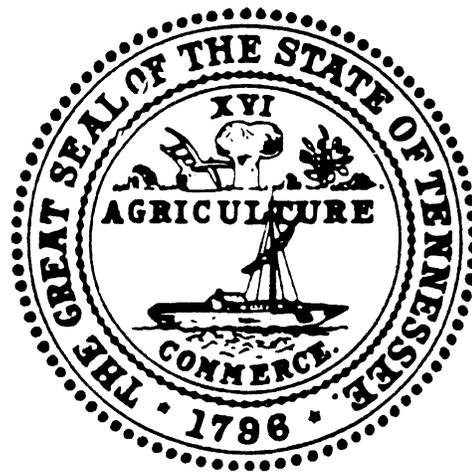


AUDIT REPORT

Department of Mental Health and Developmental Disabilities

July 2006



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit
Division of State Audit



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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

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John G. Morgan
Comptroller

July 11, 2006

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

The Honorable Virginia Trotter Betts, MSN, JD, RN, FAAN, Commissioner
Department of Mental Health and Developmental Disabilities
Cordell Hull Building, Third Floor
425 Fifth Avenue North
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Department of Mental Health and Developmental Disabilities for the period June 1, 2003, through August 31, 2005.

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

JGM/th
05/065



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

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August 31, 2005

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 Mental Health and Developmental Disabilities for the period June 1, 2003, through August 31, 2005.

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 Mental Health and Developmental Disabilities' compliance with laws, regulations, and provisions of contracts significant to the audit objectives. Management of the Department of Mental Health and Developmental Disabilities is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts.

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 Mental Health and Developmental Disabilities' management in a separate letter.

Sincerely,

A handwritten signature in black ink that reads "Arthur A. Hayes, Jr." with a stylized flourish at the end.

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 Mental Health and Developmental Disabilities
July 2006

AUDIT SCOPE

We have audited the Department of Mental Health and Developmental Disabilities for the period June 1, 2003, through August 31, 2005. 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 trust funds, payment cards, contracts, cash receipts, bank accounts, licensure revenue, consultant travel claims, the Behavioral Health Information System, inventory, Title VI of the Civil Rights Act of 1964, and the Financial Integrity Act. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. 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; participating in the negotiation and procurement of services for the state; and providing support staff to various legislative committees and commissions.

AUDIT FINDINGS

The Department Has Not Properly Assessed and Mitigated the Risks Associated With the Law Governing Patient Trust Fund Balances, Which May Prevent the Patients From Claiming Their Trust Funds and the Institutions From Benefiting From Unclaimed Trust Funds as Allowed by State Law**

The department's administration of individual trust fund balances of discharged patients and/or deceased patients did not comply with state law (page 5).

Management Has Not Adequately Assessed the Risks Associated With Payment Card Purchases

Payment card users did not have the proper approvals to be a cardholder, and payment card transactions did not comply with state policies and procedures (page 9).

Management Has Not Adequately Assessed and Mitigated the Risks Associated With Failure to Approve Contracts Before the Beginning of the Contract Period, and Therefore the Department Could Be Obligated to Pay for Unauthorized Services**

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

Management Has Not Adequately Assessed or Mitigated the Risks Associated With the Collection of Cash for Licenses Issued, and as a Result, the Department Cannot Ensure It Has Received the Revenue It Is Due

The department could not account for all revenue received during the audit period and did not reconcile license revenue received with actual licenses issued during the audit period. Although controls were deficient, we found no evidence of fraud (page 14).

Management of the Department Has Not Assessed and Mitigated the Risks of Unauthorized Access to the Department's Behavioral Health Information System

Former employees retained access to the Behavioral Health Information System, increasing the risk of inappropriate access to the system (page 16).

Management Has Not Adequately Assessed Risks Associated With the Department's Inventory System and Has Not Implemented Effective Controls to Ensure That Inventory Is Properly Accounted For**

The Statewide Mental Health Institutes have not adequately addressed the risks with the inventory control systems over pharmacy, central medical, purchasing supply items (page 18).

** This finding is repeated from prior audits.

Financial and Compliance Audit

Department of Mental Health and Developmental Disabilities

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Financial and Compliance Audit Department of Mental Health and Developmental Disabilities

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Department of Mental Health and Developmental Disabilities. 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.”

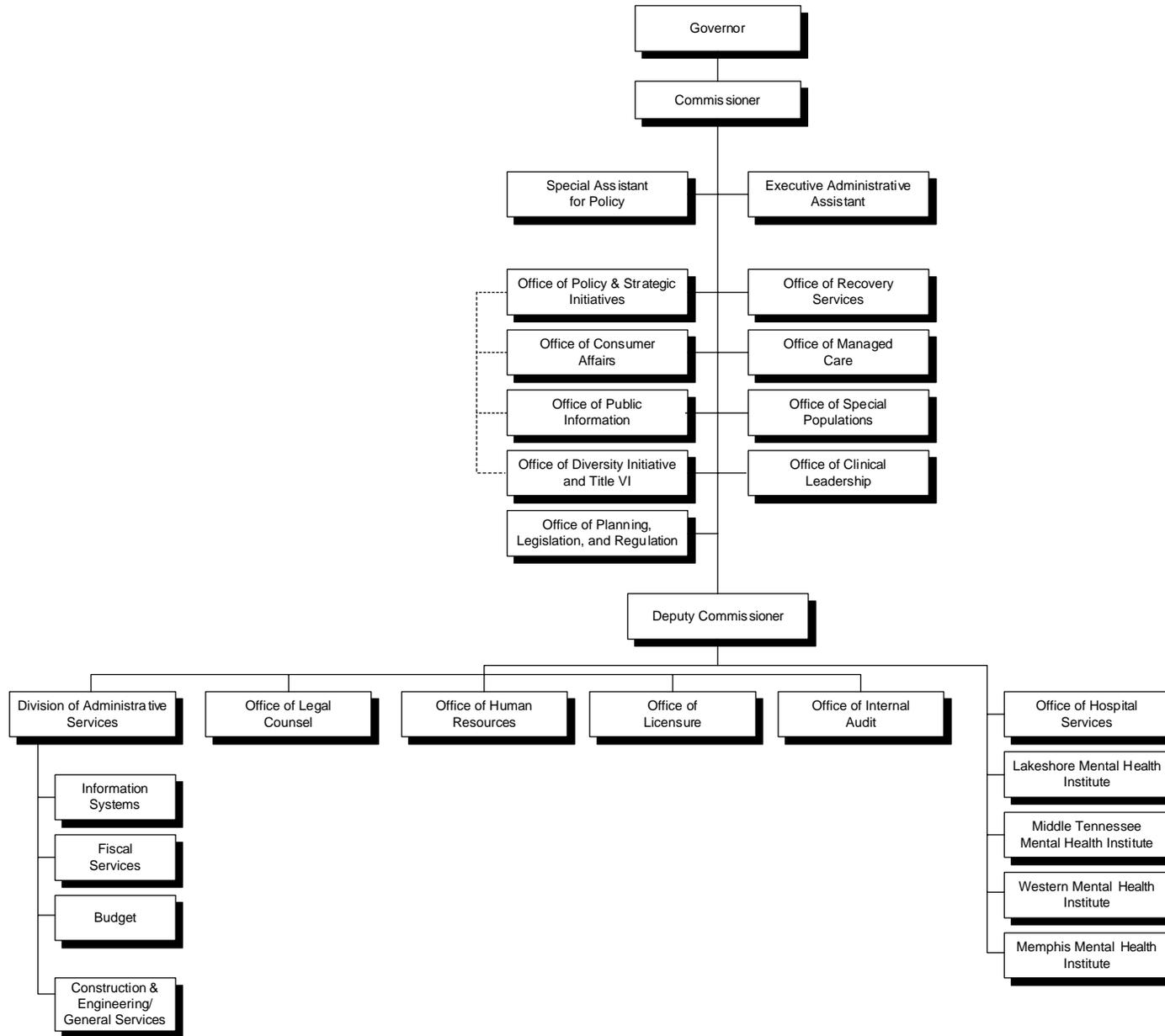
Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The department is the state’s mental health and developmental disabilities authority and is responsible for system planning, setting policy and quality standards, system monitoring and evaluation, disseminating public information, and advocacy for persons of all ages who have mental illness, serious emotional disturbance, or developmental disabilities. The department’s mission is to plan for and promote the availability of a comprehensive array of quality prevention, early intervention, treatment, habilitation, and rehabilitation services and supports based on needs of individuals with mental illness, serious emotional disturbance, or developmental disabilities. By agreement with the Bureau of TennCare, the department also oversees and monitors the programmatic components of the TennCare Partners Program; monitoring responsibilities include assessment of the adequacy of the provider network and the quality of services provided.

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

Department of Mental Health and Developmental Disabilities Organization Chart



AUDIT SCOPE

We have audited the Department of Mental Health and Developmental Disabilities for the period June 1, 2003, through August 31, 2005. 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 trust funds, payment cards, contracts, cash receipts, bank accounts, licensure revenue, consultant travel claims, the Behavioral Health Information System, inventory, Title VI of the Civil Rights Act of 1964, and the Financial Integrity Act. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. 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; participating in the negotiation and procurement of services for the state; and providing support staff to various legislative committees and commissions.

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 Mental Health and Developmental Disabilities filed its report with the Department of Audit on March 31, 2004. A follow-up of all prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the Department of Mental Health and Developmental Disabilities has corrected previous audit findings concerning

- the ineffective control environment of the department,
- the lack of uniform related-party transaction policy,
- inadequate internal controls over the cash-receipt and check-writing process at Middle Tennessee Mental Health Institute,
- inadequate internal controls over the revenue recorded in the Behavioral Health Information System, and
- incorrect processing of travel claims.

REPEATED AUDIT FINDINGS

The prior audit report also contained findings concerning

- untimely approval of contracts,
- inadequate and ambiguous policies governing discharged patients' trust fund balances, and
- improper maintenance of the department's inventory systems.

These findings have not been resolved and are repeated in the applicable sections of this report.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

TRUST FUNDS

The objectives of our review of the trust funds and specific-purpose funds in the Department of Mental Health and Developmental Disabilities' five mental health institutes were to

- document and determine the adequacy of controls over trust funds and specific-purpose funds;
- document and determine the adequacy of procedures used to compute patient payroll;
- document and determine the adequacy of procedures regarding the receipt, safekeeping, and record-keeping of patients' personal property;
- review the procedures and process of allocating interest to the trust fund and specific-purpose funds and recalculate interest allocated for one month;
- determine if the department upheld its fiduciary duty to properly administer and account for patient funds by ensuring that receipts and other fund increases were properly deposited and recorded, expenditures were properly supported with patients' or other applicable approvals where necessary, specific-purpose account expenditures were made for allowable purposes, and expenditures and other fund decreases were properly recorded; and
- determine that each institute complied with state law in the administration of discharged and/or deceased patients' trust fund balances.

We interviewed key department personnel and reviewed policies and procedures to gain and document an understanding of the controls over specific-purpose funds and trust funds, patient payroll, interest allocation to trust funds and specific-purpose funds, and patients' personal property. We recalculated interest allocated to the specific-purpose accounts for one month during the audit period. We selected nonstatistical samples of trust fund transactions occurring between June 1, 2003, and April 25, 2005, to determine if receipts were properly

deposited and recorded and to determine if expenditures were properly supported, approved, recorded, and were for allowable purposes. In addition, we selected patients with trust fund accounts of \$5.00 or more who were discharged or deceased as of September 1, October 1, and November 1, 2004, and tested samples to determine if institute staff properly handled patients' trust funds balances in compliance with state law.

Based on interviews, review of supporting documentation, and testwork we determined that controls over trust funds and specific-purpose funds, patient payroll, and patients' personal property were adequate. Also, the interest recalculated on specific-purpose accounts was accurate and interest was properly allocated. In addition, trust fund receipts were properly deposited and recorded; trust fund expenditures were supported, approved, properly recorded, and for allowable purposes.

However, we determined that the department's institutes did not comply with state law in the administration of discharged or deceased patients' fund balances as noted in finding 1:

1. The department has still not properly assessed and mitigated the risks associated with improper administration of patients' trust fund balances at death or discharge

Finding

As noted in the prior two audits, the department's central office personnel have not ensured that its mental health institutes properly notify patients or families of unclaimed trust funds balances at the time of death or discharge, and have not properly transferred unclaimed balances to the department's benevolent fund timely as required by state law.

This issue was first reported in the audit for the period July 1, 1998, through June 30, 2000. We reported that the department failed to follow state law governing trust funds of discharged or deceased patients. Furthermore, the department's policies regarding the handling of individual trust fund balances of a discharged patient were inadequate and ambiguous. The policies failed to establish a timetable for sending the notification letter to the patient and for seeking approval to transfer the balance to the benevolent fund. Management concurred with this finding and stated,

Departmental policy governing administration of the Restricted Funds and funds belonging to patients will be revised.

However, in the audit for the period July 1, 2000, through May 31, 2003, we again reported that management had not revised the policies and was still not in compliance with state law. Management concurred with this finding and stated,

Policies and procedures will be developed which clearly identify the process for return of patients' property.

In response to that prior finding, we determined that the department had implemented revised policies which addressed the handling of individual trust fund balances and established a

timetable for sending notification letters to patients and for seeking approval to transfer balances to the benevolent fund. However, timeliness of notification of patients and transfers to the benevolent fund continues to be a problem.

Section 33-4-109(d) and (e), *Tennessee Code of Annotated*, requires that

(d) If a person is discharged and leaves personal property in the facility, the chief officer shall promptly notify the person by registered mail addressed to the person's last known address that the property has been left and is subject to sale under subsection (e) if not claimed.

(e) The chief officer shall keep the deceased or discharged person's personal property for six (6) months if it is not claimed. The chief officer shall then sell the property, with the approval of the commissioner, and deposit the proceeds in a fund, maintained under the supervision of the chief officer, for the benefits of needy service recipients.

Current testwork revealed the following:

- For eight of nine discharged or deceased patients tested (89%) with trust fund balances after discharge or death, staff at Lakeshore Mental Health Institute did not follow the requirements of Section 33-4-109(e), *Tennessee Code Annotated*, by transferring funds to the benevolent fund six months after discharge. Of the eight patients' trust fund balances, seven belonged to former patients who had been discharged for more than six months. The requests by staff to transfer the trust fund balances to the benevolent fund ranged from 7 to 12 months after patient discharge. In addition, one patient's balance was transferred to the benevolent fund after four months and not maintained for the mandatory six-month period.
- For 11 of 11 discharged or deceased patients tested (100%) at Middle Tennessee Mental Health Institute, staff did not follow the requirements of Section 33-4-109(d) and (e), *Tennessee Code Annotated*, by transferring funds to the benevolent fund six months after discharge. All 11 trust fund balances belonged to former patients who had been discharged for more than six months. Staff at the institute did not request the transfer of the trust fund balances for 8 to 40 months after discharge or death. In addition, 8 of 13 patients tested (62%) were not notified of their balance in a timely manner, and of those 8 patients, 2 were not notified of a balance at all.
- For ten of ten discharged or deceased patients tested (100%) at Moccasin Bend Mental Health Institute, staff did not follow the requirements of Section 33-4-109(e), *Tennessee Code Annotated*. The balances of all ten patients were not transferred to the benevolent fund within six months as required. Staff requested the transfer of the balances to the benevolent fund from 6.5 to 40 months after discharge or death.
- For two of three discharged or deceased patients tested (67%) at Western Mental Health Institute, staff did not follow the requirements of Section 33-4-109(e), *Tennessee Code Annotated*. Two patients' funds were transferred to the benevolent

fund an average of four months after the institute had notified the patient of the balance and not maintained for the mandatory six-month period.

- We discovered one patient at Memphis Mental Health Institute that was discharged in November 2003 and readmitted in April 2005. At the time of discharge, the patient had a trust fund balance, but that balance was never transferred to the benevolent fund. The patient's funds were added back to the patient's account. The institute did not follow the requirements of Section 33-4-109(d) and (e), *Tennessee Code Annotated*, by transferring the balance within six months to the benevolent fund and did not promptly notify the patient of the balance as required.

Failing to follow state law and departmental policy to disburse trust fund balances of discharged or deceased patients may prevent the patients from claiming their trust funds and the institutions from benefiting from unclaimed trust funds in order to serve more patients in need as allowed by state law.

Recommendation

The Commissioner should ensure that risks such as these noted in this finding are adequately identified and assessed in management's documented risk assessment activities. The Commissioner should identify specific staff to be responsible for the design and implementation of internal controls to prevent and detect exceptions timely. The Commissioner should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt action should exceptions occur.

The Commissioner should ensure all staff responsible for administering patient trust funds are familiar with the requirements of Section 33-4-109(d) and (e), *Tennessee Code of Annotated*, and that staff fulfill their fiduciary duty to patients.

Management's Comment

We concur. The Department has revised and implemented policies governing individual trust fund balances and has established a timetable for sending notification letters to patients and for seeking approval to transfer balances to the benevolent fund.

PAYMENT CARDS AND CONTRACTS

The objectives of our review of the payment cards and contracts in the Department of Mental Health and Developmental Disabilities' central office and five mental health institutes were to

- document controls over purchases using payment cards;
- determine whether cardholders were properly approved;

- determine whether payment card purchases complied with 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;
- determine whether payment card purchases were adequately supported, approved, and reconciled to the monthly bank statement;
- determine whether terminated employees' payment cards were revoked timely and whether the department retained remnants of terminated employees' payment cards;
- determine whether the use of non-competitive negotiation for contracts was justified; and
- determine whether the department approved all contracts before the beginning of the contract period.

We interviewed key department personnel and reviewed policies and procedures to gain and document an understanding of the controls over purchases using payment cards. We obtained a listing of active cardholders to determine if the cardholders had received the required approvals to be valid cardholders. We selected a nonstatistical sample of payment card transactions and also tested payment card transaction listings for June 2003, August 2003, November 2003, and February 2005, to determine if transactions were adequately supported, approved, reconciled to the monthly bank statement, and complied with Department of General Services purchasing policies and procedures. In addition, we obtained a listing of terminated employees to determine whether the cardholders' payment card privileges were terminated timely and remnants of the terminated cardholders' payment card were retained by the department. We interviewed key departmental personnel and reviewed the justification for the department's decision to pursue noncompetitive negotiation for contracts. We also selected a nonstatistical sample of contracts for the period July 1, 2003, through June 30, 2005, to determine if the department approved all contracts before the beginning of the contract period.

Based on interviews, review of documentation, and testwork, we determined that the department's use of noncompetitive negotiation in contracts was appropriate. However, as noted in finding 2 below, we found that

- department management did not properly approve cardholders;
- certain payment card purchases were not adequately supported, approved, or reconciled properly to the bank statements;
- 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 items were purchased which were prohibited by the payment card manual; and
- the department did not retain the remnants of the destroyed cards for employees who were terminated.

We also found that the department did not properly approve contracts before the beginning of the contract period. See finding 3 for further details.

2. Management has not adequately assessed and mitigated the risks associated with payment card purchases and did not follow policies and procedures for those purchases

Finding

The Department of Mental Health and Developmental Disabilities did not follow established policies and procedures governing the use of state 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:

- Department management did not properly approve 27 of 28 cardholders tested (96%) before assigning payment cards to cardholders. Of these 27 payment card users, 26 did not have a properly approved payment card application and/or cardholder agreement, and the remaining cardholder did not have a signed cardholder agreement on file at the time of our review. Management obtained a new agreement which was signed by the employee in May 2005. In addition, for 5 of 28 cardholders tested (18%), management distributed payment cards to employees and allowed them to make purchases before obtaining and approving the employees' signed cardholder agreements.
- For 52 of 69 purchase transaction logs reviewed (75%) totaling \$202,771, the cardholder did not sign and date the log as required by Section 5.3 of the *State of Tennessee Payment Card Cardholder Manual*, which states, "Certify each log sheet by signing and dating it. Forward the log and receipts to your designated approver/supervisor for review and approval. . . ." We noted that for the 52 transaction logs, the cardholder and/or approver did not properly date the transaction log as required. In addition, for 10 of the transaction logs, the transaction logs were not signed at all or contained pages that were not signed by the cardholder and/or approver or both.
- Testwork revealed that 32 of 878 payment card purchases (4%) totaling \$10,505.21 were not adequately supported with receipts or invoices that included adequate documentation of the product or service purchased. Section 5.2 of the *State of Tennessee Payment Card Cardholder Manual* entitled "Purchase Documentation" states, "All receipts must contain the following information: vendor identification, date purchase was made, and a description of each item purchased."
- For all three of the terminated employees tested (100%), the department's payment card coordinator did not retain the remnants of the destroyed card. Section 2.4 of the *State of Tennessee Payment Cardholder Manual* states, "Upon retrieval of the card, the Agency Coordinator should destroy the card by cutting it down the magnetic

stripe and the embossed card number. The Agency Coordinator shall retain the remnants of the destroyed card.”

In addition to the control problems noted above, the department did not comply with state purchasing policies and procedures when purchasing goods and services with payment cards. Testwork revealed the following:

- Employees purchased items without using a statewide contract although these items were available on statewide contract. One hundred seventy-one of 867 purchases tested (20%) totaling \$15,864.17, should have been purchased from statewide contracts, agency term contracts, or through other state agencies such as Central Stores or the Tennessee Rehabilitative Initiative in Correction (TRICOR).

Section 11.2 of the Department of General Services *Agency Purchasing Procedures Manual* states, “All State 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 purchased items of a recurring nature throughout the audit. One hundred ninety-one of 867 purchases tested (22%) totaling \$23,851.69 were for items of a recurring nature. If the value of the recurring items was aggregated, the department would be required to use a statewide contract or in some instances to secure bids. Section 11.6 of the Department of General Services Purchasing Division’s *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 which were prohibited by the payment card manual. For 2 of 873 payment card purchases (1%) totaling \$504.24, the cardholder violated purchasing rules by acquiring computer equipment items, which is prohibited by Section 4.1 of the *State of Tennessee Payment Card Cardholder Manual*.
- For one of 867 items tested (1%) totaling \$551.00, the cardholder violated purchasing rules by not obtaining bids.

Section 11.6.1 of the Department of General Services Purchasing Division *Agency Purchasing Procedures Manual* states, “Statutes require that agencies secure at least three (3) competitive bids, on all Delegated Purchases which exceed \$400.”

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. Absent effective internal control, the risk of fraud or abuse in payment card transactions is high.

Recommendation

The Commissioner and top management should develop a plan to adequately address the risks noted. As a part of the plan, the Commissioner and top management should ensure that staff responsible for the payment card purchases engage in an adequate assessment of other risks of fraud, waste, or abuse in this area. That assessment should be written and fully documented. It should be reviewed by top management and should be used to design, implement, and monitor the controls to mitigate the risks identified. Management should identify specific staff to be responsible for the design and implementation of internal controls over payment card purchases to prevent and detect exceptions timely. Management should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and for taking prompt action should exceptions occur.

The Commissioner should ensure that staff adhere to established policies and procedures. 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. The scope for which the payment card will be utilized in purchase transactions in this Department has been narrowed to ensure that payment card will be used only for authorized purchases.

3. Management has not adequately assessed and mitigated the risks associated with not approving contracts before the beginning of the contract period, and therefore the department could be obligated to pay for unauthorized services

Finding

As noted in the prior two audits, management of the Department of Mental Health and Developmental Disabilities did not properly approve all contracts before the beginning of the contract period. This issue was first noted in the audit for years ended June 30, 1999, and June 30, 2000. In response to that audit finding, management concurred with the finding and stated:

. . . The department will develop deadlines that will ensure that contracts and "Authorization to Vendor" forms are properly approved before the beginning of the contract period.

However, in the audit for the period July 1, 2000, through May 31, 2003, we again reported that the department had not properly approved all contracts before the beginning of the contract period. Management again concurred with that finding and stated:

. . . Additional controls will be adopted to ensure that all parties properly approve contracts before the beginning of the contract period.

Current audit testwork revealed that although the department has made some improvement, the department still did not ensure that 15 of 60 contracts tested (25%) were approved before the beginning of the contract period. The contracts were approved from 7 to 67 days after the beginning of the contract period. Testwork did reveal that the department did not make any payments to contractors until all of the required signatures were obtained. However, the contractors did provide services to the department before all of the required signatures were in place.

Chapter 0620-3-3-04(c)(8) of the *Rules of the Department of Finance and Administration* states,

Upon approval by the Commissioner of Finance and Administration, it [the contract] shall be an effective and binding contract.

If contracts are not approved before the contract period begins, the state could be obligated to pay for unauthorized services.

Recommendation

The Commissioner should ensure that contracts are approved before the beginning of the contract period so that contractors do not provide services to the department until a fully authorized contract is in place.

Management should ensure that risks such as these noted in this finding are adequately identified and assessed in management's documented risk assessment activities. Management should identify specific staff to be responsible for the design and implementation of internal controls to prevent and detect exceptions timely. Management should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt action should exceptions occur.

Management's Comment

We concur. A schedule has been established for issuing annual grants and contracts and a system implemented to track the process of issuing contracts to ensure that all contracts are processed on time. Each step in the process of a contract is recorded in a log with the date of the action. The log is reviewed weekly to ensure that all contracts are moving through the process to completion.

CASH RECIEPTS, BANK ACCOUNTS, AND LICENSURE REVENUE

The objectives of our review of cash receipts, bank accounts, and licensure revenue in the Department of Mental Health and Developmental Disabilities' central office and five mental health institutes were to

- gain and document an understanding of controls over cash receipts and bank accounts;
- follow up a prior finding at Middle Tennessee Mental Health Institute (MTMHI) related to weak internal controls over the cash-receipt and check-writing processes;
- determine cash collected at MTMHI is adequately supported, deposited timely and intact, and properly recorded;
- determine if petty cash or change funds were authorized by the Department of Finance and Administration;
- determine if departmental bank accounts were reconciled each month, and the reconciliations were adequately supported;
- gain and document an understanding of the controls over cash receipts collected for licenses and license issuance; and

- determine if licensure revenue received and deposited at the central office reconciled to licenses issued.

We interviewed key department personnel, and reviewed policies and procedures to gain an understanding of the controls over cash receipts and bank accounts. We followed up on the prior audit finding. We tested a nonstatistical sample of cash receipts occurring between June 1, 2003, and May 30, 2005, at MTMHI for adequate support, timely and intact deposits, and proper recording. We also reviewed the authorization for the department's petty cash funds. We reviewed the reconciliations of departmental bank accounts at the five mental health institutes to ensure that bank accounts were reconciled monthly and that reconciliations were adequately supported. In addition, we reviewed and tested a reconciliation of provider licenses issued to license revenue received by the department for the period June 1, 2003, through March 31, 2005.

Based on interviews, review of documentation, and testwork, we determined that the prior audit finding at MTMHI was corrected and that cash collected at MTMHI was deposited timely and intact, adequately supported, and correctly recorded. We determined that petty cash accounts were properly authorized and that departmental bank accounts were reconciled monthly and were adequately supported. However, we determined that the controls over the collection of license revenue were weak and that the department could not account for all license revenue from licenses issued. See finding 4 for further details.

4. Management has not adequately assessed or mitigated risks associated with the collection of cash for licenses issued, and as a result, the department cannot ensure it has received the revenue it is due

Finding

The Department of Mental Health and Developmental Disabilities has not assessed and mitigated the risk of ineffective controls over the collection of cash and issuance of provider licenses. The department issues licenses to providers which provide mental health services. Section 33-2-406, *Tennessee Code Annotated*, "Application for Licensure," states,

To lawfully establish, conduct, operate, or maintain a service or facility which provides mental health, developmental disability, or personal support services, a person, partnership, association, corporation, or any state, county or local governmental unit or any division, department, board or agency of government shall obtain a license from the department.

To obtain a license, potential providers submit license applications to one of three regional offices: the Middle Tennessee Licensure Office, the East Tennessee Licensure Office, and the West Tennessee Licensure Office. The provider must submit the license fee to the department's Fiscal Services central office in Nashville. Once Fiscal Services receives the license fee, staff notify the Office of Licensure, also located in Nashville, that all license requirements have been met. Licenses are finalized with the signature of the commissioner at the Office of Licensure and then mailed to the provider.

Based on discussions with the fiscal director and the accounting manager, we determined that neither the department's fiscal staff nor its licensure staff performed a reconciliation between licenses issued and license revenue collected. We requested that management perform this reconciliation for our audit period. The department's accounting manager attempted to reconcile licensure revenue collected of \$1,778,552 with the regions' records of license applications for the period June 1, 2003, through March 31, 2005. Management informed us that they had reconciled the 22-month period with a variance of \$18,050. However, based on our review of management's reconciliation, we found that revenue collected for the Middle Tennessee Licensure Office could not be reconciled to the records of license applications. Our testwork revealed that cash collected was \$32,950 less than the amount Middle Tennessee Licensure Office had recorded for license applications fees. Based on our testwork and discussions with the department's fiscal personnel, we determined that the Middle Tennessee Licensure Office did not keep accurate records throughout the audit period and prepared the records of application fees used in the reconciliation when requested by the auditors. While the department's controls over the license reconciliation were deficient, we did not find evidence of fraud. However, absent effective internal control, the risk of fraud in this area is possible. According to the Fiscal Director, staff will continue to improve the reconciliation process and research differences as necessary.

Because the department has been unable to reconcile licensure revenue with licenses issued, it cannot be certain the state has received all the revenue from licenses issued that the state is due. In addition, because the department has not effectively mitigated its risk by reconciling licenses issued to revenue collected, the risk of fraud by department staff is increased.

Recommendation

Management should ensure that risks such as these noted in this finding are adequately identified and assessed in management's documented risk assessment activities. Management should identify specific staff to be responsible for the design and implementation of internal controls to prevent and detect exceptions timely. Management should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt action should exceptions occur. The Commissioner should ensure that internal controls are developed and enforced over licensure revenue to ensure that revenue is properly collected, recorded, and reconciled to valid licenses issued.

Management's Comment

We concur. The Department has made arrangements to purchase a new information system specifically designed for licensure applications. Implementation is anticipated to be mid-year, 2007. In the interim, internal controls for the licensure process have been reviewed and procedures implemented to ensure revenue is collected, recorded, and reconciled to valid licenses issued.

CONSULTANT TRAVEL CLAIMS

The objective of our review of consultant travel claims was to

- follow up on a prior finding and determine if travel expenditures by consultants under contracts with Memphis Mental Health Institute were paid in accordance with the Department of Finance and Administration's Comprehensive Travel Regulations.

We tested a nonstatistical sample of travel expenditures by consultants under contracts for travel occurring between June 1, 2003, and March 31, 2005. We determined that the Memphis Mental Health Institute in all material respects processed travel claims correctly using travel regulations.

BEHAVIORAL HEALTH INFORMATION SYSTEM

The objectives of our review of the Behavioral Health Information System (BHIS) controls and procedures in the Department of Mental Health and Developmental Disabilities' five mental health institutes were to test a listing of active employees with access to BHIS to determine if all employees on the listing were still active at the institute tested and if they were not active, to determine if their access to BHIS was terminated timely.

We reviewed a listing of employees with access to BHIS to determine if all employees on the listing were still active employees at the institute or to determine that access was terminated timely when individuals left the department's employment.

Based on our discussions and testwork we concluded that the institutes did not terminate access to BHIS in a timely manner as noted in finding 5.

5. Management of the department has not assessed and mitigated the risk of inadequate access security controls for the Behavioral Health Information System

Finding

The Department of Mental Health and Developmental Disabilities did not remove employees' access to the Behavioral Health Information System (BHIS) when they left the department's employment. The department uses BHIS to record patient charges and to prepare monthly bills to patients' primary and secondary insurance providers. Current testwork revealed the following:

- At Moccasin Bend Mental Health Institute, ten employees retained access to BHIS after termination.
- At Lakeshore Mental Health Institute, nine employees retained access to BHIS after termination.

- At Middle Tennessee Mental Health Institute, seven employees retained access to BHIS after termination.
- At Memphis Mental Health Institute, five employees retained access to BHIS after termination.
- At Western Mental Health Institute, two employees retained access to BHIS after termination.

If employees' access to the BHIS system is not terminated timely when employment ends, it more difficult for management to monitor and control access to the department's systems.

Recommendation

Top management should take steps to reasonably ensure that department staff over the information technology operations are knowledgeable about the significant risks to the department's information technology operations and know how to design and implement effective controls. Top management should also document its risk assessment activities. Management should identify specific staff to be responsible for the design and implementation of internal controls. Management should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt actions should exceptions occur.

The Director of Information Systems should ensure that all persons with access to the BHIS system have appropriate access. The director should develop formal monitoring procedures to ensure that only those who need access at the institutes are granted access. In addition, the director should ensure the access is terminated promptly when individuals leave the department's employment.

Management's Comment

We concur. DMHDD has a policy that addresses the issue of removing access to network systems for terminated employees. We are developing procedures in line with that policy to ensure that access for terminated employees will be removed immediately upon termination.

INVENTORY

The objectives of our review of the inventory controls and procedures at the five mental health institutes were to determine whether inventory records matched the actual inventory amounts on hand.

We performed a test count of selected inventory items at the five mental health institutes, noting any differences between the inventory records and the actual quantity counted.

During our test counts, we determined that items on hand did not agree with the inventory records at four of the five mental health institutes. See finding 6 for further details.

6. Management has not adequately assessed risks associated with the department's inventory system and has not implemented effective controls to ensure that inventory is properly accounted for

Finding

As noted in the prior two audits, the department has not ensured that the statewide mental health institutes have adequately addressed the risks with the inventory control systems over pharmacy, central medical, and purchasing supply items. According to the Fiscal Director, problems with pharmacy inventory are primarily due to human error when drugs are entered into the inventory system as dispensed, yet unused drugs are later added back into the actual inventory on hand. The institutes use a perpetual inventory system to maintain up-to-date information regarding the amounts of inventory on hand. Under this system, the inventory records are updated at the time items are added to or removed from the inventory. This issue was first noted in the audit for years ended June 30, 1999, and June 30, 2000. In response to that audit, management stated:

. . . The department will establish a plan to conduct routine spot check counts of the stock items throughout the year. Concluding that a portion of the discrepancies can be attributed to the pharmacy software, the department is currently investigating a pharmacy software package to replace the existing pharmacy software.

However, in the audit for the period July 1, 2000, through May 31, 2003, we reported that the inventory discrepancies that were noted in the prior audit still existed. Management concurred with that finding and stated:

. . . The department's existing pharmacy system is now over 10 years old and no longer is capable of maintaining an acceptable level of accountability for the pharmaceutical inventory. The department is currently in the process of identifying and purchasing a new pharmacy system, which will provide the level of accountability required; funding limitations are a significant factor in the decision.

On July 6, 2005, management finalized the contract to purchase the new pharmacy inventory system. Management is currently in the implementation phase of system deployment and plans to pilot the new system at Western Mental Health Institute beginning June 2006 with other institutes to follow in the near future.

We performed test counts of departmental inventory which revealed that for 31 of 84 total items examined (37%), the quantity did not match the amounts shown on the inventory listing.

The following discrepancies were noted:

- For one of ten pharmacy items (10%), although the quantity on hand agreed with the inventory records, the inventory on hand included expired drugs which should have been removed from inventory. For one of ten central medical supply items (10%) examined at Lakeshore Mental Health Institute, the quantity on hand did not match the inventory listing.
- For three of ten purchasing supply inventory items (30%) examined at Memphis Mental Health Institute, the quantity on hand did not match the inventory listing.
- For six of nine pharmacy items (67%) and five of ten central medical supply items (50%) examined at Middle Tennessee Mental Health Institute, the quantity on hand did not match the inventory listing.
- For eight of ten pharmacy items (80%) examined at Moccasin Bend Mental Health Institute, the quantity on hand did not match the inventory listing.
- For seven of ten pharmacy items (70%) examined at Western Mental Health Institute, the quantity on hand did not match the inventory listing.

Without mitigating the risks associated with inventory records, the institutions cannot ensure that inventory items are adequately protected from misappropriation or loss.

Recommendation

Management should ensure that risks such as these noted in this finding are adequately identified and assessed in management's documented risk assessment activities. Management should identify specific staff to be responsible for the design and implementation of internal controls to prevent and detect exceptions timely. Management should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt action should exceptions occur. The Commissioner should ensure that internal controls are developed and enforced over inventory to ensure that items are properly accounted for. Management at each institute should ensure perpetual inventory records are kept up to date and that periodic physical inventory counts are performed and necessary adjustments are made to inventory records.

Management's Comment

We concur. Software and hardware for the new pharmacy system have been purchased and installed. Implementation at a pilot hospital is scheduled to begin June 1, 2006. The issue of accuracy of the perpetual inventory record will be resolved in the new system.

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 Mental Health and Developmental Disabilities filed its compliance reports and implementation plans on June 30, 2005; June 30, 2004; and 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 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.

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 2005, 2004, and 2003 responsibility letters and 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
- corrective actions are being implemented 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 supporting documentation to ensure that the department's evaluation of its internal accounting and administrative control was properly maintained and that procedures used in compiling information for the internal accounting and administrative control report were in accordance with *Tennessee Code Annotated*. In addition, we reviewed the June 30, 2005; June 30, 2004; and June 30, 2003, responsibility letters and the December 31, 2003, internal accounting and administrative control report to determine whether they had been properly submitted to the Comptroller of the Treasury and the Department of Finance and

Administration. To determine if corrective action plans had been implemented, we interviewed management and reviewed corrective action for the weaknesses identified in the report.

We determined that with the exception of the June 30, 2004, responsibility letter, which was submitted late on July 2, 2004, the responsibility letters were submitted timely. We determined the internal accounting and administrative control report was submitted on time, support for the internal accounting and administrative control report was properly maintained, and procedures for compiling information for the report were in compliance with *Tennessee Code Annotated*. Management has taken corrective actions for compiling information for the weaknesses noted.

OBSERVATIONS AND COMMENTS

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

Auditors and management are required to assess the risk of fraud in the operations of the department. The risk assessment is based on a critical review of operations considering what frauds could be perpetrated in the absence of adequate controls. The auditors' risk assessment is limited to the period during which the audit is conducted and is limited to the transactions that the auditors are able to test during that period. The risk assessment by management is the primary method by which the department is protected from fraud, waste, and abuse. Since new programs may be established at any time by management or older programs may be discontinued, that assessment is ongoing as part of the daily operations of the department.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. It is management's responsibility to design, implement, and monitor effective controls in the department. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditor testing is limited and is usually targeted to test the effectiveness of particular controls. Even if controls appear to be operating effectively during the time of the auditor testing, they may be rendered ineffective the next day by management override or by other circumventions that, if left up to the auditor to detect, will not be noted until the next audit engagement and then only if the auditor tests the same transactions and controls. Furthermore, since staff may be seeking to avoid auditor criticisms, they may comply with the controls during the period that the auditors are on site and revert to ignoring or disregarding the control after the auditors have left the field.

The risk assessments and the actions of management in designing, implementing, and monitoring the controls should be adequately documented to provide an audit trail both for auditors and for management, in the event that there is a change in management or staff and to maintain a record of areas that are particularly problematic.

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 statements 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. We obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.

APPENDIX

DIVISIONS AND ALLOTMENT CODES

Department of Mental Health and Developmental Disabilities divisions and allotment codes:

- 339.01 Administrative Services Division
- 339.05 Mental Health Services Administration
- 339.08 Community Mental Health Services
- 339.10 Lakeshore Mental Health Institute
- 339.11 Middle Tennessee Mental Health Institute
- 339.12 Western Mental Health Institute
- 339.16 Moccasin Bend Mental Health Institute
- 339.17 Memphis Mental Health Institute
- 339.40 Major Maintenance - Equipment