets in GFS until the RFP is in place.

- (14) Automate the process of identifying refunds due;

The RFP discussed in number 1 above will address this issue. In the interim, the Fiduciary Section has implemented a manual process to segregate the refund requests from the refund recording and collection until the RFP is in place. Specifically, the manual process requires a Fiduciary staff person to initiate a refund request. A copy of the refund request will be provided to another Fiduciary staff person or Division of Family Support staff person who will enter the request for refund in a log of outstanding refunds due. The log will record when refunds are received. If

a refund is not received within 45 days a second refund request will be initiated. If a refund is not received within 15 days of the second request, collection assistance will be pursued.

The Cabinet has developed the draft "Financial Management Responsibilities SOP" which will establish a procedure for collection of refunds over a designated amount when letters of request are unsuccessful. The SOP will address whether the matters will be turned over to a collection agency or whether legal action will be pursued for recovery of the amount owed to the client.

- (15) Record refunds receivable and credit subsequent receipts against the receivables;

See response to number 14 above.

- (16) Pursue the payment of receivables due Clients.

See response to number 14 above.

Recommendations--pages 15-16:

- (17) Remaining assets are timely distributed to successor guardians, conservators, or estate administrators;

Effective October 1, 2002, Fiduciary Section staff distribute conserved funds to any newly appointed guardian within 45 days of notice of a change in guardianship. All asset and debt information is provided to the new guardian contemporaneous with the distribution of conserved funds. The Cabinet notifies any source of income for its former client of the change in guardianship. In the event that any check (income) is thereafter received by the Cabinet, the check will be returned to the payor. These processes will be more fully defined in a draft "Resignation and Termination of State Guardianship SOP".

- (18) Potential estate administrators are contacted about appointment whenever remaining assets exceed an established threshold;

Currently, the Fiduciary Section staff contact any known administrator of a client's estate or family member who may serve in that capacity. For those situations in which a client's estate administrator is not known, the Cabinet will design a process to establish an estate administrator. This process will be set out in the draft "Resignation and Termination of State Guardianship SOP".

- (19) The full value of pre-paid contracts is applied toward burial expenses before disbursing additional funds to the funeral home;

Effective immediately, the Fiduciary Section staff requires that any funeral home, which issued a pre-paid contract for a Cabinet client, send a copy of the funeral bill, proof of amount paid from the pre-paid contract, and the total amount of funds generated from the burial contract's invested funds or insurance policies. Only after this information is received will the Fiduciary Section issue a check to the funeral home for any balance due on the funeral bill. This will be further defined in the draft "Financial Management Responsibilities SOP".

- (20) Insurance policies are not allowed to lapse inadvertently and that appropriate claims are made on all policies;

Fiduciary Section staff have been assigned to monitor life insurance policies and premium payments to avoid policy lapses. Fiduciary Section staff coordinate with the client's Guardianship worker to discuss and determine whether liquidation or surrender of the policy is in the best interest of the client. This will be included in the draft "Financial Management Responsibilities SOP".

- (21) Client deficit balances are minimized, and unavoidable deficit balances are covered with funds other than those belonging to other Clients;

All deficit accounts have been reviewed and a technological solution will be developed by OTS which will eliminate the ability to write any check for an amount that exceeds the funds available. In addition, the draft "Financial Management Responsibilities SOP" will eliminate any expenditures which would result in a deficit. The Cabinet is currently working with the Office of Program Support to develop a plan to determine how to deal with any existing deficits.

- (22) Deposit Client checkable funds in an interest bearing account with each Client receiving the appropriate interest earned as required by UPIA;

This issue will be addressed in the RFP, discussed in number 1 above, which will require that client funds be deposited in interest-bearing accounts.

- (23) Client financial transactions are recorded in sufficient detail to ensure compliance with the UPIA and allow calculating and charging accurate commissions;

The Fiduciary Section is not currently recording principal and income separately although the RFP will require the contracting entity to possess the financial and technical sophistication to do so. As stated in the

response to number 12 above, the RFP will require that all state and federal law be followed in terms of collection of commissions.

- (24) Commissions are charged of veteran Clients in compliance with VA reporting requirements;

The Cabinet's Office of the General Counsel has reviewed the Fiduciary Section's legal authority to receive VA commissions for its services. This, as well as receipt of other commissions, will be addressed in the RFP discussed in number 1 above.

- (25) Statutory commissions are charged uniformly; and,

See response to number 23 above.

- (26) Entities paying benefits for Clients are timely notified of Client deaths.

It is the practice of the Cabinet to notify any entity paying client benefits of a client's death within 5 days of the Cabinet's notice of the death. In addition, this procedure and practice will be included in the draft "Resignation and Termination of State Guardianship SOP". The SOP will specifically deal with protocol for the return of any benefits issued to a client for whom guardianship has either been reassigned to another guardian or terminated due to death.

Recommendations--page 20:

- (27) All known assets are recorded in the accounting system;

See response to number 13 above. In addition, this issue will be addressed by the Cabinet's RFP.

- (28) Clients' funds are not spent irresponsibly simply to maintain Medicaid eligibility.

The Fiduciary Section establishes a priority of expenditures for its clients. It spends client funds for clients' basic needs, which include room, board, clothing, burial expenses, as well as non-basic needs such as entertainment. Once a client's basic needs are met, the remainder of the client's funds are "disposable", i.e., available for the use and enjoyment of the client, just as anyone else with disposable income. At all times, however, the Fiduciary Section has been cognizant of Medicaid eligibility rules. The Department of Medicaid Services has assured the Cabinet that efforts to maintain client's eligibility by making such purchases are legal. All clients' expenses which the Cabinet pays are allowable under the Kentucky Medicaid program. See attached letter from Commissioner Mike Robinson, Department for Medicaid Services.

Clients who are served in the Supports for Community Living ("SCL") program are at special risk if they lose Medicaid eligibility. Unlike other long-term care programs (such as nursing facilities), SCL participants cannot apply any excess income to defray the cost of their SCL services. When clients have excess resources and are SCL participants, they lose their homes provided through the SCL program, they lose Medicaid eligibility, and they lose SCL services for which there is an extensive waiting list. The Cabinet is working with the Department for Medicaid Services and the Department of Mental Health and Mental Retardation to review the SCL program's eligibility requirements so that clients may be able to make partial payments to support the cost of the SCL program without losing their Medicaid eligibility.



CABINET FOR HEALTH SERVICES
COMMONWEALTH OF KENTUCKY
275 East Main 6W-A
FRANKFORT, 40621-0001



DEPARTMENT FOR MEDICAID SERVICES
"An Equal Opportunity Employer M/F/D"

October 7, 2002

Dietra Paris, Commissioner
Department for Community Based Services
Cabinet for Families and Children
275 East Main Street
Frankfort, Kentucky 40621

Dear Commissioner Paris:

This letter is a follow-up to our meeting of September 27, 2002, in which you shared with me a draft copy of the executive summary and report on the findings of an audit of the Fiduciary and Guardianship Sections of the Department for Community Based Services. Our meeting focused on the findings and observations relating to possible misapplication of Medicaid policies and the recommendations of the auditor that the Department for Medicaid Services consider these findings to determine if improper Medicaid payments are being made for guardianship clients. At your request, we have reviewed the three (3) recommendations for the Department for Medicaid Services and are providing the following information.

Recommendation: Determine whether clients have received Medicaid benefits when they were actually ineligible.

The case situation cited in the report was Medicaid ineligible for the months the guardianship client's countable assets exceeded the program limit of \$2,000. It appears that the months of ineligibility were a result of a combination of the failure of the guardianship worker to correctly monitor the client's assets and inadequate documentation of the expenditures for the client. While we are concerned about this case and the Medicaid overpayment, we do not believe this is the usual and ongoing practice of the Department for Community Based Services or that there was any deliberate intent to defraud the Medicaid Program. The proposed corrective action plans to improve accounting and monitoring should help to prevent future occurrences.

"...promoting and safeguarding the health and wellness of all Kentuckians"



Memo to Dietra Paris
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Recommendation: Determine whether "spending down" by Fiduciary and Guardianship Sections is an intentional Medicaid violation.

"Spending down" of assets in the manner described in the report is not a violation of Medicaid policy. A penalty of a restricted period of Medicaid coverage is imposed if an individual transfers ownership of a countable asset at less than fair market value to establish or retain Medicaid eligibility. The purchase of clothing and life enhancing items such as a television and stereo are a conversion of cash, a countable asset, to excluded assets (e.g., household items and personal effects) of which the ownership is retained by the individual. Therefore, no transfer of assets has occurred. While this may be perceived by some to be inappropriate, it is not prohibited by state or federal regulations.

Also as discussed in our meeting, we are researching the provisions of the Supports for Community Living (SCL) Waiver to determine if amendments can be made to permit the client to use excess assets for private payment of SCL services without losing their placement in the SCL waiver program. This would give the Fiduciary and Guardianship Sections another option for managing clients' assets as well as benefit the Medicaid Program.

Recommendation: Determine whether potential Medicaid estate recoveries have been overlooked.

It is our understanding from the discussions in our meeting that at one time there was a backlog of estate recovery information forms (PA1.1A Supplement E) to be completed by Fiduciary Section staff for Medicaid recipients in guardianship and that this backlog is likely the cause for the lack of estate recovery information in the cases cited in the report. It is also our understanding that this backlog has been cleared and that new case processing procedures are in place to assure that the estate recovery information form is obtained at the time of the Medicaid application. Based on this information, it appears this problem has been resolved.

I hope this information is beneficial. If you have questions or need more information, please contact me at your convenience.

Sincerely,



Mike Robinson
Commissioner

AUDITOR'S REPLY

We applaud the concern expressed by the Secretary for Families and Children resulting in immediate action to address the recommendations made in our report. We agree it is important that appropriate policies and procedures are institutionalized in a manner that will ensure the best delivery of fiduciary services to their clients. We believe the action plan presented in the Cabinet's response will significantly improve the Cabinet's ability to administer its fiduciary and guardian responsibilities.