

Department of Health

February 2005

Arthur A. Hayes, Jr., CPA, JD, CFE
Director

Edward Burr, CPA
Assistant Director

Kandi Thomas, CPA, CFE
Audit Manager

Michael S. Edwards, CPA
In-Charge Auditor

Thad Sanders
Jennifer Whitsel
Staff Auditors

Amy Brack
Editor

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 401-7897

Financial/compliance audits of state departments and agencies are available on-line at
www.comptroller.state.tn.us/sa/reports/index.html.
For more information about the Comptroller of the Treasury, please visit our Web site at
www.comptroller.state.tn.us.



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

**John G. Morgan
Comptroller**

February 28, 2005

The Honorable Phil Bredesen, Governor
and

Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and

The Honorable Kenneth S. Robinson, M.D., Commissioner
Department of Health
Cordell Hull Building, Third Floor
426 Fifth Avenue North
Nashville, Tennessee 37247

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Department of Health for the period July 1, 2002, through July 31, 2004.

The review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements 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

GM/th
04/064



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765**

August 13, 2004

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 Health for the period July 1, 2002, through July 31, 2004.

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. These standards require that we obtain an understanding of internal control significant to the audit objectives and that we design the audit to provide reasonable assurance of the Department of Health's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Department of Health is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

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's internal control and instances of noncompliance to the Department of Health's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/th

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Department of Health
February 2005

AUDIT SCOPE

We have audited the Department of Health for the period July 1, 2002, through July 31, 2004. Our audit scope included a review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements in the areas of expenditures, equipment, contracts, the Board of Social Worker Certification and Licensure, payment cards, and the Financial Integrity Act. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

AUDIT FINDINGS

Controls Over Expenditures Need Improvement

Supporting documentation was not cancelled to prevent duplicate payments, approval was not obtained, and payment was late (page 5).

The Department Could Not Provide Supporting Documentation for Non-Competitive Contract Negotiations Exceeding \$1 Million

The department did not comply with the Department of Finance and Administration's policies governing non-competitive contract negotiation (page 7).

Inadequate Contract Controls**

The department did not approve contracts before the beginning of the contract period (page 12).

For the Past 19 Years the Department Has Circumvented the State's Employment Process to Obtain Staffing Services**

The department has used grant agreements with a nonprofit organization, community services agencies, and human resource agencies to obtain staffing services (page 10).

The Department Did Not Comply With All Provisions of the Financial Integrity Act

The department did not comply with the Financial Integrity Act, which requires management to submit a letter acknowledging responsibility for internal controls (page 21).

The Department Did Not Establish Adequate Internal Control Over Purchases Made Using Payment Cards

The department did not maintain adequate documentation for purchases made using the department's payment card, purchases were

not properly approved, payment card transaction logs were not reconciled to the bank statements, and payment cards were not canceled upon termination of employees (page 15).

The Department Violated State Law and Purchasing Policies and Procedures

The department failed to purchase goods from available statewide contracts and failed to obtain bids to ensure the lowest prices (page 18).

** This finding is repeated from prior audits.

Financial and Compliance Audit Department of Health

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
Post-Audit Authority	1
Background	1
AUDIT SCOPE	3
PRIOR AUDIT FINDINGS	3
Resolved Audit Finding	3
Repeated Audit Findings	3
OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS	4
Expenditures	4
Finding 1 - Established controls over expenditures should be followed	5
Equipment	6
Contracts	7
Finding 2 - The department could not provide adequate supporting documentation to justify the use of non-competitive negotiation for contracts examined exceeding \$1 million	7
Finding 3 - For the past 19 years, the department has continued to circumvent the state's employment process by using grant agreements to obtain staffing services	10
Finding 4 - The department did not approve contracts before the beginning of the contract period	12
Board of Social Worker Certification and Licensure	13
Payment Cards	14

TABLE OF CONTENTS (CONT.)

	<u>Page</u>
Finding 5 - The department did not establish adequate internal control over purchases made using payment cards	15
Finding 6 - The department did not comply with state purchasing policies and procedures	18
Financial Integrity Act	20
Finding 7 - The department did not comply with all provisions of the Financial Integrity Act	21
OBSERVATIONS AND COMMENTS	23
Fraud Considerations	23
Title VI of the Civil Rights Act of 1964	23
APPENDIX	24
Divisions and Allotment Codes	24

Financial and Compliance Audit Department of Health

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Department of Health. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which requires 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.

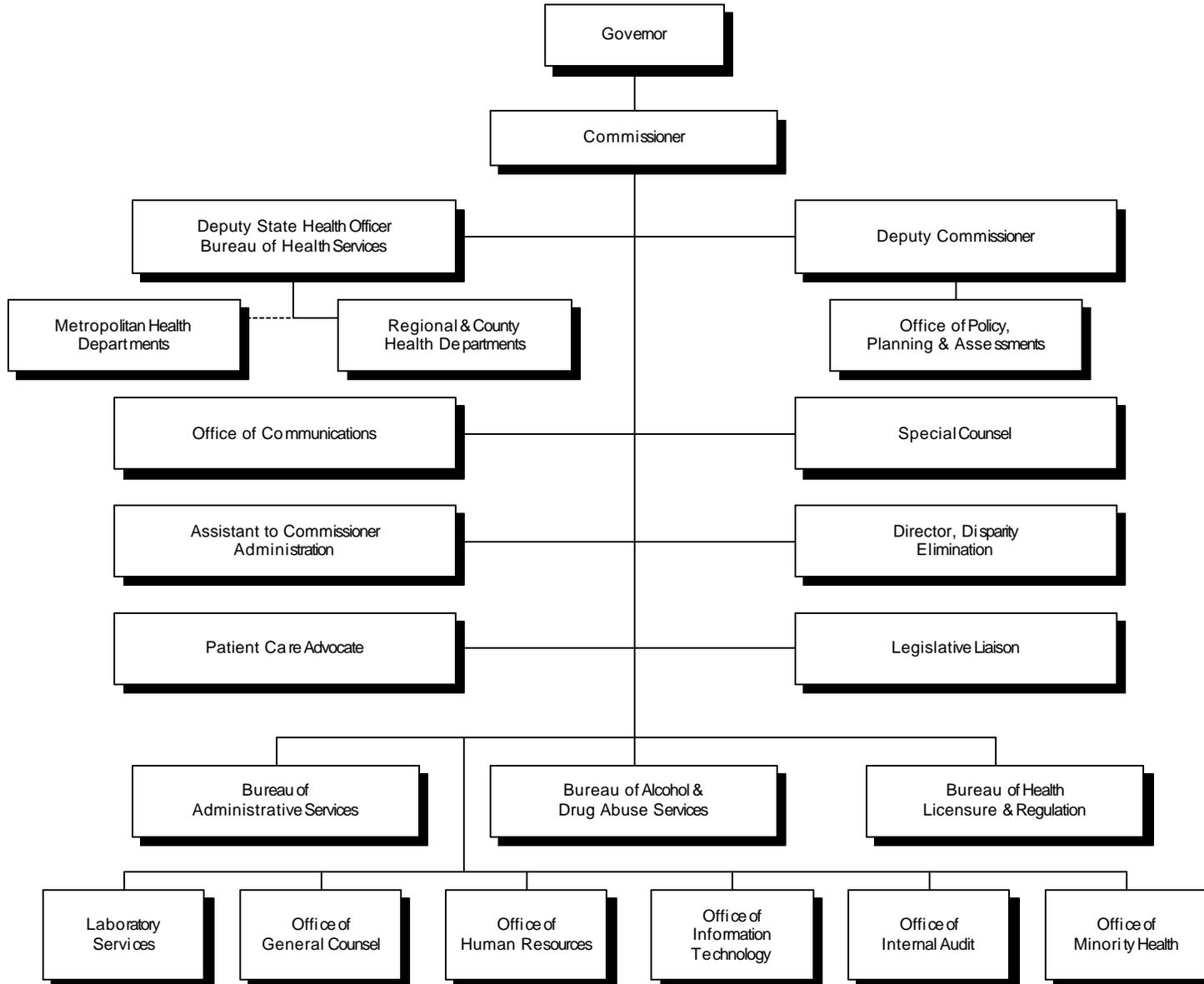
BACKGROUND

The mission of the Department of Health is to protect and promote the health of the community. To fulfill this mission, the department comprises five functional sections: Executive Administration, the Bureau of Administration, the Bureau of Health Licensure and Regulations, the Bureau of Alcohol and Drug Abuse Services, and the Bureau of Health Services and Laboratory Services.

One of the department’s many responsibilities is to provide overall direction to, coordination of, and supervision for the state and local health departments to enable them to meet the health needs of the state’s citizens. The department ensures the quality of medical resources available in the state through the regulation, certification, and licensure of health professionals and health care facilities. The central office works in coordination with seven rural regional offices, six metropolitan health departments, and 89 county health departments to provide services which protect and promote health and prevent disease and injury. The department also works to improve access to quality health care services in underserved areas of the state and to underserved populations. To decrease the incidence and prevalence of alcohol and other drug abuse and dependence, the department coordinates prevention, treatment, and rehabilitation services. The department is also responsible for preserving and issuing copies of all vital records.

An organization chart of the department is on the following page.

Tennessee Department of Health Organization Chart



AUDIT SCOPE

We have audited the Department of Health for the period July 1, 2002, through July 31, 2004. Our audit scope included a review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements in the areas of expenditures, equipment, contracts, the Board of Social Worker Certification and Licensure, payment cards, and the Financial Integrity Act. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

The Department of Health is in the executive branch of state government. The department follows all executive branch policies and procedures including those prescribed by the Department of Finance and Administration and approved by the Comptroller of the Treasury. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration, approving certain state contracts, and participating in the negotiation and procurement of services for the state.

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 Health filed its report with the Department of Audit on August 26, 2003. A follow-up of certain prior audit findings reported in audit report number 02/097 issued in April 2003 was conducted as part of the current audit.

RESOLVED AUDIT FINDING

The current audit disclosed that the Department of Health has corrected a previous audit finding concerning untimely reporting of lost and stolen items to the Comptroller of the Treasury.

REPEATED AUDIT FINDINGS

The prior audit report also contained findings concerning the circumvention of the state's employment process by using grant agreements to obtain staffing services, and the failure to approve contracts before the beginning of the contract period. These findings have not been resolved and are repeated in the applicable sections of this report.

Most Recent Audit Results

Report number 03/093 – The Department of Health’s Audit Results from the Comprehensive Annual Financial Report and Single Audit Procedures, issued in March 2004, contained certain audit findings that were included in the State of Tennessee *Single Audit Report*. These findings were not relevant to our current audit and, as a result, we did not pursue their status as a part of this audit.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

EXPENDITURES

Our objectives in reviewing expenditure controls and procedures at the Department of Health were to determine whether

- expenditures were for goods or services authorized, approved, and received,
- expenditures for goods or services were properly recorded in the correct object code and amount,
- supporting documentation was canceled to prevent duplicate payment,
- payments were made in a timely manner,
- contract payments were in compliance with contract terms and were properly approved and recorded against the contract,
- payments for travel were paid in accordance with the Comprehensive Travel Regulations, and
- department records were reconciled with Department of Finance and Administration reports.

We reviewed the applicable laws and regulations, interviewed key personnel, and reviewed supporting documentation to gain an understanding of the department’s procedures and controls over expenditures. A nonstatistical sample of expenditures for the period July 1, 2002, through November 30, 2003, was selected and tested to determine if expenditures had been properly approved and were for goods or services authorized and received. Expenditures were also tested to determine if the object code and amount had been recorded correctly, payment had been made timely, and supporting documentation was cancelled to prevent duplicate payment. Contract expenditure transactions were tested to determine if contract payments were in compliance with contract terms, properly approved, and recorded against the contract. Travel expenditure transactions were tested for compliance with the

Comprehensive Travel Regulations. Reconciliation procedures were discussed with management. We reviewed the reconciliation of voucher registers with the Department of Finance and Administration's State of Tennessee Accounting and Reporting System (STARS) reports.

Based on our reviews, interviews, and testwork, we noted that problems exist in the department's controls over expenditures including supporting documentation not being canceled to prevent duplicate payments, an expenditure not being properly approved, and an expenditure not being paid timely (see finding 1). We determined that expenditure transactions were recorded correctly and that those expenditure transactions were for goods and services authorized and received. We determined that the department's contract payments were in compliance with contract terms, and payments were properly approved and recorded. However, see the Contracts section of this report for details of testwork on non-competitive contracts. We determined that payments for travel were in accordance with Comprehensive Travel Regulations. Finally, we determined that voucher registers are reconciled to STARS reports.

1. Established controls over expenditures should be followed

Finding

The Department of Health did not follow control procedures for expenditures. Testwork revealed discrepancies with 7 of 60 expenditures (12%) tested. The specific weaknesses are as follows:

- Supporting documentation for six expenditure items was not canceled to prevent duplicate payment. One of the six was not properly approved before payment.
- One item was not paid within 45 days after the invoice was received by the fiscal office as is required by the Prompt Pay Act of 1985.

An effective system of internal control is essential to detect improper expenditures or prevent them from occurring. Management has the responsibility to monitor compliance with control procedures to ensure that expenditures are proper and to provide reasonable assurance that errors or fraud will be prevented or detected in a timely manner.

Recommendation

The fiscal staff should follow established controls for expenditures. Invoices and/or other supporting documentation for payments made should be canceled to prevent duplicate payments. Approvals should be obtained before payments are made, and payments should be made in accordance with the Prompt Pay Act. The Commissioner should monitor compliance with established control procedures and implement corrective action when noncompliance is detected.

Management's Comment

We concur. The department understands and agrees with the auditors that, for the period in question, some invoices were not processed in accordance with all applicable policies, procedures, and guidelines. However, in September 2003, management began revising applicable policies and procedures. By January 1, 2004, the department established controls to prevent duplicate payments and facilitated department-wide retraining efforts to ensure that fiscal staff adheres to controls for expenditures. Approvals are being obtained before funds are disbursed, and payments are being made in accordance with the Prompt Payment Act. From September 2003 to July 2004, the department has been nearly flawless in processing of disbursements without duplication and has received acknowledgement from the Department of Finance and Administration relative to the improved performance.

EQUIPMENT

Our objectives in reviewing equipment controls and procedures at the Department of Health were to determine whether

- the information on the Property of the State of Tennessee (POST) property listing was accurate,
- lost and missing equipment was reported to the Comptroller's Office and removed from the property listing, and
- property and equipment were adequately safeguarded.

We interviewed key departmental personnel and reviewed supporting documentation to gain an understanding of the department's procedures and controls over equipment. We tested a nonstatistical sample from POST and equipment selected at random to determine whether the equipment information was properly recorded including state tag number, description, location, and serial number. We physically observed the equipment located in Davidson County, while all other equipment sample item information was confirmed by letter. A nonstatistical sample of equipment reported as lost or stolen was tested to determine if the equipment was properly reported to the Comptroller's Office and removed from the property listings. We observed and discussed the safeguarding of equipment with the department.

Based on our interviews and review of supporting documentation, we determined that equipment information on the POST property listing was materially accurate. We determined that lost or stolen equipment items appeared to be reported to the Comptroller's Office and properly removed from the property listing. Finally, we determined that equipment items appeared to be adequately safeguarded.

CONTRACTS

Our primary objective in the area of contracts was to follow up on the prior audit finding and to determine whether

- the use of non-competitive negotiation for contracts was justified,
- the department continued to enter into grant agreements to obtain staffing services,
- grantee cost allocation plans were approved in accordance with Department of Finance and Administration Policy 3, and
- the department allowed contract services to be rendered before proper approvals of the contracts were obtained.

We interviewed key department personnel and reviewed support for a listing of non-competitive negotiation contracts. We reviewed terms of contracts, authorizations and dates, contract payment support, memorandums, and expenditures. We interviewed key personnel concerning grant agreements for staffing services. We tested a nonstatistical sample to determine if grantee cost allocation plans were approved in accordance with Department of Finance and Administration Policy 3, and to determine if the department allowed contract services to be rendered before proper approvals of contracts were obtained.

Based on our interviews and review of supporting documentation, we determined that grantee cost allocation plans were approved in accordance with Department of Finance and Administration Policy 3. However, the department could not provide adequate supporting documentation to justify the use of non-competitive negotiation for contracts (see finding 2). In addition, the department entered into grant agreements to obtain staffing services (see finding 3) and allowed contract services to be rendered before proper approvals of the contracts were obtained (see finding 4).

2. The department could not provide adequate supporting documentation to justify the use of non-competitive negotiation for contracts examined exceeding \$1 million

Finding

The department did not comply with the Department of Finance and Administration's contracting policies and procedures governing non-competitive negotiations. *Rules of the Department of Finance and Administration*, Chapter 0620-3-3.03(5)(e), states, "The procuring agency shall document the Non-Competitive Negotiation process." The rules do permit the state's departments and agencies to enter into contracts without following competitive procurement policies and procedures when certain conditions are met, such as when there is only one uniquely qualified service provider capable of performing the needed service or when the use of non-competitive negotiation is in the best interest of the state.

Our testwork revealed that the department had 38 non-competitive contracts for the period July 1, 2002, through June 30, 2004. From the 38 contracts, we selected six contracts for review that were potentially high-risk. These six contracts were with five entities. None of the six contract files contained adequate documentation supporting why there was “only one uniquely qualified service provider capable of performing the needed service” or why the non-competitive contract was “in the best interest of the state.” Our review of four of the contract files revealed that the department did not have documentation to indicate that alternative vendors were considered. Our review of the other two contract files contained evidence that in each case one vendor other than the eventual contractor was considered; however, the department did not adequately document why the competitor could not provide the services needed by the department. The primary purposes of the six contracts were to provide public service announcements on either television or radio related to health issues and to provide computer services. The total contract amount for the audit period for the six contracts noted above was \$1,661,330.

If the department does not thoroughly document valid reasons for entering into non-competitive contracts, the state may incur excessive costs and/or receive inferior services. Also, competing vendors may be deprived of the opportunity to do business with the state.

Recommendation

Because the use of the non-competitive negotiation process by state agencies presents a potential fraud risk, the bureau directors and the Commissioner should implement stringent controls to minimize this risk of fraud when seeking contractors outside the competitive process. The Commissioner and Contract Office personnel should strive to avoid any appearance of favoritism in the procurement process and should thoroughly consider all viable alternatives before using the non-competitive negotiation process. Once the non-competitive process is selected, proof of why this method of procurement is necessary and why the contractor is the only alternative should be specifically documented. The Commissioner, Contract Office, and bureau directors should carefully monitor the contract negotiation and the award process to ensure controls are followed and to mitigate the risk of fraud within the process. The Commissioner should follow up on the contracts identified in the finding and assure himself that the non-competitive negotiation process was in the best interest of the state. Any facts supporting that conclusion should be documented in the files.

Management’s Comment

Department of Health

We concur in part. While we agree there may not have been documentation in the files that the auditors felt was “adequate,” we do not concur with the seeming assertion that the department did not put forth diligent efforts in justifying these six non-competitive contracts.

Although there are no specific guidelines as to what constitutes “adequate documentation,” we do believe that the lack of some documentation in the contract files represents a “weakness” and the department has already taken corrective action to add support documentation to the contract files. Moving forward, we will continue our efforts to obtain supporting documentation for current non-competitive contracts and develop internal guidelines for acquiring and maintaining adequate documentation for future non-competitive contracts.

However, we do not concur with the apparent assertion that the department did not put forth due diligence necessary to justify these six non-competitive contracts. The department submitted the documentation and information required by Finance and Administration’s Office of Contract Review Rule .06(a) and subsequently received approval from the Commissioner of Finance and Administration for all six requests for non-competitive negotiations examined by the auditors. Such documentation is contained in each contract file.

Furthermore, we believe staff made reasonable efforts to justify the use of non-competitive contracts. For example, the contract with QS Technologies, Inc., (\$1.192 million [72%] of the \$1.661 million examined) has been a long-standing non-competitive contract for the maintenance and support of the department’s Patient Tracking, Billing Management Information System (PTBMIS). QS Technologies (QST) developed the software for this system that enables the department to coordinate the provision of health care services statewide. General Services administered this contract before the department’s assumption of the responsibility. There is documentation contained in the contract file which indicates a “sole-source” request was presented to General Services. There is further documentation in the file that General Services subsequently approved a non-competitive contract with QST for software maintenance and license usage. When Health assumed the administration of this contract, we had no reason to believe the contract should not remain non-competitive. However, when audited, the contract file did not contain “hard” evidence attesting to the fact that QST owns the copyrights to the software. The department has obtained the appropriate documentation to support the non-competitive contract with QST, and this documentation has been added to the contract file.

Department of Finance and Administration

We concur. A request for a non-competitive procurement, which included justification, was submitted by the Department of Health to F&A OCR and subsequently approved by F&A OCR. F&A generally accepts a department’s statements in the justification as fact without requiring additional documentation from the department. We agree, as appropriate, a department should have additional documentation to support their statements of fact that are included in the justification.

3. For the past 19 years, the department has continued to circumvent the state's employment process by using grant agreements to obtain staffing services

Finding

As noted in audit reports since 1986, the Department of Health has used grant agreements with a nonprofit organization, community services agencies (CSAs), and human resource agencies (HRAs) to obtain staffing services used to assist in implementing programs. In the response to the prior audit finding, management indicated that a plan would be developed to address the auditors' concerns with these grant agreements; however, no such plan was developed. Although the department made progress during the audit period in reducing the number of individuals under grant agreements from 77 as of June 30, 2002, to 37 for grant agreements entered into for fiscal year 2004, these agreements continue to circumvent the state's employment process. The following characteristics of these relationships indicate these individuals are acting as state employees.

1. The contractors' employees are performing the same functions as state and county employees and are interchangeable with them.
2. The state still retains the basic responsibility for the administration of the programs through the grant agreements with the above-mentioned agencies.
3. The Department of Health or the Department of Personnel establishes the related job specifications, and state employees interview prospective individuals to fill vacant positions.
4. The department assigns and has established the acceptable procedures for day-to-day tasks and responsibilities of these contractors' employees. The department supervises and reviews the performance of the contractors' employees.
5. The department retains the right of termination for these employees for either misconduct or security reasons.
6. The grant agreements do not mention a specific project. The scope of services section in the grant agreements describes work of a day-to-day nature.
7. The contractors invoice the state based upon their employees' actual time worked as opposed to accomplished results.
8. In addition to working in the Cordell Hull state office building and the department's regional offices and county health departments, the contractors' employees also use the state's equipment and supplies.
9. The department uses the Patient Tracking and Billing Management Information System (PTBMIS) in its county health departments. On this system, there is no difference shown between state and contractors' employees. Furthermore, there is no difference between

state and contractors' employees when indirect costs are allocated within the county health departments.

10. The department pays the accrued leave balances of these contractors' employees when their employment is terminated.
11. A departmental policy even states that for these contractors' employees, "salary increases shall be allowable provided they are consistent with salary increases received by State employees," if funding is available or provided for this purpose.

Chapter 0620-3-3-.08(1) of the *Rules of the Department of Finance and Administration* defines a grant as "a contract used to effect an award of funding or property to a grant recipient or grantee. Deliverables pursuant to a Grant Contract shall be comprised of services to third-party beneficiaries rather than services provided to the State." These rules continue to give three examples of acceptable uses of grants. They are

1. a contract effecting an award to a nonprofit organization or governmental entity, the primary purpose of which is to grant funds to finance operations or program activities;
2. a contract passing through a federal award which specifically identifies by name a grantee or subrecipient; or
3. a contract effecting an award to fund work toward the completion of an activity or program which could not otherwise be more advantageously procured under a fee-for-service type contract. . . .

Also, Chapter 0620-3-3-.07(12) 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 grant agreements, the department in effect circumvented the state's employment process for obtaining staff. The state's employment process would have included a state application, an independent examination by the Department of Personnel, development of a register by the Department of Personnel, and preference given to veterans. Also, since the state's employment process was avoided, the Department of Personnel's *Rules* designed to protect state employees concerning tenure, suspension, termination, privileges, benefits, and other rights would not be available to these contracted employees. For example, these individuals, except for the community services agencies' employees, would not have access to the Office of the Attorney General and Reporter providing defense counsel. Therefore, the department should not use grant agreements in these situations.

Furthermore, the state apparently has incurred additional cost by contracting with non-state entities to provide individuals. In addition to paying the salaries and benefits, travel, training, and supplies of these “employees,” an additional administrative fee is paid to these organizations. Secondly, the department also pays the CSAs for equipment rental and maintenance, telephone, postage and shipping, printing and publications, insurance, and occupancy for the administrative functions of the community services agencies. Also, the department does not have a current cost-benefit analysis that proves the benefit of this method of obtaining “employees.”

In discussions with the Commissioner of the Department of Health, the Commissioner has stated that the department will not add new agreements of this nature in the future and the existing agreements will be resolved over time through attrition.

Recommendation

The Department of Health should not enter into any new grant agreements with nonprofit organizations, community services agencies, or human resource agencies to provide individuals who are, in effect, performing state services. Either these contractors’ employees should be placed on the state payroll system through the proper employment procedures, or existing state employees should perform all state responsibilities. Also, the department should continue, through attrition, to eliminate these employment grant agreements.

Management’s Comment

We concur. The department will continue to make every attempt possible to eliminate the need for these agreements without sacrificing public health services. This will be accomplished through attrition without creating new state positions or jeopardizing the benefits of grant employees.

4. The department did not approve contracts before the beginning of the contract period

Finding

As noted in the five prior audits, the Department of Health did not approve contracts before the beginning of the contract period. Management concurred with the prior audit finding and indicated that steps would be taken to correct the problem. However, based on testwork performed, this deficiency has not been corrected.

Testwork revealed that 17 of 25 contracts (68%) tested were not approved on or before the effective date. These contracts were approved between 13 to 97 days late for an average of 44 days late. An analysis of these late contracts indicated that 88% were initiated by Bureau of Health Services Administration (HSA), 6% were initiated by the Bureau of Alcohol and Drug Abuse Services, and 6%

were initiated by the Bureau of Health Licensure and Regulation. While no payments were made against a contract until it was fully approved, potential liabilities to the state occurred because the contracts were without proper authorization.

Chapter 0620-3-3-.06(3) of the *Rules of the Department of Finance and Administration* states that “upon approval by the Commissioner of Finance and Administration, a contract shall be fully approved.” If contracts are not approved before the contract period begins and before services are rendered, the state could be obligated to pay for unauthorized services.

Recommendation

The department’s bureau directors should adhere to the department’s deadlines for submitting contracts for review and Commissioner approval to help ensure the contracts will be completely approved before the beginning of the contract period.

Management’s Comment

We concur. Some contracts were not signed by all appropriate authorities before the start date. Based on the auditors’ fieldwork, it appears that certain program areas account for the majority of the department’s late contracts. Seven (41%) of the late contracts were new endowment grants to local hospitals for the Bioterrorism Hospital Preparedness Program. The department anticipates implementing a new online contract management system by July 1, 2005. The department will continue working with the identified program areas in the department with late contracts in order to ensure timely processing in the future.

BOARD OF SOCIAL WORKER CERTIFICATION AND LICENSURE

Our objectives in reviewing the board were to determine whether

- procedures and controls over cash receipts were adequate,
- applicants for certification as a Certified Master Social Worker were properly certified in accordance with state law, and
- disciplinary actions taken by the board against certificate or license holders were in accordance with relevant policies and procedures.

We interviewed key department personnel and reviewed state laws to gain an understanding of legal requirements for the board. We interviewed personnel responsible for cash receipts and reviewed supporting documentation to determine if policies and procedures were adequate. In addition, we tested a nonstatistical sample of Certified Master Social Workers to determine whether they had been properly certified in accordance with state law. Finally, we reviewed supporting documentation to

determine if disciplinary action taken by the board was in accordance with relevant policies and procedures.

Based on our interviews and review of supporting documentation, we determined that the board complied with applicable state laws and policies and that controls were adequate, except for cash receipts. We noted that an Office of Internal Audit report on the controls over cash receipts revealed several weaknesses. However, these weaknesses were substantially corrected during our audit period. We determined that Certified Master Social Workers were properly certified and that disciplinary action taken by the board was in accordance with relevant policies and procedures.

PAYMENT CARDS

Our objectives in reviewing controls and procedures over the use of payment cards were to determine whether

- internal controls over payment cards were adequate;
- payment card purchases were adequately supported, approved, and reconciled to the monthly bank statement;
- cardholder cycle dollar limit increases were properly justified;
- terminated employees' payment cards were revoked timely;
- payment card purchases appeared reasonable and valid; and
- payment card purchases complied with the Department of General Services Purchasing policies and procedures concerning recurring purchases; purchases from statewide contract; and purchases requiring bids, including purchases that were split to avoid bid requirements.

We reviewed the applicable laws and regulations, interviewed key department personnel, and reviewed supporting documentation to gain an understanding of the controls and procedures over payment cards. We tested a sample of payment card transactions for adequate documentation, proper approvals, and reconciliation to the bank statement. We also tested for purchases which exceeded the single purchase dollar limit, and to determine if purchases appeared reasonable and necessary for the conduct of state business. In addition, we tested listings of suspicious vendors, items purchased on a weekend or holiday, multiple purchases from an individual vendor which exceeded \$2,000 over a two-day period, and purchases of items which were prohibited by policies and procedures governing payment card purchases, and to determine if purchases appeared reasonable and necessary. We reviewed the department's justification for cardholder cycle dollar limit increases. We reviewed evidence that terminated employees' cards had been canceled. We tested a sample and several listings of purchases and transaction logs for compliance with the Department of General Services' purchasing

policies and procedures and determined whether the purchases appeared reasonable and necessary for the conduct of state business.

Based on our interviews and our review of supporting documentation, we determined that internal controls over payment cards were inadequate and that certain purchases were not adequately supported, approved, or reconciled to the bank statements. Also, we determined that the department did not adequately justify increasing cardholder cycle dollar limits and that terminated employees' payment cards were not revoked in a timely manner (see finding 5). We determined that certain payment card purchases did not appear to be reasonable and necessary to conduct state business. We determined that payment card purchases did not always comply with Department of General Services policies, the department bought items of a recurring nature without purchasing from a statewide contract, bids were not solicited when required by state law and purchasing policies, items were not purchased through a statewide contract when a statewide contract was available, and invoices appeared to be split to avoid state bidding provisions (see finding 6).

5. The department did not establish adequate internal control over purchases made using payment cards

Finding

The department has not established adequate internal control for departmental purchases made using the state's payment cards. The Department of Finance and Administration implemented the State Payment Card system in March 2002 to provide departmental personnel an alternative payment method for small purchases. A review of the department's purchasing and payment card process revealed the following internal control problems:

- The department did not adequately document the justification for cardholder cycle dollar limit increases. Twenty-three of 134 payment cardholders tested (17%) had cycle dollar limits greater than the state's standard \$2,500 limit. The cardholders' increased monthly cycle limits ranged from \$5,000 to \$80,000. For 2 of the 23 increases, justification appeared adequate. For 21 of 23 cardholders (91%) whose cycle dollar limit was increased, there was either no documented reason for the increase in purchasing capability or the reason given was not justified. Section 3.0, *State of Tennessee Payment Card Cardholder Manual*, states that the cycle dollar limit "is determined by the agency on an individual cardholder basis." However, sufficient justification is essential when the department changes the cycle dollar limit.
- Testwork on transaction logs revealed that 12 of 438 payment card transaction logs (3%) totaling \$11,473 could not be located by the department or by the Department of Finance and Administration, where the logs are submitted for review. The transaction logs document the cardholders' payment card purchases for a specific period of time which is called the transaction cycle. Three of the 12 logs totaling \$2,043.84 were submitted subsequent to fieldwork.

- One hundred twenty-nine of 1,960 payment card purchases tested (7%) totaling \$32,089 were not adequately supported with receipts. Testwork did reveal that the department had taken administrative action, including terminating the employees' credit cards. In addition, subsequent to audit testwork, the department was able to obtain the documentation from the vendors and provide all 129 receipts. Section 5.1 of the *State of Tennessee Payment Card Cardholder Manual*, entitled "General Cardholder Responsibilities," Item 7, instructs cardholders to "Retain receipts for all purchases and VISA charge signature slips for in-person transactions." In addition, Section 4B, *Department of Health Purchasing Card Procedures*, states, "It is the responsibility of the cardholder to obtain receipts."
- Thirteen of 426 payment card transaction logs tested (3%) did not reconcile to the applicable bank statements. For 4 of 13 transaction logs, the transaction log totals were less than the bank statements by \$4,354. For 5 of 13 logs, the log totals exceeded the bank statements by \$3,433. For the remaining four logs, the department could not provide documentation that reconciliations were performed. Section 5.1 of the *State of Tennessee Payment Card Cardholder Manual*, entitled "General Cardholder Responsibilities," Item 9, outlines the need to agree transaction logs with bank statements, instructing cardholders to "Reconcile each cycle's U.S. Bank statement with that cycle's corresponding Transaction Log."
- Forty-eight of 426 payment card transaction logs tested (11%) totaling \$443,957 were not properly approved by a supervisor. Section 6.0 of the *State of Tennessee Payment Card Cardholder Manual*, Item 3, requires supervisors to "Review, certify, and forward Cardholder Transaction Logs and/or Statements (depending on agency guidelines) in a timely manner in order to meet agency cycle deadlines."
- The department did not cancel former employees' payment cards on a timely basis. Testwork revealed that five of seven former employees tested (71%) had payment cards that were not canceled when employment terminated. The payment cards were terminated between 9 and 152 days late (an average of 85 days late). In addition, for one employee who terminated employment September 12, 2003, a purchase was charged to this employee's card. An additional review of the employee's transaction log for November 21, 2003, through December 20, 2003, revealed a transaction with Hemocue, a vendor of medical supplies, on October 14, 2003. The bank statement showed the transaction for December 6, 2003. According to department personnel, the arrangement with this vendor was a standing order to purchase hemoglobin controls which are automatically shipped to the department every three months. Because the department failed to cancel the employee's card when she terminated employment, the account was still open, and the vendor processed the purchase and charged the account. When the department received the bank statement, staff prepared the transaction log for this cardholder since she was no longer employed. This was the only purchase made to the account after termination of the employee.

Based on our testwork of the items noted above, it appeared that while the department's controls over payment card transactions were deficient, the department's purchases were for appropriate business purposes. Absent effective internal control, the risk of fraud in payment card transactions is high. When established controls are not followed, management and staff cannot ensure that purchases are necessary, authorized, and in compliance with purchasing policies and procedures.

Recommendation

The Commissioner should monitor the payment card process to ensure that purchasing and fiscal staff follow established policies and control procedures for payment card transactions. The department's payment card coordinator should ensure that all staff adhere to the established controls. The department's fiscal and purchasing staff should continue to provide training to all staff that are responsible for purchasing with payment cards. The Commissioner should ensure that appropriate disciplinary action is taken for employees who fail to follow established guidelines and controls related to the payment card process. This disciplinary action should include holding employees financially liable as authorized by Section 6.0 of the *State of Tennessee Payment Card Cardholder Manual*, which allows the department to hold the supervisor liable for any charges that the supervisor approves for payment which are subsequently determined to be improper. The manual also allows the department to hold the cardholder financially responsible for misuse of the card. Failure to do so could subject the Commissioner to personal liability per Section 12-3-105(c), *Tennessee Code Annotated*, which states

(c) If any such department, institution or agency, including the department of general services, purchases any supplies, materials, or equipment contrary to the provisions of this chapter or the rules and regulations made hereunder, the head of such department, institution or agency shall be personally liable for the costs thereof, and if such supplies, materials, or equipment are so unlawfully purchased and paid for out of state moneys, the amount thereof may be recovered in the name of the state in an appropriate action instituted therefor.

Management's Comment

We concur. Corrective action has been implemented. In March 2004, the Payment Card Procedures Manual was completed and re-training of all cardholders was initiated. Effective April 2004, all cardholders were re-trained on purchasing rules and payment card procedures. The department's payment card coordinator reviews every purchase made with the payment cards. If potential violations have occurred, the cardholder, approver, and supervisor are notified in writing and a written justification is required. If continued violations occur with the same cardholder or approver, additional training will be required and/or appropriate disciplinary action will be taken for employees who fail to follow established guidelines and controls related to the payment card process.

6. The department did not comply with state purchasing policies and procedures

Finding

The department did not comply with state purchasing policies and procedures when purchasing goods and services. Our audit procedures included a review of the department's purchases made using the state's payment card as a method of payment. Testwork revealed the following:

- Employees of the department did not solicit bids as required by state law. For 116 of 1,960 purchases tested (6%) totaling \$29,019, the cardholder violated purchasing rules by not obtaining bids for purchases of items, which either exceeded \$400 singly or when aggregated by vendor for a given transaction cycle. The Department of General Services Purchasing Division *Agency Purchasing Procedures Manual* states, "Statutes require that agencies secure at least three (3) competitive bids, whenever practical, on all Delegated Purchases which exceed \$400.00." In addition, 570 of 1,594 purchases tested (36%) totaling \$83,401 were for items of a recurring nature. If the value of the items was aggregated, the department would be required to use a Statewide Contract or in some instances to secure bids. The *Agency Purchasing Procedures Manual* states that a "Local Purchase Authority should not be used for purchases of a **recurring** nature where purchases by the Purchasing Division in larger volume will result in savings."
- Employees purchased items without using a statewide contract although these items were available on statewide contract. Three hundred seventy-eight of 1,970 purchases tested (19%) totaling \$57,087 should have been purchased on statewide contracts, agency term contracts, or through other state agencies such as Central Stores or the Tennessee Rehabilitative Initiative in Correction (TRICOR). The *Agency Purchasing Procedures Manual* states, "All agencies must utilize existing statewide contracts." Section 4.1.6 of the *State of Tennessee Payment Card Cardholder Manual* states, "Purchases of any supply, material, or equipment covered by a statewide or agency term contract **shall not** be made using the State Payment Card. This is in violation of TCA section 12-3-105." Section 12-3-105(c), *Tennessee Code Annotated*, states, "If any such department, institution or agency, including the department of general services, purchases any supplies, materials, or equipment contrary to the provisions of this chapter or the rules and regulations made hereunder, the head of such department, institution or agency shall be personally liable for the costs thereof, and if such supplies, materials, or equipment are so unlawfully purchased and paid for out of state moneys, the amount thereof may be recovered in the name of the state in an appropriate action instituted therefor."
- Employees "split" invoices, thus circumventing state purchasing rules. For 26 of 1,986 purchases tested (1%) totaling \$6,223, invoices appeared to be split to avoid state bidding provisions. "Invoice splitting" occurs when a single purchase is split into multiple purchases where each is below a limit that requires bids or other purchasing controls. For example, in one case an employee incurred an expenditure for an item which cost \$275 and also made

an identical purchase on the same day. If the employee had combined the purchases, the single purchase would have exceeded \$400 and would have required the department to obtain bids. Section 4.1.14 of the *State of Tennessee Payment Card Cardholder Manual* states, "Purchases **shall not** be artificially divided so as to appear to be purchases under \$400.00. Such practice is referred to as a 'split invoice' and is specifically prohibited under TCA section 12-3-210." Section 12-3-210(a), *Tennessee Code Annotated*, states, "Any procurement not exceeding two thousand dollars (\$2,000), for which a source of supply has not otherwise been established, shall be made without requisitioning such goods or services through the department; provided, that procurement requirements shall not be artificially divided so as to constitute a small purchase under this section."

In addition to the violations of the state purchasing regulations, other problems were noted:

- Fifty-one of 1,970 purchases tested (3%) did not appear to be reasonable and necessary for the conduct of state business. These purchases included 44 items totaling \$5,800 for items purchased from Franklin Covey, an upscale office supply vendor. Items from Franklin Covey are more expensive than similar items available from statewide contract, or in the absence of statewide contracts, from other vendors. Items purchased included day planners, planner refills, calendars, and leather planner binders.

When state purchasing policies and procedures are not followed, the risk of inappropriate use of state funds increases. In addition, when statewide contracts are not utilized to the fullest extent possible, the state may not get the best possible price for goods and services purchased.

Recommendation

The Department of Health's purchasing division should establish the oversight necessary to ensure that all cardholders fully comply with all applicable purchasing policies and procedures. The department's fiscal and purchasing staff should systematically analyze the demand for goods and services of all its divisions and determine how to procure goods and services in accordance with the state's purchasing regulations.

Management's Comment

Department of Health

We concur in part. In March 2004, the Payment Card Procedures Manual was completed and re-training of all cardholders was initiated. Effective April 2004, all cardholders were re-trained on purchasing rules by representatives of the Department of General Services' Purchasing Division, the Department of Finance and Administration's Division of Accounts and the Department of Health's Division of Fiscal Services. However, it continues to be difficult to navigate within the General Services

Purchasing website to determine if a needed item is on a statewide contract, especially for employees with limited purchasing experience.

However, we do not concur with the interpretation of the rules to require the aggregation of purchases department wide by vendor for a given transaction cycle. The department does not believe it is cost effective to aggregate purchases for all 95 county offices, as additional central office staff would be required to accommodate the increased workload, as well as the potential for increased cost of storage and transportation. Also, such aggregation creates the potential for critical supply needs to be delayed or unfilled for extended timeframes.

Department of General Services

We concur. Based upon the information provided by State Audit, the Department of Health needs to do a better job of procurement within the state statutes, rules and regulations of the Department General Services. The Purchasing Office of the Department of General Services is willing to assist with additional training as requested.

Department of Finance and Administration

We concur. The payment card process is a very efficient method of payment and provides an excellent audit trail. Because of the card's reporting capability, purchasing patterns can reveal misuse of the card, violations of purchasing procedures or the need for additional training.

Auditor Comment

The Department of Finance and Administration and the Department of General Services agreed with our position. If the Department of Health determines that an exception to the rules noted above is necessary, then the department should seek an exception with the Department of General Services.

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. In addition, the head of each executive agency is required to conduct an evaluation of the agency's internal accounting and administrative control and submit a report by December 31, 1999, and December 31 of every fourth year thereafter.

Our objectives were to determine whether

- the department's June 30, 2003, responsibility letter and December 31, 2003, internal accounting and administrative control report were filed in compliance with Section 9-18-104, *Tennessee Code Annotated*;
- documentation to support the department's evaluation of its internal accounting and administrative control was properly maintained;
- procedures used in compiling information for the internal accounting and administrative control report were in accordance with the guidelines prescribed under Section 9-18-103, *Tennessee Code Annotated*; and
- if applicable, the department implemented corrective action for weaknesses identified in the report.

We interviewed key employees responsible for compiling information for the internal accounting and administrative control report to gain an understanding of the department's procedures. We also reviewed the June 30, 2003, responsibility letter and the December 31, 2003, internal accounting and administrative control report and supporting documentation to determine whether they had been properly submitted to the Comptroller of the Treasury and the Department of Finance and Administration. We reviewed the supporting documentation for the department's evaluation of its internal accounting and administrative controls. We also reviewed the department's procedures for compilation of the evaluation results and report preparation. We reviewed the report and supporting documentation, and discussed whether the evaluation resulted in any weaknesses.

We determined that the Financial Integrity Act June 30, 2003, responsibility letter was not submitted timely (see finding 7). The internal accounting and administrative control report was submitted on time, and procedures used were in compliance with *Tennessee Code Annotated*. In addition, the department maintained support for the internal accounting and administrative control report, except for the Commissioner's Office, which did not provide the necessary information so that department staff could evaluate the controls for that office (see finding 7). The department's procedures for compilation of the evaluation results and for report preparation were adequate, except that one office did not follow procedures to evaluate controls. The department did not have any identified weakness for correction.

7. The department did not comply with all provisions of the Financial Integrity Act

Finding

The Department of Health did not comply with the Financial Integrity Act by preparing and submitting a responsibility letter by June 30, 2003, acknowledging responsibility for maintaining the internal control system of the department. In addition, a risk assessment of controls for the

Commissioner's Office was not performed in conjunction with the department's assessment of internal accounting and administrative controls for the Financial Integrity Act Report for December 31, 2003.

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 (F&A) and the Comptroller of the Treasury by June 30, 1999, and each year thereafter. Also, this law requires the department to perform an evaluation of the internal and administrative controls of the department and submit a report to the Commissioner of the Department of Finance and Administration and the Comptroller of the Treasury every four years.

Based on a review of the documentation supporting the four-year report, management of the Department of Health planned to obtain internal accounting and administrative control risk assessments for each bureau within the department. However, the Commissioner's Office in the Department of Health did not provide the necessary information so that department staff could evaluate the controls for that bureau.

Without proper evaluation of the internal accounting and administrative controls in all bureaus within the department, management has not fulfilled its responsibility for maintaining the internal control system of the department.

Recommendation

The Commissioner of the Department of Health should ensure that the required letter is submitted to the Commissioner of Finance and Administration and the Comptroller of the Treasury by the submission deadlines. The Commissioner and staff should also ensure that, when applicable, all offices and bureaus within the department provide all information necessary to evaluate internal and administrative controls.

Management's Comment

We concur in part. We acknowledge that the June 30, 2003, internal control responsibility letter was not submitted. This was because the department had not interpreted T.C.A. §9-18-104(a) to require the June acknowledgement letter in the same year that the December evaluation report required in T.C.A. §9-18-104(b) was filed. Steps have been taken to ensure that the June acknowledgement letter is filed each year.

We do not concur with the statement in the finding that "management has not fulfilled its responsibility for maintaining the internal control system" because the one office did not complete an internal control evaluation. The Department's Office of Internal Audit considered the lack of information from that office in its evaluation of the department's overall internal control system and determined the negative impact from the lack of that information on the overall assessment of the internal controls in the

Department to be immaterial. This was due to the few staff in the office (16), the small annual budget (less than \$200,000 in non-salary expenses), the lack of handling risky transactions (cash), and the ethical standards placed on the key members of the staff by the Governor's Executive Orders. However, we agree that all bureaus should complete the internal control evaluations and steps have been taken to ensure that is done in the future.

Auditor Comment

We think it is important for the head of the department to set the proper tone for the department as whole.

OBSERVATIONS AND COMMENTS

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99 promulgated by the American Institute of Certified Public Accountants requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statement due to fraud. The standard also restates the obvious premise that management, and not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments. During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate.

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 Health filed its compliance reports and implementation plans on July 1, 2003, and June 30, 2004.

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 Tennessee Title VI Compliance Commission is responsible for 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.

APPENDIX

DIVISIONS AND ALLOTMENT CODES

Department of Health allotment codes:

- 343.01 Executive Administration
- 343.03 Bureau of Administrative Services
- 343.04 Bureau of Information Systems
- 343.05 Office of Health Licensure and Regulation
- 343.07 Emergency Medical Services
- 343.08 Laboratory Services
- 343.10 Health Related Boards
- 343.20 Policy Planning and Assessment
- 343.39 Division of General Environmental Health
- 343.44 Bureau of Alcohol and Drug Abuse Services
- 343.45 Health Services Administration
- 343.47 Maternal and Child Health
- 343.49 Communicable and Environmental Disease Services
- 343.52 Population-Based Services
- 343.53 WIC Supplemental Foods
- 343.60 Local Health Services