

Department of Finance and Administration

November 2003

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**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

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John G. Morgan
Comptroller

November 13, 2003

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

and
The Honorable Dave Goetz, Commissioner
Department of Finance and Administration
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Department of Finance and Administration for the period July 1, 2002, through June 30, 2003.

The review of management's controls and compliance with policies, procedures, laws, and regulations resulted in certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/cj
03/076



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT**

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July 31, 2003

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Finance and Administration for the period July 1, 2002, through June 30, 2003.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. These standards require that we obtain an understanding of management controls relevant to the audit and that we design the audit to provide reasonable assurance of the Department of Finance and Administration's compliance with the provisions of policies, procedures, laws, and regulations significant to the audit. Management of the Department of Finance and Administration is responsible for establishing and maintaining internal control and for complying with applicable laws and regulations.

Our audit disclosed certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. The department's administration has responded to the audit findings; we have included the responses following each finding. We will follow up the audit to examine the application of the procedures instituted because of the audit findings.

We have reported other less significant matters involving the Department of Finance and Administration's internal controls and instances of noncompliance to the department's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/cj

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Department of Finance and Administration
November 2003

AUDIT SCOPE

We have audited the Department of Finance and Administration for the period July 1, 2002, through June 30, 2003. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of the Division of Mental Retardation Services' contract management, the Bureau of TennCare's cost allocation, the Division of Mental Retardation Services' personnel procedures, the developmental centers' operations, and the Financial Integrity Act. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

AUDIT FINDINGS

The Division of Mental Retardation Services Has Inadequate Controls Over the \$11,206,210 Community Services Network of West Tennessee (CSN) Contract and Has Failed to Seek Federal Reimbursement of Over \$2,000,000

The division has not followed the provisions of the CSN contract, has not reviewed support for claims, has not maximized federal financial participation, has overspent and reallocated CSN expenditures to other contracts, and has not monitored administrative expenditures. The division reimbursed CSN over \$23,000 for birthday lunches, Christmas parties, and other meals that appeared to be unreasonable and unnecessary (page 6).

The Division of Mental Retardation Services Has Inadequate Controls Over Other Contracts

A contract was awarded without competitive bids, support for contract payments was not properly approved, and payments were not always within the contract terms. The division's *Operating Guidelines* that are referenced in multiple contracts are not complete. Also, documentation was not available to support certain requests for payment. Unsupported services exceeded \$36,000 in the transactions sampled (page 10).

Documentation for Waiver Services Was Inadequate

Services related to the Home and Community Based Services (HCBS) waiver were not approved, and clients' files did not include required documentation. Unsupported services exceeded \$21,000 in the transactions sampled (page 14).

The Division of Mental Retardation Services Does Not Have Appropriate Processes in Place to Maximize Federal Financial Participation, Resulting in Additional Costs to State Taxpayers

The process for obtaining federal financial participation for the HCBS waiver and Arlington/West waiver is inadequate, resulting in conflicting rates and denied or pending claims (page 16).

TennCare Did Not Use the Approved Cost Allocation Plan to Claim Administrative Costs Related to the Home and Community Based Services Waiver for the Mentally Retarded and Developmentally Disabled**

Although TennCare received a written approval for the cost allocation plan, due to a lack of documentation, TennCare has not submitted the administrative costs to the federal government (page 18).

Personnel Files of the Division of Mental Retardation Services Were Incomplete *

Current and complete personnel files were not maintained. The files did not include documentation required by the federal government, state law, and the Department of Personnel (page 21).

The Department of Finance and Administration, Division of Mental Retardation Services, Has Established Improper Employer-Employee Relationships*

Management has contracted with agencies to provide individuals that are directly supervised by state employees and contracts for employees that supervise state employees and other contractors. Also, there are multiple contract employees who function much in the same manner as state employees (page 23).

Inadequate Recordkeeping for Equipment at the Developmental Centers Resulted in Missing Equipment That Cost \$470,615 **

Equipment items could not be located, serial numbers and locations listed in the equipment records were not correct, and state tags were missing. Also, an excessive amount of missing items was reported at year-end for the second consecutive year (page 26).

Management of Clover Bottom Developmental Center Continues to Refuse to Address Issues Related to the Circumvention of Bid Requirements, and the Division of Mental Retardation Services Does Not Follow a Conflict-of-Interest Policy **

Competitive bids were not obtained when necessary, and key employees were not subject to a conflict-of-interest policy (page 28).

* This finding is repeated from the prior audit.

** This finding is repeated from prior audits.

“Audit Highlights” is a summary of the audit report. To obtain the complete audit report, which contains all findings, recommendations, and management comments, please contact

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Financial and Compliance Audit

Department of Finance and Administration

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Financial and Compliance Audit

Department of Finance and Administration

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Department of Finance and Administration. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The mission of the Department of Finance and Administration is to provide financial and administrative support services for all facets of state government. The business, finance, and managerial functions of state government are centralized here. The department prepares and executes the state budget, accounts for state revenues and expenditures, operates a central data processing center, plans and reviews construction and alteration of state buildings, and controls state-owned and leased property. Also, as a result of Executive Orders, the department is responsible for the state’s TennCare program and the state’s Mental Retardation Services, including its developmental centers.

The Department of Finance and Administration contains nine divisions: Budget, Administration, Accounts, Office for Information Resources, Insurance Administration, Resource Development and Support, Capital Projects and Real Property Management, TennCare, and Mental Retardation Services.

The Division of Mental Retardation Services is responsible for providing services to Tennesseans of all ages with mental retardation and other developmental disabilities. The division oversees three regional offices, which coordinate services to individuals in the community as well as the operation of the three developmental centers (Arlington in the west, Clover Bottom in the middle, and Greene Valley in the east.)

The Division of Mental Retardation Services currently serves approximately 750 individuals in the developmental centers and over 12,000 individuals in the community. Of the total number served, approximately 4,400 are served through the Medicaid Waiver. As of January 31, there were 3,074 people on the waiting list for waiver services. This includes individuals who are not currently receiving any services as well as those waiting for specifically requested services that are not yet available. The division currently operates under four court orders: *United States v. State of Tennessee* (Arlington Remedial Order), *People First v. Clover Bottom et al.* (Settlement Agreement), Revised Consent Decree Governing TennCare Appeals (Grier Lawsuit), and *Beth Ann Brown et al. v. Tennessee Department of Finance and Administration* (Waiting List – currently in settlement negotiations).

Organization charts of the Department of Finance and Administration and the Division of Mental Retardation Services are on the following pages.

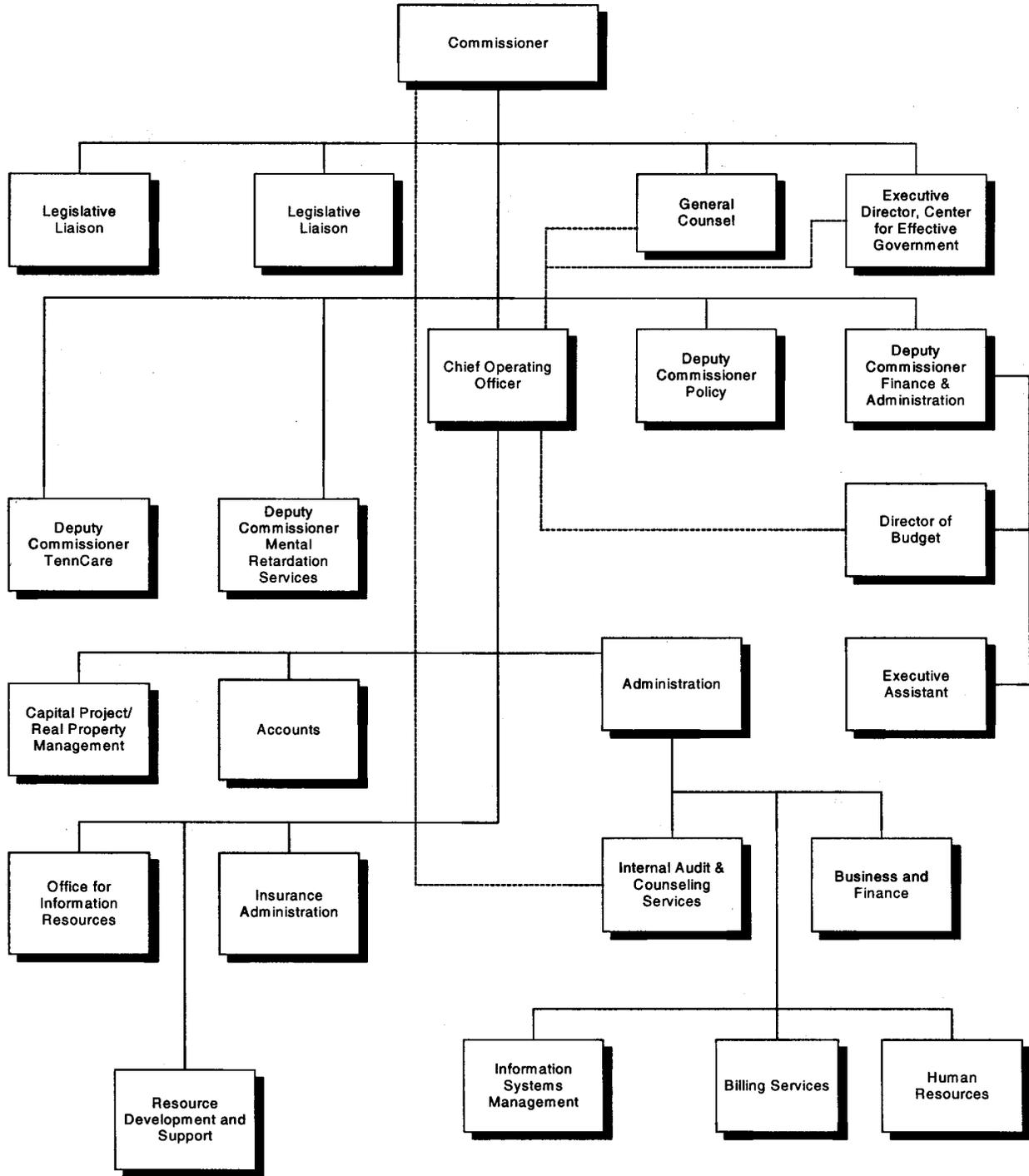
AUDIT SCOPE

We have audited the Department of Finance and Administration for the period July 1, 2002, through June 30, 2003. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of the Division of Mental Retardation Services' contract management, the Bureau of TennCare's cost allocation, the Division of Mental Retardation Services' personnel procedures, the developmental centers' operations, and the Financial Integrity Act. This audit did not include certain other areas material to the *Tennessee Comprehensive Annual Financial Report* for the year ended June 30, 2003, and the Tennessee Single Audit for the same period. The results of our audits for those areas, including the Medical Assistance Program (Medicaid/TennCare), the State Children's Insurance Program (SCHIP), and the statewide controls administered by the Department of Finance and Administration, will be reported in the *Tennessee Single Audit Report* which will be released in the spring of 2004. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

PRIOR AUDIT FINDINGS

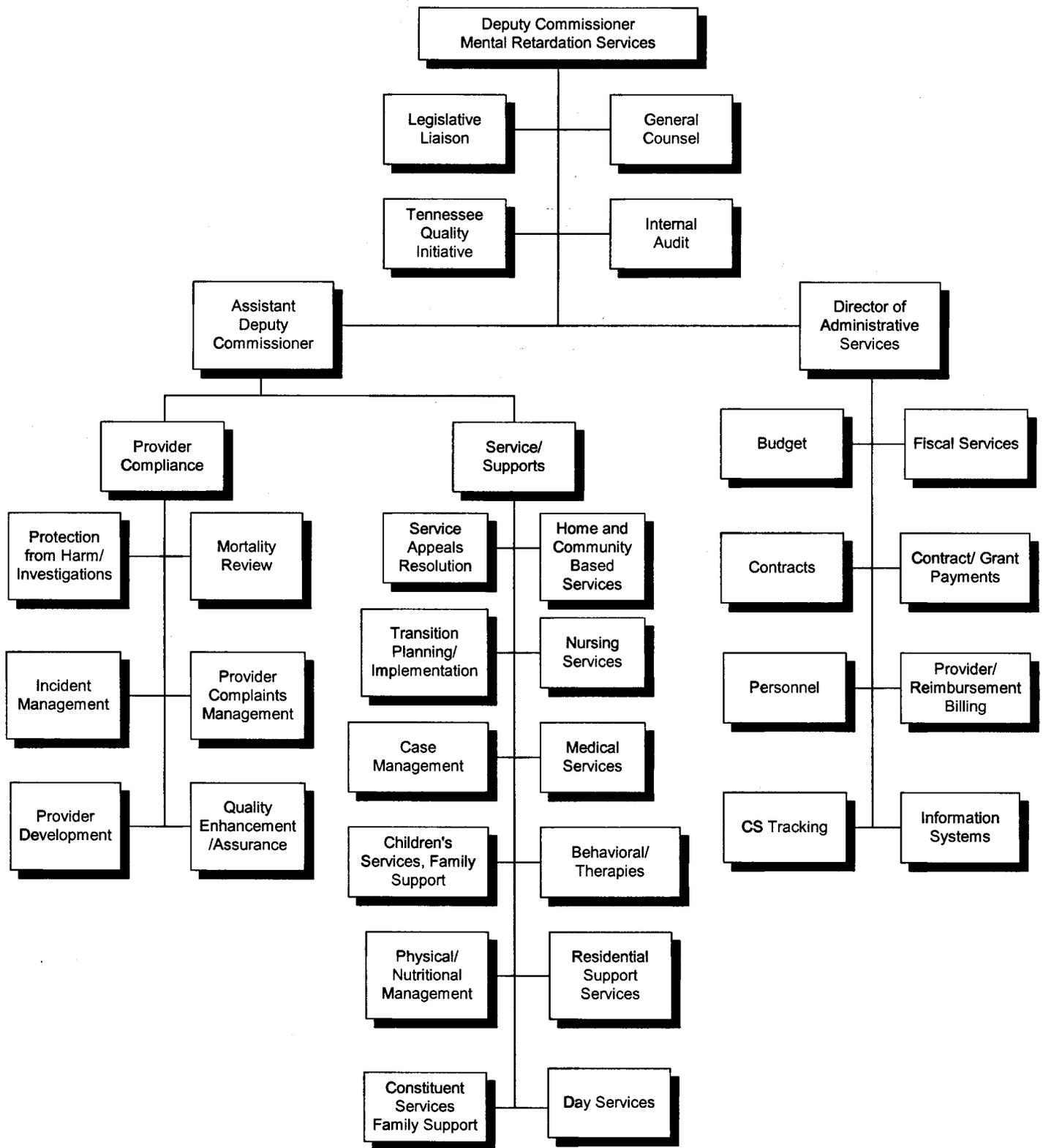
Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Department of Finance and Administration filed its report with the Department of Audit on August 4, 2003. A follow-up of audit findings that were not reported in the *2002 Tennessee Single Audit Report* was conducted as part of the current audit.

DEPARTMENT OF FINANCE AND ADMINISTRATION ORGANIZATION CHART



Note: Dashed lines indicate to whom a division reports for business matters if it is different from administrative matters

DIVISION OF MENTAL RETARDATION SERVICES CENTRAL OFFICE



SINGLE AUDIT FINDINGS

The prior audit report included objectives and conclusions for work performed as part of the annual audit of the *Comprehensive Annual Financial Report* and the Tennessee Single Audit. The 39 findings related to those objectives were included in the *Tennessee Single Audit Report* for the year ended June 30, 2002, and will be followed up as part of the Tennessee Single Audit for the year ended June 30, 2003. That report will be released in spring of 2004. Reviews of the Medical Assistance Program (Medicaid/TennCare), Division of Insurance Administration, Real Property Management, and the resolution of the prior findings related to these areas were not an objective of this audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the Department of Finance and Administration has corrected previous audit findings concerning controls over drug and supplies inventories at the developmental centers, internal control over cash receipts at Clover Bottom Developmental Center, Financial Integrity Act reports, and reporting related to Title VI of the Civil Rights Act of 1964 and Title IX of the Education Amendments of 1972.

REPEATED AUDIT FINDINGS

The prior audit report also contained findings concerning the lack of an approved cost allocation plan, incomplete personnel files, improper employer-employee relationships, inadequate recordkeeping related to equipment, and inappropriate handling of developmental center disbursements. These findings have not been resolved and are repeated in the applicable sections of this report.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

DIVISION OF MENTAL RETARDATION SERVICES' CONTRACT MANAGEMENT

The objectives of our review of the controls and procedures over contract management were to determine whether

- internal control over contracts and federal financial participation was adequate;
- proper support was maintained for contract payments, and the amounts paid were proper;
- contracts were appropriately initiated;

- payments on the Community Services Network of West Tennessee (CSN) and Guardian Healthcare Providers, Inc., contracts were properly supported, reasonable, and allowable;
- internal control over payments to CSN were adequate;
- direct services paid were on an approved cost plan; and
- the division complied with F&A policy 22 regarding subrecipient monitoring.

We interviewed key personnel and reviewed rules and policies to gain an understanding of the division's procedures and controls over contract management and maximization of federal financial participation. We selected a nonstatistical sample of payments related to selected contracts as of March 31, 2003, to determine if amounts paid were proper, allowable, and supported, and that the contracts were appropriately initiated. We also selected two additional nonstatistical samples of CSN payments and Guardian payments as of March 31, 2003, to determine if such payments were properly supported, reasonable, and allowable. Applicable transactions in each of the samples were reviewed to determine if direct services were present on an approved cost plan. To determine if internal control over CSN payments was adequate and to determine if the division was complying with F&A policy 22, we interviewed key state officials.

Based on our interviews and testwork, we determined that the division was complying with F&A policy 22. However, we determined that controls over contract management were not adequate. Multiple deficiencies were noted including the lack of proper support for payments to contractors, questionable approval of a sole-source contract, and a lack of control over payments to CSN. Payments made to the contractors were not always allowable or reasonable. The CSN weaknesses are detailed in finding 1, and other contract weaknesses, including those related to Guardian, are detailed in finding 2. We also determined that documentation for waiver services was inadequate, as discussed in finding 3, and the division does not have appropriate processes in place to maximize federal financial participation, as noted in finding 4.

1. The Division of Mental Retardation Services has inadequate controls over the \$11,206,210 Community Services Network of West Tennessee contract and has failed to seek available federal reimbursement of over \$2,000,000

Finding

The Department of Finance and Administration, Division of Mental Retardation Services, has not implemented adequate controls over the Community Services Network of West Tennessee, Inc., (CSN) contract. The division has not followed the contract provisions, has not reviewed support for claims, has not established an appropriate mechanism to obtain federal financial participation on allowable claims, has inappropriately reallocated significant contract expenditures to a Departmental Purchase Authority (DPA), has not established procedures for receiving reimbursement of unspent administrative fees, and has not monitored administrative expenditures by CSN. Also, CSN is providing costly services for two class members who moved to East Tennessee, and a CSN board member has a potential conflict of interest.

CSN, a nonprofit organization, was developed in October 2000 by state employees and consultants, with the court's approval, as a solution to a court order. CSN provides services to class members of the court order who were not being adequately covered by the traditional TennCare or Medicaid program. CSN's goal is to establish and maintain a network of service providers for these class members. The \$11,206,210 contract was for services provided for a three-year period. During the year ended June 30, 2003, there were approximately 206 class members enrolled with CSN. Total payments to CSN for the same period totaled approximately \$9,265,000. This averages \$44,976 per class member for that year.

The original contract provided that the Division of Mental Retardation Services pay CSN \$603.50 per month for each class member who was eligible to receive and did receive certain defined services. However, CSN quickly determined that it would not be able to provide all the services at that rate; so the division began paying CSN for actual expenditures related to class members. The contract was never amended to reflect this change in payment methodology. Moreover, the amendments to the contracts that extended the terms through June 30, 2003, kept the same payment methodology wording but increased the amount to \$627.64 per month, even though the division was paying actual costs. According to division management, changes to the contract required court approval, so they have not modified the contract even though the actual payment methodology differs from the contract. The actual amount paid per month for the defined services averages approximately \$1,300 per class member.

To ensure timely payments to CSN for these actual costs, the Division of Mental Retardation Services established a zero-balance bank account to reimburse CSN for its expenditures. This allows CSN to automatically be reimbursed from state funds as checks written from CSN's account clear the bank. This has prevented the division from reviewing support for the expenditures before they are paid. The Division of Mental Retardation Services has permitted CSN to ignore the portion of the contract which states "the Grantee agrees to provide the State with monthly invoices, with all of the necessary supporting documentation, in a form acceptable to the State, prior to any reimbursement of allowable costs." CSN has submitted the data in a form that the Division of Mental Retardation Services has determined is too labor-intensive for manual addition to the Community Services System (CS Tracking), the division's claim system, and the division has not been able to establish an automated method to process claims information received from CSN. Also, the division has chosen not to review the data in the format received. Therefore, the claims information has not been reviewed and was not tracked in the division's claims system.

The Division of Mental Retardation Services is responsible for administering funds related to the Home and Community Based Services Waiver for the Mentally Retarded and Developmentally Disabled (HCBS waiver), which is a waiver from normal Medicaid regulations. HCBS waiver expenditures are tracked through CS Tracking, and the information from CS Tracking is used to request federal financial participation. Although CSN bills for services that would be eligible for federal financial participation under the HCBS waiver, the division has not been able to regularly process that information on CS Tracking; therefore, those allowable expenditures were not reimbursed. Based on claims data received from CSN, \$3,226,285 was spent on waiver-related services in the first 10 months of the year ended June 30, 2003, and

\$3,520,236 was spent in 2002. Federal financial participation for the 2003 waiver-related services would have exceeded \$2,000,000.

Also, in a prior year, CSN had a primary contract with the Division of Mental Retardation Services as well as a provider agreement contract under the division's Departmental Purchase Authority (DPA), which allows the division to contract with various providers using standard wording without having to go through the review of the Department of Finance and Administration, Office of Contract Review, each time. Waiver services were to be billed under the DPA, with all of the same terms and conditions that other providers are subject to, while other expenditures were assigned to the primary contract. During the current audit period, CSN did not have a provider agreement under the DPA. However, CSN has substantially exceeded the amount of the primary contract. The contract amount for the year ended June 30, 2003, was \$3,701,350, but total payments made to CSN were over \$9,000,000. As CSN has gotten close to exceeding the expenditures allowable in the primary contract, the Acting Director of Administrative Services has obtained verbal estimates from CSN management of the approximate amount of waiver services provided. The division then transferred some of the excess charges to the DPA, even though CSN no longer had a contract under the DPA. Transfers of \$6,000,000 were made to reduce the amount of expenditures related to this contract for the period stated. The funds spent by CSN over the contract amount and the transfer of funds to the DPA, as well as the use of estimates in this process, were inappropriate.

CSN receives an administrative fee of \$160,000 to cover overhead costs each month. According to the contract between the state and CSN, any unspent funds are to be returned to the state. However, the state has not developed a procedure for CSN to reimburse the state. As of May 2003, it appeared that CSN owed the state approximately \$291,000 for funds remaining from the fiscal year 2002 contract. The Division of Mental Retardation Services is relying on CSN to notify the division if CSN has any excess funds. Also, there is not a time frame within which CSN is expected to return the funds. When asked why the money was not reimbursed, CSN showed documentation that it had inquired of Division of Mental Retardation Services management where to send the funds in April 2003, and division management had not replied. The Acting Director of Administrative Services thought that the issue had been handled when actually no one from the division had responded to CSN. Without an established reimbursement process, the division cannot collect state funds in a timely manner.

The contract also states that CSN shall be compensated for "actual, reasonable, and necessary costs." However, the state does not monitor the administrative expenditures of CSN. Since the contract was initiated, CSN has used the administrative fee to pay for at least 17 staff birthday lunches totaling \$1,329, catering of 19 board meeting meals totaling \$9,628, two meals with the court monitor totaling \$232, other restaurant charges of \$10,508, and Christmas parties that totaled \$2,107. These expenditures do not appear to be reasonable and necessary, and without adequate monitoring, CSN spending is free of state scrutiny. Furthermore, the contract states that CSN will receive reimbursement for travel, meals, or lodging in the amount of actual costs, subject to the maximum amounts and limitations specified in the State of Tennessee Comprehensive Travel Regulations. Based on a review of various CSN credit card expenses, CSN is not following the state travel regulations. CSN employees are using CSN credit cards to

pay for hotels and food for board members and employees at rates higher than the allowable amount. For example the state rate for lodging in Knoxville and Memphis is \$60 per night. Included on the credit cards were lodging payments for these cities ranging from \$99 to \$145 per night. Employees use their CSN credit cards to incur costs for travel, instead of incurring the cost themselves (or obtaining a travel advance) and then seeking reimbursement through an approved travel claim. Without adequate monitoring by the state, CSN has been reimbursed for expenditures that are not in compliance with the contract.

In addition, two class members who moved to East Tennessee still receive services through CSN. CSN is located in Memphis, and as a result, it is very inefficient and costly for CSN to provide services for these clients. Charges for administrative personnel to travel to East Tennessee to recruit providers totaled approximately \$4,000. We did not calculate the cost of travel for the case managers assigned to these individuals; however, the cost of case management for the two East Tennessee class members averaged \$1,250 per month. The average cost of case management for the West Tennessee class members was \$570 per month. Although there is a court order for CSN to provide these services to all class members who live in Tennessee, a more efficient method should be sought through the courts.

Furthermore, as reported in CSN's independent auditor's report, a CSN board member who is also CSN's legal counsel has a conflict of interest. This individual is a member of a law firm that also provides legal counsel to a member of CSN's provider network. This could raise questions about transactions between CSN, on behalf of the Division of Mental Retardation Services, and the provider.

Because the Division of Mental Retardation Services has not adequately monitored CSN's compliance with the contract, the division has no support for payments made to CSN and has lost federal financial participation associated with payments. The division has also inappropriately moved significant over-expenditures to a DPA instead of the CSN contract to avoid expenditure controls. The division has not required CSN to follow any purchasing guidelines because the contract still states that the division will pay CSN a set amount per client, regardless of actual costs. The lack of procedures for reimbursement of excess funds from CSN has created delays in the return of unused state funds. Also, without review, the state is paying CSN administrative expenditures that do not appear to be necessary and reasonable and are not in compliance with state travel regulations. In addition, the potential conflict of interest could give the appearance that certain arrangements may not be in the best interest of the state.

Recommendation

The Commissioner should review the history of this arrangement with CSN and determine exactly how the issues raised in this finding arose. Although the former Deputy Commissioner had identified this contract as having problematic issues, and had brought this contract to the auditors' attention, current management should review other contract arrangements to determine if similar problems exist. The Commissioner should take immediate steps to amend the contract with CSN to reflect the actual payment responsibilities of the state.

The Commissioner should determine why a method to obtain CSN expense information in an acceptable form was not developed and ensure that one is developed immediately. The zero-balance bank account arrangement should be reviewed, and any other such arrangements should be reassessed and approved by the Commissioner.

The Commissioner should determine why the Division of Mental Retardation Services staff have not been reviewing claims information for each class member before the claims are paid and ensure that reviews are made in the future. The Commissioner should require CSN to track actual HCBS waiver expenses and submit the support for such waiver expenses in a form acceptable to the state to obtain federal financial participation. The Commissioner should determine why inappropriate transfers were made and discontinue the practice of moving funds from the CSN contract to the DPA. If needed for tracking of CSN waiver expenditures, a new contract should be established for CSN. In addition, the division should establish a written procedure to direct CSN how and when to refund money to the state and to direct the division how and when to monitor the administrative fees of CSN. The Commissioner should consider attempting to recoup any amounts owed to the department by CSN, including but not limited to extravagant administrative expenses. This could possibly be accomplished by reducing future monthly allowances for administrative expenses. The division should establish a more economical way to provide services to the two class members who moved. Finally, the division should ensure that all potential conflicts of interest are eliminated.

Management's Comment

We concur that the contract arrangement with Community Services Network is problematic. We are currently in negotiations with the agency to re-evaluate the form and substance of the contract and to redesign the payment methodology. The Division is eager to rectify any questionable practices and will investigate and address any such issues in regard to the CSN contract or any other agreement.

The Division will also investigate the eligibility of the services provided by CSN for Waiver funding and will pursue this funding if available.

2. The Division of Mental Retardation Services has inadequate controls over other contracts

Finding

In addition to the CSN contracting issues mentioned in finding 1, the Division of Mental Retardation Services does not have internal control over other contracted arrangements. A contract was awarded without competitive bidding, support for contract payments was not properly approved, payments were not always within the contract terms, the division's Operating Guidelines are not complete, and documentation was not available to support certain requests for payment.

The *Rules of the Department of Finance and Administration* require that contracts representing the procurement of services be awarded on a competitive basis, except in certain circumstances including unique qualifications of the contractor. However, a \$544,000 contract with Focused Health Care Solutions to provide consulting for maximization of Medicare revenues and for a billing system was not awarded through the bid process. This contractor was recommended by a contracted consultant responsible for making such recommendations (see finding 7). The contract included payments of \$75 per hour for the consulting services. An internal contract summary stated that the division believes the contractor was uniquely qualified, but the summary also stated that on-site employees could do the job. Also, a different contract with Focused Health Care Solutions for consulting services was bid out at \$54 per hour. Based on the approximate hours charged to this contract, the higher rate cost the state approximately \$125,000.

Each state agency is responsible for the effective management of all of its contracts. The *Rules of the Department of Finance and Administration* state that each agency should implement management practices related to contracts as necessary to ensure accountability. However, support for contract payments was not always properly approved. When reviewing 60 Guardian Healthcare Providers, Inc., contract payments for nursing services, it was discovered that 12 of 60 invoices (20%) were not approved. Based on review of the 617 time sheets and 8 travel claims related to those 60 payments, 282 time sheets (46%) and 8 travel claims (100%) were not properly approved. In addition, it was noted during testwork that the Guardian Healthcare employees' time sheets that are approved by the West Tennessee Regional Director are not the same time sheets submitted in support of the invoice to the Division of Mental Retardation Services. One set of time sheets is used to support the weekly billings to the state, and the other time sheets are used to support the biweekly payments to the employees. This could result in different amounts of time being billed to the state than were actually approved.

In a separate sample of contract payments related to Action Rehabilitation Services, HOPE Center, West Tennessee Family Solutions, and Focused Health Care, 18 of 60 contract payments (30%) were not properly approved. Nine of the documents did not have an approval signature, two documents were approved by Department of Mental Health and Developmental Disabilities personnel instead of Division of Mental Retardation Services personnel, and the approvals for seven documents did not include the whole amount of the payment and therefore did not document approval of the entire payment.

In addition, payments were not always in compliance with the contract terms. The Arlington Developmental Center contract with Guardian states that invoices shall include the official workstation and that only certain nurses are eligible for travel compensation in the amounts of actual costs. We selected a sample of 44 payments to Guardian for this contract. These 44 payments involved 288 Guardian employees' time sheets, and represented \$186,714 out of \$1,156,475 paid to Guardian by Arlington Developmental Center during the year ended June 30, 2003. The employees' official workstations were not included for any of these payments. Also, 32 of the 288 time sheets for the regional office nurses (11%) appeared unreasonable for the mileage charged. The three nurses that submitted the 32 time sheets claimed mileage amounts from their residences to the developmental center instead of from their official

workstations to the developmental centers. The number of excess miles and associated cost for those 32 time sheets was 4,464 miles for \$1,428. Nine of the 288 time sheets (3%) included mileage charges for nurses who are not eligible to be reimbursed for mileage. This mileage totaled 801 miles for \$256. Also, one of the time sheets included a charge for an employee's paid day off, and one of the time sheets included a charge for a 15-minute lunch break, resulting in overpayments of \$240. The contract indicates that nurses' compensation is an hourly rate per nurse for hours worked.

The Clover Bottom Developmental Center contract with Guardian states that invoices shall include the number of hours rounded to tenths. The contract also states that certain education and experience documents are to be maintained and that certain written verifications regarding immunizations and skin tests are to be provided. Eight invoices were reviewed related to this contract. Review of select individuals whose time was claimed on those invoices resulted in determining that hours worked were rounded to the nearest fourth of an hour instead of to the nearest tenth. In addition, the majority of the files maintained for the nurses did not include diplomas, transcripts, documentation of certain immunizations and skin tests, or documentation of contact with the personal and professional references.

A sample of 14 payments totaling \$46,033 out of \$91,053 of contract payments for one of the Focused Health Care Solutions contracts for the year ended June 30, 2003, indicated that all 14 payments were made for services outside the scope of the contract. Although it appears that the services were performed to satisfy a court case, the Focused Health Care Solutions contract was not modified to include the extended scope of services. The contract states that travel compensation is subject to the maximum amounts and limitations specified in the Comprehensive Travel Regulations; however, the payments included mileage and/or lodging amounts that were not in compliance with those regulations.

The Action Rehabilitation Services contract states that "Travel reimbursement . . . shall be limited to travel . . . to provide community-based services for individuals who have transitioned from Clover Bottom Developmental Center." However, in a sample of \$262,503 of the \$905,311 in payments to Action, 2 of the 21 Action payments reviewed (10%) included clients who have never resided at Clover Bottom. The overcharges totaled \$368.

Each provider under the departmental purchase authority has in its contract that it is to follow DMRS *Operating Guidelines*. However, the *Operating Guidelines* have not been completed. Because the guidelines are not completed, the division expects the contractors to follow the DMRS *Operations Manual*. However, this directive may not be enforceable if it is not referenced in the contract.

The Division of Mental Retardation Services *Operations Manual* requires the provider to maintain documentation of all service units that are billed. Documentation for selected items on contract invoices was reviewed to determine whether or not the goods or services were actually provided. If enough information was not included in the division's records, the contractor was contacted, and its records were reviewed. The division paid Guardian Healthcare Services \$4,172,983 for the year ended June 30, 2003. We examined a sample of 328 time sheets which

served as support for 60 contract payments to Guardian. In the sample, 27 of the 328 time sheets reviewed (8%) contained charges that could not be supported. One of the 328 included a travel claim that was not located. The charges related to these unsupported services were \$17,440. In another sample including invoices from the HOPE Center, West Tennessee Family Solutions, and Action Rehabilitation Services, support—such as progress notes, calendars, time cards, or attendance logs—was not located for 8 of 60 payments tested (13%). The charges related to the unsupported services were \$19,172. The division paid those contractors \$6,004,333 for the year ended June 30, 2003.

When state departments award contracts without going through appropriate bid procedures, the state may pay inflated prices for services. Without proper approval of invoices and related support, the Division of Mental Retardation Services paid for more than the services actually provided and paid for services outside the scope of the contract. In addition, without completed *Operating Guidelines*, the contractors cannot comply with the contract terms and may not perform the tasks outlined in the *Operations Manual*.

Recommendation

The Commissioner should review the controls related to contracts to determine why the contract exceptions occurred. The Commissioner should review contracts and ensure that competitive bids are obtained whenever possible. All payments on the contract and supporting documentation for the payments should be approved by authorized Division of Mental Retardation Services' employees. The division should pay Guardian biweekly so the charges correspond with approved time sheets. Underlying support for the payments retained by the provider should be periodically reviewed for evidence of services provided and for determination that the services are within the scope of the contract. The Commissioner should ensure the *Operating Guidelines* are completed, approved, and distributed to provider agencies. The Division of Mental Retardation Services should immediately recover the costs of unsupported services and services that were voluntarily performed by contractors in a manner that did not conform to contract terms.

Management's Comment

We concur and are currently in the process of redesigning the Division's contract services operations, so that these issues are immediately addressed.

The Division is also in the process of re-writing and having approved through TennCare a Provider Manual that will clearly outline the requirements to which community providers will be held accountable.

3. Documentation for waiver services was inadequate

Finding

Services related to the Home and Community Based Services (HCBS) waiver were not approved, and client files did not include required documentation. The Division of Mental Retardation Services *Operations Manual* requires all services funded through the waiver and all services funded by the division (except Early Intervention and Family Support) to be preauthorized by the regional offices through the use of a service plan for each client. The approved service plan, or cost plan, is used as a mechanism to control costs within the Community Services System (CS Tracking), the system used to summarize claim payments and the system from which data is collected for federal financial participation requests. The division's *Operations Manual* also requires the provider to maintain documentation of all service units that are billed. In addition, the *Operations Manual* states that certain information must be maintained for each person receiving waiver services to maintain Medicaid eligibility.

During a review of certain contract expenditures, clients' files were reviewed at the regional offices and at providers of waiver services including HOPE Center, West Tennessee Family Solutions (WTFS), and providers paid by Community Services Network of West Tennessee (CSN). When the expenditure selected was for a waiver service, the client's approved cost plan was obtained and Medicaid eligibility documentation in the client's file was reviewed. Twenty-two of 33 waiver expenditures reviewed (67%) involved clients who received services that were not listed on an approved cost plan. Twenty of the waiver expenditures in question were related to CSN. As mentioned in finding 1, CSN expenditures have not gone through CS tracking; therefore, the waiver-related expenditures have not been subject to the cost plan controls and were not submitted for federal reimbursement. The remaining two instances were for the Hope Center and WTFS, both of which are on CS Tracking. Subsequent to payment of the unauthorized services, the approved cost plans for these expenditures were modified on CS Tracking. However, support for the changes in the cost plans was not included in the clients' files.

The providers reviewed did not maintain adequate documentation. For 9 of the 33 waiver expenditures (27%), evidence of the services provided was not available either at the regional office or in the providers' files. This included three CSN clients with services totaling \$4,131, four Hope center clients with services totaling \$16,325, and two WTFS clients with services totaling \$888. In addition, per the *Operations Manual*, the files should include documentation of a physical exam performed every one to three years and an income verification. However, 4 of the 33 client files (12%) did not have documentation that a physical exam had been performed; all 4 were CSN clients. Also, 24 client files (73%) did not have a current income verification form (4 Hope Center, 20 CSN). In addition to the requirements for provider files, the *Operations Manual* also requires the regional offices to maintain a copy of the income verification forms. These 24 forms were not located at the regional offices either.

The amount paid to providers for waiver services for the year ended June 30, 2003, exceeded \$300,000,000 and involved over 3,000 transactions. As a result of the Division of

Mental Retardation Services allowing payment for services beyond those approved in a client's cost plan, the state may incur unnecessary expenditures. The state also may be paying for services that were not performed when the provider does not have the documentation for services billed. The lack of appropriate documentation in the client files will result in federal questioned costs. Although the Division of Mental Retardation is not currently receiving federal reimbursement for CSN waiver services, CSN will be required to have the appropriate documentation on file when the division begins to request federal financial participation for those services.

Recommendation

The Deputy Commissioner should immediately develop a reasonable method to ensure that all waiver services payments go through CS Tracking and should ensure that changes to the approved cost plan occur prior to payment of services. Client files should be updated when revisions to the approved cost plan occur. The Deputy Commissioner should also take action to ensure that monitoring procedures include determining that providers maintain complete client files including evidence of services provided, and documentation of required verifications and exams. The division should recover costs from the providers when payments are not supported or required documentation is not retained. In addition, the Deputy Commissioner should determine why the regional offices are not maintaining required documentation and should ensure that the offices retain copies of required forms in the future.

Management's Comment

We concur in part. All changes to cost plans must be made prior to payment in order for the payment to be processed. This is the current procedure. We do concur that client files must be updated timely and will take steps to investigate and ensure that this occurs in each region. The Division currently recovers costs from providers in many cases when payments are not supported or if insufficient documentation exists. In some cases, it may be decided that recoupments would not be cost-effective or would be otherwise deleterious to the state. We will immediately address the issue of recoupments to assure that consistent criteria are applied.

Auditor's Rebuttal

As stated in the finding, 22 of 33 waiver expenditures reviewed involved clients who received services that were not listed on an approved cost plan. The cost plans for two of these expenditures were modified, albeit without support, to include the services provided, but not until after the services were rendered. No approved cost plan containing the services provided existed (or was available or could be provided or was on file) for the other 20 expenditures.

Management's comments have not addressed how the department will ensure that payments will not be made for services not included in the cost plans and that services for which payments are made are actually provided.

4. The Division of Mental Retardation Services does not have appropriate processes in place to maximize federal financial participation, resulting in additional costs to state taxpayers

Finding

The process for obtaining federal financial participation for the HCBS waiver and Arlington/West waiver is inadequate, resulting in conflicting rates and denied claims or pended claims. Also, as mentioned in finding 1, the waiver expenditures incurred through the Community Services Network (CSN) contract have not been regularly submitted for federal reimbursement.

The Division of Mental Retardation Services establishes rates for all services paid to providers but is reimbursed from TennCare for allowable HCBS waiver and Arlington waiver expenditures at different rates from the actual rates paid to providers. Waiver services were examined for the period July 2002 through April 2003. If the division had submitted all waiver services to TennCare for reimbursement for this time period and all such claims were reimbursed with TennCare rates, the division would be paying approximately \$9,000,000 more to the waiver services providers than TennCare would have paid had TennCare paid the providers directly. However, it appears that not all waiver services have been submitted or approved.

Also, due to the reimbursement process in place during the audit, the Division of Mental Retardation Services may not be reimbursed for all valid claims. The division creates a computer file of claims to be reimbursed from TennCare. This file is sent to TennCare, where it is entered into the TennCare Management Information System (TCMIS). TCMIS performs a data match, and one of three results occurs: 1) the claim is approved and paid; 2) the claim is denied; or 3) the claim is placed into a pended status within the TennCare system. The division receives a report from TennCare detailing the number of claims paid and denied. However, the claims that are placed into a pended status are not reported to the division. Such claims are either approved or denied at a later time. As a result, the division does not have an adequate procedure to track all claims sent to TennCare or to reconcile the reports to determine if the claims were appropriately handled or resolved. The division does not currently have knowledge of exactly how much money or how many claims are unpaid by TennCare. The denied claims may be valid waiver expenses that are simply missing some required information. Without a tracking system, such claims may sit idle until the allowable period of submission has passed. Thus, the division has not been able to maximize federal financial participation.

Furthermore, the volume of claims denied is such that the division is having difficulty reviewing and resubmitting the denied claims in a timely manner. According to the Division of Mental Retardation Services personnel, the backlog is so substantial that the division will not

catch up without hiring additional personnel. A scan of the denied claims information in the TennCare Management Information System showed that the claims were frequently denied due to untimely filing.

Also, as mentioned in finding 1, the Community Services Network has incurred valid waiver expenses under its contract outside of the CS Tracking system. Because the Division of Mental Retardation Services has not had access to this data, it has been unable to get federal financial participation related to those expenditures.

Federal financial participation is available to match the state costs related to the HCBS waiver. When federal dollars are not maximized, the state and the state's taxpayers are forced to bear the additional costs related to such expenditures.

Recommendation

The Deputy Commissioner should continually monitor the rate system to ensure that total amounts paid to providers equal or only minimally exceed the amounts paid by TennCare. Furthermore, the Deputy Commissioner should take action to create a reconciliation procedure to track all claims submitted to TennCare, claims approved, claims denied, and claims still currently pending. The Deputy Commissioner should see that specific division staff are immediately assigned to review all denied claims and to resubmit them as appropriate. The Deputy Commissioner should ensure that staff fulfill that responsibility and are held accountable for failure to do so.

Management's Comment

We concur. There is currently an effort underway to research and redesign the rate structure as it impacts community providers and to more closely align TennCare rates paid to the Division to those paid by the Division to providers.

In addition, we are restructuring the Office of Administrative Services to allow an intensive reconciliation process to be performed and all denied claims resubmitted for reimbursement.

BUREAU OF TENNCARE'S COST ALLOCATION

The objective of our review of the Bureau of TennCare's cost allocation methods was to follow up on the prior-year finding regarding the Bureau of TennCare operating without an approved cost allocation plan. We interviewed key personnel and reviewed documentation to determine if a cost allocation plan had been approved. As a result of our work, we determined, as noted in finding 5, that although a cost allocation plan was approved, the plan has not yet been used.

5. TennCare did not use the approved cost allocation plan to claim administrative costs related to the Home and Community Based Services Waiver for the Mentally Retarded and Developmentally Disabled

Finding

TennCare did not use the approved cost allocation plan to claim administrative costs related to the Home and Community Based Services Waiver for the Mentally Retarded and Developmentally Disabled (HCBS MR/DD). In the previous four audits, we noted that TennCare did not have an approved Medicaid cost allocation plan to provide for the recovery of administrative costs associated with the HCBS MR/DD waiver. This issue was first reported in the audit for year ended June 30, 1999. Management concurred with that audit finding and stated:

. . . The Bureau is currently in the process of developing a cost allocation plan to be submitted for approval as determined necessary.

In the audit for year ended June 30, 2000, we reported that according to TennCare's Chief Financial Officer, no cost allocation plan was developed or submitted for approval. We reported that management could not explain why an approved cost allocation plan had not been obtained. Management concurred with that audit finding and stated:

A letter was submitted to HCFA [now the Centers for Medicare and Medicaid Services (CMS)] in spring of 2000 requesting approval of a cost allocation method for the MR/DD waiver. HCFA responded that the letter should be submitted to the Department of Health and Human Services (HHS). The letter to HHS was submitted in June of 2000. They in turn sent the letter to HCFA financial experts for review. Consequently, we have not received approval from HCFA to proceed with the cost allocation plan.

In the audit for year ended June 30, 2001, we reported again that TennCare did not draw federal funds related to administrative costs during the current audit period. We reported that a cost allocation plan was submitted to CMS, but without approval from CMS the costs cannot be claimed. Management concurred with that audit finding and stated:

. . . Representatives from TennCare, the Department of Mental Health and Developmental Disabilities, and the Division of Mental Retardation Services have worked with CMS since submission of the plan to obtain approval. CMS has recently indicated verbal approval for the cost allocation plan submitted in 2000, but written approval has not yet been received. Approval of the plan will allow the State to claim federal matching funds at a 50% administrative rate.

In the audit report for the year ended June 30, 2002, we reported that although management had submitted the cost allocation plan, they had not received approval and still

could not formally claim reimbursement for the administrative costs. In response to the finding, management stated:

We concur that the written approval of the cost allocation plan was not received during the previous fiscal year. . . . We have now received a written approval letter from CMS for the cost allocation plan which will allow collection of federal matching funds retroactively.

Although TennCare received a written approval for this plan in a letter dated August 23, 2002, TennCare did not submit documentation of the related administrative costs to the federal government. Discussions with TennCare management revealed that although TennCare management had some documentation, review of this documentation by the Comptroller's Medicaid/TennCare division revealed certain unsupported amounts. For example, a report from the Medicaid/TennCare division to the Bureau of TennCare regarding the documentation of support (administrative) costs for the year ended June 30, 2002, stated that the division

. . . can make no recommendation or conclusion regarding the reported amount of MR Community-Personal Services Contracts due to the absence of any supporting documentation.

According to the report from the Medicaid/TennCare division, TennCare planned to claim \$112,984,671 in administrative costs for the six years ended June 30, 1997, through June 30, 2002. However, based upon the review by the Medicaid/TennCare division, the total supported administrative costs were \$110,480,657, a difference of \$2,504,014. These supported administrative costs represent \$55,240,329 in federal matching funds that were not claimed.

Furthermore, the *Code of Federal Regulations*, Title 45, Part 95, Section 7, states that the federal government

. . . will pay a State for a State agency expenditure made after September 30, 1979, only if the State files a claim with us for that expenditure within 2 years after the calendar quarter in which the State agency made the expenditure. Section 95.19 lists the exceptions to this rule. . . .

Based on the review by the Medicaid/TennCare division, there was approximately \$85,201,345 of administrative costs for years ended June 30, 2001, and prior, that now exceed the federal two-year time limitation. Therefore, approximately \$42,600,673 of federal costs may not be available for federal reimbursement. During fieldwork, we discussed the federal regulation with a CMS official, who stated that TennCare must request permission from CMS for the costs claimed beyond the two-year limitation.

In response to the review of administrative costs by the Medicaid/TennCare division, TennCare's management has continued to review the proposed administrative costs to attempt to determine their accuracy. Because of the lack of documentation, TennCare has not used the approved cost allocation plan to recover federal matching funds for HCBS MR/DD

administrative costs. In addition, because of the delays in claiming federal matching funds, there is now a risk that some of the administrative costs cannot be claimed because they now exceed the federal two-year limitation. Since TennCare has not maximized federal revenue by claiming allowable administrative cost, the state has had to fund the administrative costs of the HCBS MR/DD waiver for at least the last six years.

Recommendation

The Director of TennCare should ensure that all parties involved provide and maintain adequate documentation to support administrative costs that are allowable for federal participation under the HCBS MR/DD waiver. For the costs that are adequately supported, the Director should attempt to recover these funds from the federal government. For the costs that are beyond the required two-year limitation, the Director should request permission from CMS to claim the costs.

Management's Comment

We concur in part. As noted in the finding, we requested a review of the support for these costs be performed by the Comptroller's office and adjustments have been made to the costs to be claimed. We agree that adequate support should be maintained and will continue to work with the Division of Mental Retardation Services to ensure that this happens. We will claim federal participation on all applicable costs. However, we do not concur that permission is required from CMS to claim costs beyond two years. Title 45 Part 95 Section 19 states:

Sec. 95.19 Exceptions to time limits.

The time limits in Secs. 95.7 and 95.10 do not apply to any of the following—

(a) Any claim for an adjustment to prior year costs.

(b) Any claim resulting from an audit exception.

(c) Any claim resulting from a court-ordered retroactive payment.

(d) Any claim for which the Secretary decides there was good cause for the State's not filing it within the time limit.

As noted in the finding, this issue was raised in an audit and a cost allocation plan was submitted to CMS. This plan was not approved by CMS until two years later despite continued discussions by the State with CMS. Additionally, we requested a review by the Comptroller's TennCare Division of the support before any costs were to be claimed. Waiting on approval of the settlement methodology and reviewing documentation have extended the timeframe of collecting these funds. The cost settlements are adjustments to prior year costs and are claims resulting from an audit exception, which qualify under exemptions (a) and (b) above. We have advised CMS of our position on this issue and will claim these funds. We therefore do not concur with the statement that CMS has the option of not allowing the claiming of these funds due to the two years requirement.

Auditor's Comment

As stated in the finding, based on discussion with a CMS official, we perceive there is a risk that some of the administrative costs cannot be claimed.

DIVISION OF MENTAL RETARDATION SERVICES' PERSONNEL PROCEDURES

The objectives of our review of the controls and procedures over the Division of Mental Retardation Services' personnel procedures were to determine whether

- proper documentation is kept in DMRS personnel files, and
- improper employer/employee relationships exist.

We researched the Department of Personnel's requirements and state law to determine which documents are required to be maintained in each employee's personnel file. We selected a nonstatistical sample of DMRS employees as of March 31, 2003, to ensure their personnel files contained the proper documentation. In addition, we reviewed the contracts tested as part of the contract management review and examined the supervisory structure at the developmental centers and regional offices to determine whether improper employer/employee relationships existed.

As noted in finding 6, we determined that the division was not complying with the Department of Personnel's requirements and state law. Also, as noted in finding 7, improper employer/employee relationships were identified.

6. Personnel files were incomplete

Finding

As noted in the prior audit, a review of West Tennessee Regional Office (WTRO) personnel files revealed that current and complete personnel files were not maintained. The personnel files for the WTRO are kept at the Arlington Developmental Center in Arlington. This year the audit of personnel files was expanded to include Middle Tennessee Regional Office (MTRO), East Tennessee Regional Office (ETRO), and the Division of Mental Retardation Services central office in Nashville. MTRO files are kept at Clover Bottom Developmental Center in Nashville, ETRO files are maintained at Greene Valley Developmental Center in Greeneville, and the Department of Mental Health and Developmental Disabilities maintains the files of the Division of Mental Retardation Services' central office. Management substantially concurred with the prior finding and stated that they would ensure that the documentation was obtained. The corrective action included a checklist process, but the process was not completed as of the date of review, and the Division of Mental Retardation Services had not done anything to avoid similar deficiencies at the other regional offices and the central office. Testwork

indicated that personnel files did not have current applications for the position held or proof of education documented. Current job plans and evaluations were not found. Also, IRS I-9 forms, Internet agreement forms, and drug-free workplace statements were not on file. In addition, personal references, prior job references, background checks, and authorization of release of information forms were not documented.

The State of Tennessee Department of Personnel requires the personnel division of all facilities to have a current application for position held, copies of proof of education, a current signed job plan, and a current annual evaluation. These items are required to ensure that an employee is qualified for the position and is capable of performing the duties the position requires. The department also requires an Internet agreement to be on file for every employee who has access to the Internet. In order to ensure that employees know the rules and regulations concerning what is acceptable, employees are required to sign a statement stating they fully understand the Internet usage policy of the State of Tennessee. The Department of Personnel requires a drug-free workplace agreement to be on file for every employee. A signed statement from employees is required to ensure that they understand the drug-free workplace policy of the State of Tennessee.

Section 33-2-12, *Tennessee Code Annotated*, requires the department to check prior job references, check personal references, and do background checks of all personnel whose positions would include direct contact with or direct responsibility for any persons with mental illness or developmental disabilities, regardless of whether personnel are employees or volunteers. The code also requires that a signed authorization of release form for the background check is obtained. The Division of Mental Retardation Services is required to perform these procedures to ensure the safety of its clients.

The Federal Immigration Reform and Control Act of 1986 requires the completion of the I-9 form. In order to verify the identity of an employee and eligibility to work in the United States, an I-9 form must be completed and on file.

Sixty employees' personnel files were randomly selected to ensure that the proper records were being maintained. Testwork revealed the following:

- Nine of 58 applicable personnel files (16%) did not contain a current state application for the position held.
- Seven of 53 applicable personnel files (13%), including one LPN and several technicians, did not have documentation of the proper level of education obtained, for the positions held.
- Forty-nine of 58 applicable personnel files (84%) did not contain a current signed job plan.
- Five of 45 applicable personnel files (11%) did not contain annual performance evaluations.

- Five of 43 applicable personnel files (12%) did not contain a signed Internet agreement form.
- Six of 60 personnel files (10%) did not contain a drug-free workplace statement.
- Four of 36 applicable personnel files (11%) did not have the employees' prior jobs reference checks documented.
- Thirteen of 36 applicable personnel files (36%) did not have personal reference checks documented.
- Six of 38 applicable personnel files (16%) did not contain documentation of background checks.
- Three of 41 applicable personnel files (7%) did not have a signed authorization form for the release of information.
- Two of 47 applicable personnel files (4%) did not contain an IRS I-9 form.

Recommendation

The personnel officer should ensure that personnel staff adheres to the state and federal law and written guidelines established by the Department of Personnel in maintaining employees' personnel files and all required documentation. The Deputy Commissioner should take the utmost care to ensure that individuals who have direct contact with clients have the appropriate background checks. All files should be reviewed, background checks should be performed, and missing documents should be obtained.

Management's Comment

We concur and will take steps to assure that all required personnel files are updated and regularly monitored for compliance.

7. Department of Finance and Administration, Division of Mental Retardation Services, has established improper employer-employee relationships

Finding

As noted in the prior audit, a review of personnel files found that the West Tennessee Regional Office (WTRO) has established improper employer-employee relationships. In the current audit, these issues as well as others were noted not only at WTRO, but also at the East Tennessee Regional Office (ETRO), Middle Tennessee Regional Office, and developmental centers of the Division of Mental Retardation Services. Management concurred in part with the prior finding and stated that they recognized that the situation of contracting for staff and having contract staff as supervisors is not optimal, but demonstrated an unwillingness to correct the

problem by citing various reasons that they felt the contracts were necessary, including the perceived inability to fill the positions and cost concerns. Therefore, corrective action has not been taken. In the current audit, we even noted a contract employee with the ability to recommend contracts who recommended and received a contract for his spouse.

The regional offices direct and support the developmental centers and also have regional monitoring, training, abuse investigation, and intake coordination duties for home- and community-based services in Tennessee. Management has entered into contracts with agencies to provide individuals that are directly supervised by state employees and contracts for employees that supervise state employees and other contractors. Three contract positions at WTRO, one contract position at ETRO, and one contract position at Clover Bottom Developmental Center are considered supervisory positions. A contract employee who is contracted through an agency as an Occupational Therapist holds the Deputy Regional Director position at WTRO. In addition to the supervisory positions noted, there are multiple contract employees who function much in the same manner as state employees at each regional office and developmental center. These contract employees report to work at the regional office or developmental center on a day-to-day basis, use the state's supplies and property, and have their daily duties directed by state employees. The practice of allowing employees of non-state entities to report directly to department officials/employees in carrying out what can be construed as state programs raises serious policy and legal issues. The manner by which the contract employees are utilized by the division meets multiple tests and criteria established by the IRS and upheld by Tennessee case law defining employee status. The division controls the manner by which contractors perform services, the division establishes the working hours and workplace arrangements, the contractors perform services that supplement division staff, and the tenure of most contractors is continuing. All of these factors meet the criteria that define employee status.

Chapter 0620-3-3-.07 of the *Rules of the Department of Finance and Administration* requires that "State employees shall be hired through the merit system of the Department of Personnel." Section 8-30-201 (a), *Tennessee Code Annotated*, establishes "a system of personnel administration based on merit principles and scientific methods. That system shall govern the appointment, promotion, transfer, layoff, removal and discipline of employees, and other incidents of state employment." Section 8-30-201(b), *Tennessee Code Annotated*, gives the Department of Personnel the responsibility of administering and improving this system. By entering into these contracts, the department in effect circumvented the state's employment process for obtaining staff.

Furthermore, an individual obtained a contract with the state for \$265,000 per year for consulting services that included, among other duties, the authority to review and recommend contracts relating to the Division of Mental Retardation. As a result, an \$82,200 per year contract with his spouse was awarded in which the duties listed were directly related to duties listed in his own contract. For example, the \$265,000 contract states that the contractor is to develop, implement, and monitor all plans required by the Court. The spouse's contract states that the contractor is to "continue to provide assistance in developing implementation plans and monitoring strategies to facilitate compliance. . . ."

Recommendation

The Commissioner should make serious attempts to eliminate present barriers to hiring qualified personnel through the state payroll system. The Commissioner should consider the costs of the decisions to contract with third parties rather than using state employees. The Deputy Commissioner of the Division of Mental Retardation Services should take a leadership role and immediately review the current use of contract employees. The Deputy Commissioner should establish policies for the regional offices to follow to avoid establishing employer-employee relationships with individuals who are, in effect, performing state services. These individuals should be placed on the state payroll system through the proper hiring procedures established by the Department of Personnel. If contract individuals are again given the authority to recommend contracts in the future, careful review should be performed by state employees to determine if the contract arrangement is in the best interest of the state.

Management's Comment

We concur. Contract policies have been changed to require re-evaluation of each contract and an effort made to convert any possible contractor positions to state employees. This has resulted in a conversion in the current fiscal year of approximately 25 positions. The Division has been instructed to closely review each contract for possible conversion or reduction.

DEVELOPMENTAL CENTERS' OPERATIONS

Our objectives in reviewing the controls and procedures over the developmental centers' operations were to determine whether

- controls over equipment and inventory at the centers were adequate to ensure that information in the equipment and inventory records was accurate,
- controls over cash receipts and expenditures at Clover Bottom Developmental Center were adequate to ensure that transactions were handled in compliance with state rules and regulations, and
- conflict-of-interest statements were prepared at Clover Bottom Developmental Center and Greene Valley Developmental Center.

We interviewed key personnel to obtain an understanding of the controls and procedures for equipment, inventory, expenditures, and cash receipts. We selected nonstatistical samples of equipment at March 31, 2003, at each developmental center to determine the accuracy of the information recorded in the Property of the State of Tennessee (POST). We selected nonstatistical samples of inventories in April 2003 to determine the accuracy of each developmental center's perpetual inventory records. To determine if expenditures were in compliance with state rules and regulations, we tested a nonstatistical sample of Clover Bottom Developmental Center's expenditures as of March 31, 2003, and reviewed certain transactions

with the characteristics of split invoices. Also, we tested a nonstatistical sample of Clover Bottom Developmental receipts as of April 21, 2003, to determine if cash receipts were deposited properly and recorded correctly. Conflict-of-interest statements were reviewed at Clover Bottom and Greene Valley.

Based on testwork performed, we determined that controls over inventory were adequate to ensure that information in the inventory records was accurate. Also, controls over Clover Bottom cash receipts were adequate to ensure that transactions were handled in compliance with state rules and regulations. However, we determined that recordkeeping for equipment at the developmental centers was inadequate, expenditures at Clover Bottom were not handled appropriately, and conflict-of-interest statements were not always completed. See findings 8 and 9.

8. Inadequate recordkeeping for equipment at the developmental centers resulted in missing equipment that cost \$470,615

Finding

Equipment records are not accurate at Greene Valley Developmental Center in Greeneville, Arlington Developmental Center in Arlington, and Clover Bottom Developmental Center in Nashville. Several equipment items could not be located, serial numbers and locations listed in the records were not correct, and state tags were missing. These inaccuracies were noted in the prior two audits for Greene Valley, and location inaccuracies for Arlington were noted in the prior audit. Although the department corrected the problems reported in the prior audit related to Clover Bottom not establishing internal control over the removal of equipment from property records, our current audit revealed that Clover Bottom now has inaccurate records as well. In addition, as a result of the lack of control over equipment, an excessive amount of property has again been reported as missing.

The state has made major expenditures over the years for assets for the department to carry out its mission. The department has a fiduciary responsibility to ensure these taxpayer-purchased assets are adequately safeguarded and accounted for properly. If management does not maintain an accurate, up-to-date equipment inventory system that holds individuals accountable for state property, that property may be misused or misappropriated. This could result in jobs not being performed because of the lack of needed equipment or an increase in costs to the state to replace lost or stolen equipment.

In response to the prior audit finding, Greene Valley management concurred and stated that they would ensure that Greene Valley property records on the Property of the State of Tennessee (POST) system are updated as necessary to accurately reflect the status of Greene Valley's property inventory. In addition, Arlington management concurred and stated that a complete inventory of all property items had been conducted and updated in the POST system. However, management's corrective actions have been unsuccessful. Subsequent inventories

revealed that the updates were not complete, and many problems were still noted at all three developmental centers in the current audit.

Internal control at each facility was reviewed. Equipment was verified by selecting 75 items from Greene Valley, 60 items from Arlington, and 25 items from Clover Bottom from an equipment listing on POST. Our examination yielded the following results.

Greene Valley

- Five of 75 property items selected from the POST property listing (7%) could not be located. The cost of the missing equipment was \$34,717.
- Six of the 70 remaining property items selected from the POST property listing (9%) had incorrect serial numbers.
- One of the 70 remaining property items selected from the POST property listing (1%) was surplus in September of 1996 but had not been removed from the property listing.

Arlington

- Four of 60 property items selected from the POST property listing (7%) could not be located. The cost of the missing equipment was \$18,485.
- Four of the remaining 56 property items selected from the POST property listing (7%) did not have a state property tag attached.
- For 13 of the remaining 56 property items selected from the POST property listing (23%), the location code in POST did not agree to the physical location of the item.
- Seven of the remaining 56 items selected from the POST property listing (13%) had incorrect serial numbers in POST.

Clover Bottom

- Three of 25 property items selected from the POST property listing (12%) had incorrect serial numbers.
- For 2 of 25 property items selected from the POST property listing (8%), the location code in POST did not agree to the physical location of the item.

In the prior audit, it was noted that Greene Valley reported equipment costing \$108,561 as lost, stolen, or destroyed, and Arlington reported equipment costing \$191,470 as lost, stolen, or destroyed. Results of the equipment inventory received from the Tennessee Department of Mental Health and Developmental Disabilities for the current audit period again showed an excessive amount of missing items.

- Greene Valley reported a book value of \$11,937 in missing items. The original cost of the items was \$54,870.
- Arlington reported a book value of \$18,279 in missing items. The original cost of the items was \$115,714.

Recommendation

The Commissioner needs to demonstrate a genuine commitment to resolving this issue. The Commissioner should determine why the problems are still occurring and hold individuals responsible and accountable for the failed results of previous corrective efforts. The fiscal directors at each of the developmental centers should ensure that records are updated as necessary for loss, recordkeeping errors, and location changes. State tags should be placed or replaced on each piece of equipment. Thorough physical inventories should be conducted on an annual basis, and errors found should be corrected. Individuals should be assigned responsibility for equipment in their areas, and they should be held accountable for missing items.

Management's Comment

We concur. Issues surrounding purchasing and inventory will be investigated and addressed and responsible parties held accountable.

9. Management of Clover Bottom Developmental Center continues to refuse to address issues related to the circumvention of bid requirements, and the Division of Mental Retardation Services does not follow a conflict-of-interest policy

Finding

As in the prior two audits, developmental center disbursements were not handled appropriately. In prior years, a review of controls and procedures related to disbursements at the Clover Bottom Developmental Center and Greene Valley Developmental Center revealed weaknesses in internal control and noncompliance with policies and procedures. Bids were not obtained when necessary, conflict-of-interest statements were not prepared, and disbursements were not coded to the appropriate object codes. The current audit revealed that Clover Bottom and Greene Valley have partially corrected the conflict-of-interest portion of the finding and have corrected the coding of object codes for disbursements. However, bids were still not obtained when necessary at Clover Bottom, and only Clover Bottom executive staff and Greene Valley procurement staff have completed conflict-of-interest statements. Furthermore, it was noted during the current audit that the Division of Mental Retardation Services has not developed a division-wide conflict-of-interest policy. As a result, a significant number of key central office employees do not have conflict-of-interest statements on file.

In the prior audit, Clover Bottom management did not concur with the finding related to obtaining bids, stating that Clover Bottom had not received information on the specific transactions that were split. Because Clover Bottom did not concur and correct this issue, it was noted again in the current audit.

According to the *Department of General Services Purchasing Procedures Manual*, purchases over \$400 require three phone bids. At Clover Bottom, we obtained a list of invoices that, based on dates and vendors, had characteristics of split invoices. A split invoice occurs when an employee avoids bid requirements on higher-dollar items by splitting up the invoice into several smaller invoices. The employee is then able to make a purchase without obtaining three phone bids. Splitting invoices is a method used to circumvent controls and can lead to irresponsible spending.

From the listing obtained, we examined a sample of 22 sets of questionable invoices. At Clover Bottom, 5 of 22 questionable sets (23%) appeared to be split invoices. Four of the five sets involved purchase orders for the same day and the same vendor, and accumulated in amounts over \$400. The remaining set involved two purchase orders for the same day and same vendor that accumulated in an amount over \$400, and one purchase order for the same vendor that was dated the next day from the previous two, although all three purchase requisitions were received in the purchasing office the same day.

Clover Bottom management responded to the prior audit finding on potential conflicts of interest being identified by stating that they would adopt a conflict-of-interest policy. However, no written policy was provided to the auditors. In addition, Greene Valley management responded to the same issue by stating they would use documents used by the state's Department of General Services to document potential conflicts of interest for all individuals involved in the purchasing process. However, only procurement personnel were required to complete these forms. Although Greene Valley required its procurement personnel and Clover Bottom required its executive staff to complete conflict-of-interest statements, both institutions failed to identify potential conflicts of interest from all employees for whom conflicts of interest could influence or give the appearance of influencing their decisions. Furthermore, the central office for the Division of Mental Retardation Services does not have a conflict-of-interest policy. Although the Department of Finance and Administration has a conflict-of-interest policy, the Division of Mental Retardation Services has not considered that policy to be applicable to the division. It was noted that 7 of 10 key employees reviewed (70%) did not have potential conflicts of interest documented in their personnel file. Without such a requirement, purchases to a vendor for which a conflict of interest exists could go unnoticed.

Recommendation

The Commissioner of the Department of Finance and Administration should determine why Clover Bottom Developmental Center management is resisting corrective efforts and ensure the developmental center takes an appropriate course of action. The Commissioner should also ensure that the issue is analyzed for applicability to other areas of the division as well and

corrective action is taken as necessary. The Commissioner should ensure that the Division of Mental Retardation Services either follows the departmental conflict-of-interest policy or implements a policy at least as restrictive as the departmental policy. The Deputy Commissioner of the division should ensure that a policy is developed and implemented to prevent invoice splitting. The performance of the employees who are responsible for purchasing should be monitored, and, when necessary, disciplinary action should be taken.

Management's Comment

We concur. Issues of internal control are being investigated and will be addressed immediately. A Division-wide conflict of interest policy will be developed and implemented. Central Office executive staff have signed the Executive Conflict of Interest policy as directed by Executive Order # 3 and that statement is on file for each.

FINANCIAL INTEGRITY ACT

Section 9-18-104, *Tennessee Code Annotated*, requires the head of each executive agency to submit a letter acknowledging responsibility for maintaining the internal control system of the agency to the Commissioner of Finance and Administration and the Comptroller of the Treasury by June 30 each year.

Our objective was to determine whether the department's June 30, 2003, responsibility letter was filed in compliance with Section 9-18-104, *Tennessee Code Annotated*.

We reviewed the June 30, 2003, responsibility letter submitted to the Comptroller of the Treasury and to the Commissioner of the Department of Finance and Administration to determine adherence to the submission deadline. We determined that the Financial Integrity Act responsibility letter was submitted on time.

OBSERVATIONS AND COMMENTS

TITLE VI OF THE CIVIL RIGHTS ACT OF 1964

Section 4-21-901, *Tennessee Code Annotated*, requires each state governmental entity subject to the requirements of Title VI of the Civil Rights Act of 1964 to submit an annual Title VI compliance report and implementation plan to the Department of Audit by June 30 each year. The Department of Finance and Administration filed its compliance report and implementation plan on June 30, 2003.

Title VI of the Civil Rights Act of 1964 is a federal law. The act requires all state agencies receiving federal money to develop and implement plans to ensure that no person shall, on the grounds of race, color, or origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal funds. The Human Rights Commission is the coordinating state agency for the monitoring and enforcement of Title VI. A summary of the dates state agencies filed their annual Title VI compliance reports and implementation plans is presented in the special report *Submission of Title VI Implementation Plans*, issued annually by the Comptroller of the Treasury.

POTENTIAL CONFLICT OF INTEREST IN PRIOR FISCAL YEARS

The Community Services Network of West Tennessee (CSN) contract, mentioned primarily in finding 1 of this report, was developed, with the court's approval, as a solution to a court order against the state. The previous job of the Executive Director of CSN was an assistant to the former court monitor for the case that created that court order, *United States of America v. State of Tennessee et al.* This relationship gives the appearance of a potential conflict of interest related to the creation of CSN.

APPENDIX

ALLOTMENT CODES

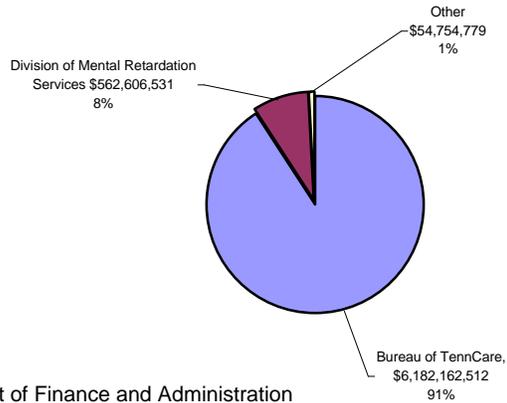
Department of Finance and Administration allotment codes:

317.01	Executive Offices
317.02	Division of Budget
317.03	Office for Information Resources
317.04	Insurance Administration
317.05	Division of Accounts – Internal Service Fund
317.06	Criminal Justice Programs
317.07	Resource Development and Support
317.10	Real Property Management
317.11	Commission on National and Community Services
317.30	Management Information Systems
317.86	Tennessee Insurance System
317.99	Division of Accounts - Other

- 318.01 Office of Health Services
- 318.65 TennCare Administration
- 318.66 TennCare Services
- 318.67 Waivers and Crossover Services
- 318.68 Long-Term Care Services
- 339.21 Mental Retardation-Administration
- 339.22 Developmental Disabilities Services
- 339.23 Community Mental Retardation Services
- 339.25 West Tennessee Region (Arlington)
- 339.26 Middle Tennessee Region (Clover Bottom)
- 339.27 Greene Valley Developmental Center
- 355.02 State Building Commission
- 501.03 Facilities Management
- 501.04 Facilities Revolving Fund–Capital Projects
- 501.05 Facilities Revolving Fund–Debt Service

**Department of Finance and Administration
General Fund Expenditures**

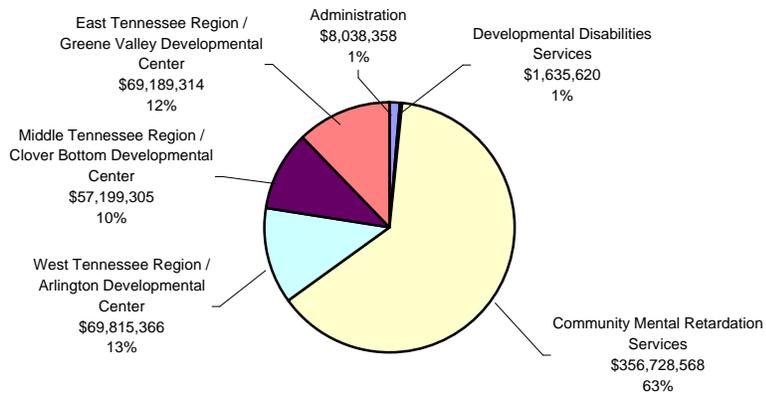
Fiscal Year Ended June 30, 2003 (Unaudited)



Source: Department of Finance and Administration

**Division of Mental Retardation Services
Expenditures**

Fiscal Year Ended June 30, 2003 (Unaudited)



Source: Department of Finance and Administration