

Department of Finance and Administration

**For the Year Ended
June 30, 1996**

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July 18, 1997

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
and
The Honorable John Ferguson, Commissioner
Department of Finance and Administration
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Finance and Administration for the year ended June 30, 1996.

We conducted our audit in accordance with generally accepted government auditing standards. These standards require that we obtain an understanding of management controls relevant to the audit and that we design the audit to provide reasonable assurance of the Department of Finance and Administration's compliance with the provisions of laws, regulations, contracts, and grants significant to the audit. Management of the Department of Finance and Administration is responsible for establishing and maintaining the internal control structure and for complying with applicable laws and regulations.

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

A special investigation of activities at Arlington Developmental Center was conducted. The finding resulting from this investigation is included in this report.

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

Very truly yours,

W. R. Snodgrass
Comptroller of the Treasury

WRS/cr
96/115

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Department of Finance and Administration
For the Year Ended June 30, 1996

AUDIT SCOPE

We have audited the Department of Finance and Administration for the period July 1, 1995, through June 30, 1996. Our audit scope included those areas material to the Tennessee Comprehensive Annual Financial Report for the year ended June 30, 1996, and to the Tennessee Single Audit Report for the same period. These areas included the TennCare program and the statewide controls administered by the Department of Finance and Administration and other state agencies. In addition to those areas, our primary focus was on management's controls and compliance with policies, procedures, laws, and regulations in the areas of equipment records at the Office for Information Resources, billing methods in the Division of Resource Development and Support, State Building Commission contracts, the Divisions of Real Property Management and Capital Project Management, and recording of federal grant expenditures and revenues (Department of Finance and Administration's Policy 20). The audit was conducted in accordance with generally accepted government auditing standards. Also, a special investigation of activities at the Arlington Developmental Center was conducted. The finding resulting from this investigation is included in this report.

AUDIT FINDINGS

Tennessee Insurance System Does Not Reconcile With STARS

Daily activity recorded in the Tennessee Insurance System (TIS) does not agree with the corresponding State of Tennessee Accounting and Reporting System (STARS) accounting transactions, nor can it be completely reconciled. Although the accounting has been corrected as much as possible, all information may not be correct on STARS because certain TIS history is not available (page 5).

Program Change Request Numbers Not Adequately Documented

The "request for service" numbers for program changes assigned through the MultiTrak system provide an audit trail of program changes and the corresponding approvals. Although OIR

procedures require that this number be documented in the program before the revised program is put into production, several programs did not have documented service request numbers (page 7).

Unverified Eligibility of TennCare Enrollees*

The eligibility of TennCare enrollees has not been verified or reverified for a significant number of enrollees (page 10).

State Losing Interest on Uncollected Cost Settlements

The state is losing interest on \$18 million because TennCare has not collected cost settlements from some Medicaid providers (page 12).

Weak Controls Over TennCare Manual Checks*

Controls over manual checks issued by TennCare do not ensure accurate and timely recording of transactions. Also, the reconciliation of departmental records with the Department of the Treasury's records needs to be performed more timely (page 13).

Reserve Fund Pool Payment Procedures Inadequate

Qualifying providers were paid over \$23 million from the TennCare Reserve Fund Pool based on surveys submitted by those providers. After the payments were made, a study of sample surveys raised significant doubts about the validity of the data. However, no further testing was performed to evaluate the extent of the problem. Modified surveys were used to disburse \$17,940,325 in fiscal year 1997, but no testing has been done to evaluate the validity of the data used (page 16).

TennCare Premium Accounts Receivable Procedures Need Improvement*

Procedures for managing premium accounts receivable need to be improved. Improvements are needed in writing off bad debts and resolving credit balances in enrollee accounts (page 18).

Allowable Rates for TennCare Mental Health Services Improperly Raised

As a condition of the TennCare waiver, the state was allowed to continue paying for mental health services on a fee-for-service basis at the rates in existence prior to TennCare. During fiscal year 1995, however, the allowable amount for mental health services was raised for inflation (page 19).

Some TennCare Providers Overpaid for Medicare Eligible Enrollees

TennCare sometimes pays more for Medicare deductibles than departmental rules allow (page 21).

Revision of TennCare's Rules Needed

Several departmental rules governing TennCare were inconsistent with TennCare's practices or did not address certain practices (page 21).

Late Return of Medicaid Refunds to the Federal Government*

Recoveries from third parties were not used to promptly reduce federal participation (page 25).

Office for Information Resources Inventory Not Performed at Leasing Agencies

The division, which leases telephone and computer equipment to state agencies, failed to ensure that an inventory of equipment at the leasing agencies was performed for fiscal year 1996. As a result, the division's equipment records cannot be relied on to indicate the location of the leased equipment (page 26).

The Division of Resource Development & Support's Procedures and Basis for Allocation of Costs Inadequate

The division, which supplies program evaluation of and fiscal review services for federal programs for other state agencies, does not provide those services under any formal written agreement with those agencies. Also, the division allocates costs to those agencies based on each department's share of the total population of contracts to be monitored, not the actual time spent monitoring the contracts (page 28).

Inadequate Oversight of Operations and Failure to Safeguard Assets at Arlington Developmental Center

A review of numerous allegations of improprieties determined that management had failed to ensure that the center was operated in a fiscally responsible manner. The following instances of improper activities or questionable practices were detected during our review:

- Maintenance employees admitted taking items for personal use (page 34).
- Center staff divided purchases to circumvent state purchasing policies and procedures (page 34).
- Three former developmental technicians obtained employment based on bogus high school diplomas, and one did not have documentation of high school graduation (page 35).
- Controls over the residents' "trust fund bank" were insufficient (page 35).
- A developmental technician was allowed to take sick leave while incarcerated (page 35).
- A developmental technician was allowed to accumulate and use unofficial compensatory time (page 36).
- A team leader attempted to have unofficial compensatory time recorded on her official time sheet (page 36).

* This finding is repeated from the prior audit.

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

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Audit Report
Department of Finance and Administration
For the Year Ended June 30, 1996

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Department of Finance and Administration For the Year Ended June 30, 1996

INTRODUCTION

POST-AUDIT AUTHORITY

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

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

BACKGROUND

The mission of the Department of Finance and Administration is to provide financial and administrative support services for all facets of state government. The business, finance, and managerial functions of state government are centralized here: the department prepares and executes the state budget, accounts for state revenues and expenditures, operates a central data processing center, plans and reviews construction and alteration of state buildings, and controls state-owned and -leased property. The department also administers the TennCare program.

The Department of Finance and Administration contains eight divisions: Administration, Budget, Office for Information Resources, Accounts, Resource Development and Support, Capital Projects Management, Facilities Management, and TennCare Administration.

Executive Order 9 transferred the management and operations of Arlington Developmental Center and the West Tennessee Office of Community Services to the Department of Finance and Administration effective February 7, 1996. In addition, Executive Order 10 transferred the management and operation of Cloverbottom, Greene Valley, and Nat T. Winston Developmental Centers and the Middle and East Tennessee Offices of Community Services to the Department of Finance and Administration effective October 14, 1996.

Effective January 3, 1997, the functions related to the TennCare Program transferred from the Department of Finance and Administration to the Department of Health.

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

AUDIT SCOPE

We have audited the Department of Finance and Administration for the period July 1, 1995, through June 30, 1996. Our audit scope included those areas material to the Tennessee Comprehensive Annual Financial Report for the year ended June 30, 1996, and to the Tennessee Single Audit Report for the same period. These areas included the TennCare program and the statewide controls administered by the Department of Finance and Administration and other state agencies. In addition to those areas, our primary focus was on management's controls and compliance with policies, procedures, laws, and regulations in the areas of the Office for Information Resources' equipment records, the Division of Resource Development and Support's billing method, the State Building Commission's contracts, the Divisions of Real Property Management and Capital Projects Management, and the recording of federal grant expenditures and revenues (Finance and Administration's Policy 20). The audit was conducted in accordance with generally accepted government auditing standards. Also, a special investigation of activities at the Arlington Developmental Center was conducted.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

AREAS RELATED TO TENNESSEE'S COMPREHENSIVE ANNUAL FINANCIAL REPORT AND SINGLE AUDIT REPORT

Our audit of the Department of Finance and Administration is an integral part of our annual audit of the Comprehensive Annual Financial Report (CAFR). The objective of the audit of the CAFR is to render an opinion on the State of Tennessee's general-purpose financial statements. As part of our audit of the CAFR, we are required to gain an understanding of the state's internal control structure and determine whether the state complied with laws and regulations that have a material effect on the state's general-purpose financial statements.

The Department of Finance and Administration is responsible for maintaining the state's central accounting system and preparing the state's CAFR. The department, in conjunction with other state agencies, provides centralized statewide controls in the following areas:

- Statewide accounting system
- Budgets and appropriations
- Cash receipts and disbursements
- Payroll transaction processing
- Fixed asset records

As a part of our audit of the CAFR, we reviewed selected controls over these areas in the Department of Finance and Administration and other state agencies.

To address our statewide audit objectives, we interviewed key department employees; reviewed applicable policies and procedures; examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements; performed analytical procedures, as appropriate; assessed the accounting principles used and significant estimates made by management; and evaluated the overall financial statement presentation. Our testing focused on the propriety of financial statement presentation, the adequacy of internal controls, and compliance with applicable finance-related laws and regulations.

Our audit of the Department of Finance and Administration is also an integral part of the Tennessee Single Audit which is conducted in accordance with the Single Audit Act of 1984. The Single Audit Act requires us to determine whether

- the state complied with rules and regulations that may have a material effect on each major federal financial assistance program, and
- the state has internal accounting and administrative control systems to provide reasonable assurance that it is managing federal financial assistance programs in compliance with applicable laws and regulations.

We determined that the TennCare program was material to the Single Audit and to the CAFR. In January 1, 1994, Tennessee inaugurated the TennCare program to provide medical services to the state's uninsured and uninsurable population. Most of these services are delivered in a managed care setting as opposed to the fee-for-service system of Medicaid, which TennCare replaced. A waiver from the Health Care Financing Administration was necessary before the program could be implemented.

We have issued an unqualified opinion on the general-purpose financial statements of the State of Tennessee in our Independent Auditor's Report dated December 20, 1996, which is included in the CAFR for the year ended June 30, 1996. The Tennessee Single Audit Report for the year ended June 30, 1996, will include our reports on the Schedule of Federal Financial Assistance, internal control structure, and compliance with laws and regulations.

As a result of our work, we determined the following:

- Computer controls over Tennessee Insurance System and program changes to the state's computer systems need improvement as discussed in findings 1 and 2.
- The Resource Access Control Facility (RACF) security controls for the State Employee Information System and general services mainframe computer applications need improvement. These findings will be included in the audit reports for the Departments of General Services and Personnel.

- The TennCare program had significant weaknesses and needs improvement as discussed in findings 3 through 12.

COMPUTER CONTROLS

1. The Tennessee Insurance System and the State of Tennessee Accounting and Reporting System do not reconcile

Finding

Daily activity recorded in the Tennessee Insurance System (TIS) does not agree with the corresponding State of Tennessee Accounting and Reporting System (STARS) accounting transactions, nor can it be completely reconciled. Each day the Division of Insurance Administration (DIA) enters insurance collections, refunds, and other related transactions into TIS. The Division of Accounts (Accounts) then compares the net change in the TIS database each day to the cumulative accounting transactions passed from TIS to STARS as a result of the TIS/STARS interface. Through this daily reconciliation process, Accounts corrects any differences that can be identified. Unreconciled amounts for the reconciliations reviewed during fiscal year 1996 ranged from \$72.18 to \$70,616.91 and averaged \$24,618.07.

Some of these unreconciled differences are due to manual adjustments made to TIS via the Application Development Facility (ADF) screen. ADF is a software program used to change a participant's account directly in the TIS database rather than through transactions, an approach DIA called "going through the back door" of the system. In order for an ADF change to be made, the system's security must be overridden. DIA sends a request for the ADF change to the department's Information Systems Management (ISM) group, who in turn submits a request to the Office for Information Resources (OIR). OIR assigns one of its employees to make the ADF changes on the TIS database. However, overriding system security to make manual adjustments is considered a significant deficiency in the design and operation of the system. Making changes directly to a database instead of correcting errors through properly authorized and documented transactions circumvents the controls the system is designed to provide.

Although division staff stated that they maintain paper documentation of the ADF changes, the electronic system has no history or record of the changes because the changes simply replace previous information in the database. ADF is used each month as a "quick fix" for an incorrect participant balance or charge believed attributable to some unknown system problem. DIA then records the problem, date of request, and its priority on the Systems Information Request Log. As system problems are researched and corrected through program changes or other measures, the items are cleared from the log. However, the log included several high-priority system problems several years old, some of which have been partially corrected.

The following are other reasons for the unreconciled differences between TIS and STARS:

- Errors occur when a participant transfers from one insurance program to another through a retroactive change. In one instance, health care providers were overpaid more than \$700,000 in one year when TIS inappropriately recertified PruCare enrollees' dependents. (The overpayments were recouped through credits on subsequent payments.)
- Employees keyed transactions incorrectly.
- Portions of the TIS computer program are not written correctly.
- Known and requested program change requests have not been made, tested, and applied.

Through discussions with DIA and Accounts staff and review of departmental memorandums, the TIS database is believed to be correct but the accounting transactions generated by TIS and passed to STARS are incorrect. Although the accounting has been corrected as much as possible, all information may not be correct on STARS because certain TIS history is not available. Analytical reviews and other measures were taken by the Division of Accounts staff and the Division of State Audit at fiscal year-end to ensure that the insurance funds' financial statements presented in the state's Comprehensive Annual Financial Report were fairly stated. However, Accounts staff would not have had to perform the additional work had all data entered into TIS flowed properly into STARS.

Recommendation

Management of the Divisions of Accounts and Insurance Administration must work together to bring TIS and STARS into balance. Together, the divisions should correct the daily unreconciled differences between TIS and STARS. DIA should explain ADF and other changes to Accounts, and Accounts staff should communicate daily unreconciled differences to DIA. Old items on the Systems Information Request Log should be cleared as soon as possible. As problems arise in the future, causes of the problems should be identified and TIS should be corrected quickly through program changes. The use of ADF changes should be minimized, and if possible, eventually eliminated.

Management's Comment

We concur. The Division of Accounts and the Division of Insurance Administration (DIA) established a work group in April 1997 to identify and remedy problems related to balancing issues between TIS and STARS. Also, a plan is being developed to minimize the use

of the Application Development Facility (ADF). Our eventual goal is to eliminate the need for this type of data changes.

The \$700,000 overpayment referred to in the finding occurred due to a reporting problem on the provider payments report. This problem was identified by the DIA staff and has since been corrected. The finding also indicates that unreconciled differences between STARS and TIS are caused by “employees keyed transactions incorrectly.” It is important to note that there are numerous edits in TIS designed to prevent employees from keying transactions that would create an out-of-balance situation between TIS and STARS.

2. Request for service numbers for computer program changes are not always documented in the programs

Finding

The state has now largely automated the computer program change process by using the MultiTrak system to record and document changes. An essential element of this process is the “request for service” number assigned through the MultiTrak system. This number provides an audit trail of program changes and the corresponding approvals for those changes. The Office for Information Resources’ (OIR’s) procedures require that programmers document the source of and required approvals for program change requests by recording this number in the program’s Identification Division before the revised program is put into production. The Identification Division is an area within the program code used for recording descriptive remarks about the program’s history and operation. We reviewed program changes in the following systems:

- State of Tennessee Accounting and Reporting System (STARS)
- Tennessee Online Purchasing System (TOPS)
- Property of the State of Tennessee (POST)
- Tennessee Revenue Information Management System (TRIMS)
- Treasury Reconciliation Accounting and Control System (TRACS)
- Women, Infants, and Children (WIC)
- State Employee Information System (SEIS)

Our review disclosed that request for service numbers were not always documented in the programs. As a result, the history of program changes for the items below—what changes were made, when they were made, why they were made, and who authorized them—is

extremely difficult to determine. Because of the nature of the computer programs, the failure to document this information will not prevent the program from processing. Specifically, our review disclosed the following:

- The request for service number was not documented for a change made to TOPS program MACOINV by the application's vendor programmers.
- The request for service number was not documented for a change to the TOPS copy book member STABREC. Copy book members are essentially lines of program code that are used by one or more individual programs. OIR has no procedure requiring documentation of service numbers for changes to copy book members.
- The request for service numbers were not documented for changes to POST programs BAPS870 and BAPA950. However, the Department of General Services had appropriately issued an ongoing, year-long request for service number—BA1295—that applied to these changes. Although OIR's policies require the source of and required approvals for program change requests, OIR's programmer did not understand that the long-term service number should be recorded for these changes.
- The request for service number was not documented for a change to POST program MAM455T. This change was recommended by the vendor. Because OIR has no procedure for documenting changes originating from outside sources such as vendors, the standard procedure should be followed. However, in this case the normal change documentation process was not performed.

Recommendation

The Director of Systems Development and Support should develop, implement, and monitor computer program change procedures to

- require contract programmers to follow OIR's practice of including the MultiTrak request for service number in the changed program;
- require that programmers include comments within changed copy book members to document the applicable MultiTrak request for service number;
- require programmers to document long-standing request for service numbers in a changed program just as any other request for service; and
- require programmers to follow OIR procedures requiring adequate documentation of program changes that originate from a software vendor.

Management's Comment

We concur in part. The only errors noted pertain to two systems; the Tennessee On-line Purchasing System (TOPS) and the Property of State of Tennessee (POST) systems. These systems require unique, non-routine vendor procedures which increase the risk of human error. Although we do not dispute the accuracy of the items in the audit report, we are concerned that the conclusions formed from a small sample, 21 items, are misleading. This concern is increased by the fact that the sample included items unique to our normal operating processes.

We will implement procedures to help reduce the likelihood of future occurrences, but when we are dealing with the volume of changes that require individual handling, we will have some errors. We will work to insure that we are not placing our product in question and that the effort for improving the process is justified by the risk involved.

Auditor Comments

We agree that the audit exceptions published in our report relate to systems requiring unique, nonroutine, vendor-recommended procedures. Our sample included changed program modules from automated systems considered vital to the financial management of state government without regard to the source of those systems or continuing maintenance procedures for them. Our finding indicates that vendor-supported systems are inherently at greater risk of undocumented and potentially unauthorized program code revisions than systems developed and maintained exclusively by OIR staff. Therefore, we consider our recommendations to be appropriate for the observed conditions.

TENNCARE

To address the objectives of the audit of the CAFR and the Single Audit Report, as they pertain to this major federal financial assistance program, we interviewed key department employees, reviewed applicable policies and procedures, and tested representative samples of various types of transactions. These transactions included payments (and related adjustments) to

- managed care organizations (MCOs) for monthly capitation,
- MCOs for adverse selection (to cover enrollees with high-cost conditions),
- mental health providers, nursing homes, and Department of Children's Services for fee-for-service claims,
- providers from the Reverse Fund Pool for malpractice and above-average case loads, and

- hospitals from the Unallocated Fund Pool for medical education.

Transactions were tested for adequate support and compliance with applicable laws and regulations. We also evaluated the program for compliance with general grant requirements, eligibility requirements, and special terms and conditions of the TennCare Waiver.

Estimates for TennCare's accounts receivable and accrued liabilities were tested for reasonableness.

The findings that resulted from our audit of the TennCare program follow.

3. TennCare eligibility verification procedures were not adequate

Finding

The prior audit of the Department of Finance and Administration noted that in many cases, the eligibility of TennCare participants who are classified as uninsured or uninsurable had not been verified. Management concurred with the prior finding, stating that new procedures had been implemented. However, based on the results of this year's audit, verification procedures have instead worsened.

TennCare mailed letters to approximately 87,000 unverified enrollees in May 1996 requesting eligibility information. The response to the mailing, however, was poor. As a result, approximately 50,000 people were disenrolled between August 28 and October 21, 1996, because they did not respond to the mailing. TennCare has not yet analyzed the responses to determine the eligibility of the 37,000 who did respond to the mailing.

Moreover, TennCare does not systematically verify eligibility information. At present, verification appears random—some enrollees' eligibility is updated as part of various activities such as data matches with the state insurance system or information obtained from the managed care organizations, the TennCare hotline, and the TennCare grievance unit. However, these methods do not ensure that the eligibility of the entire uninsured and uninsurable enrollee population is updated or if updates are performed timely and completely. The bureau has not systematically reverified the 200,000 to 300,000 enrollees previously determined eligible since the inception of the program in January 1994. It is possible then that the eligibility status of some enrollees has never been updated. Without systematic and timely review of eligibility information, there is no assurance that current information is being used to determine how many enrollees are still eligible for TennCare.

Adequate verification procedures are needed to ensure that funds are being spent only for those eligible to be in TennCare. The average amount paid to a managed care organization per month for each participant is \$113. In fiscal year 1996, TennCare paid approximately \$517,493,590 to managed care organizations for uninsured and uninsurable enrollees. Annual

reverification is also necessary to obtain current, accurate information about family size, income, and access to other medical insurance. This information is needed to determine whether participants previously considered eligible have become ineligible because of changes in their family or personal circumstances. Also, this information is used to determine the correct premium and deductible amounts paid by participants.

Furthermore, the bureau has done little to track this information and had not compiled statistics on unverified enrollees until the audit. It took the bureau eight weeks to provide the auditors with current eligibility information.

The delay in obtaining reports from management is a concern because adequate monitoring cannot occur without accurate and timely information. If eligibility information is not readily available, it is more difficult for TennCare staff and federal and state oversight agencies to monitor the accuracy and timeliness of eligibility information. The inadequacy of TennCare's verification procedures will be reported as a material internal control weakness in the 1996 Tennessee Single Audit.

Recommendation

The Assistant Commissioner for TennCare should ensure that verification procedures are adequate and fully implemented. To evaluate the effectiveness of the procedures, reports should be produced regularly and reviewed for content and accuracy. Appropriate steps should be taken in response to the results of those reports. If reports are not made timely, the reason for the delay should be determined and corrected.

Management's Comment

We concur that eligibility verification procedures were not adequate.

Even though the eligibility verification process is still being modified and enhanced, it is important to note that numerous processes have been in place or recently implemented which involve components of verification and reverification of the TennCare uninsured and uninsurable population. Through these processes TennCare obtains current, accurate information about family size, income and access to other medical insurance. Examples of these processes include data matching with files such as TEIS, Bendex, and Buy-In to identify enrollees with access to other medical insurance. Terminations occur on a regular basis as a result of the daily, weekly, and monthly processes. Questionnaires have been mailed to enrollees to verify income, access to insurance, and current mailing addresses. Information is received on a regular basis from MCOs which further identifies enrollees with access to insurance, address changes, and other enrollee information. Specific TennCare divisions and units, i.e. the Hotline and the Grievance units, receive correspondence and inquiries from enrollees requesting family size changes or income changes. These units correspond directly with the enrollee to verify not only the

requested changes but other information critical for continued TennCare eligibility and premium collection, if applicable.

Major changes have occurred in the TennCare eligibility process for uninsured/uninsurable applicants in 1997. The application and employer questionnaire were redesigned to allow for more accurate collection of information during the application process. With the opening of enrollment for uninsured children in April 1997, TennCare began the implementation of face to face eligibility determination and eligibility verification through the 95 local health departments. A pilot conducted in early 1996 in Putnam County provided valuable information for the redesign of the application, the development of processes and procedures for eligibility determination and verification, and specification of the necessary systems' modifications. It is our intent to expand this process for all uninsured/uninsurable applicants. We are currently preparing for a mass mailing that will begin the face to face eligibility reverification process.

While substantial progress has been made in our ability to produce reports to track and compile statistics for the monitoring of eligibility status, there continues to be opportunities for improvement.

4. Because of uncollected cost settlements, TennCare is losing interest on \$18 million and has remitted over \$11 million in state dollars to the federal government

Finding

The state is losing interest on \$18 million because TennCare has not collected cost settlements from some Medicaid providers. Under Medicaid, some providers such as hospitals filed annual cost reports listing costs and reimbursements. During audits of these reports, some costs would be disallowed. These disallowed costs would be recouped from future payments to the providers. However, when Medicaid was phased out and this type of reimbursement ceased, TennCare was left with \$28 million in uncollected Medicaid cost settlements. Management sent letters to these providers requesting that they remit the funds owed and threatening to have Medicare deduct the amount owed from Medicare payments. By December 31, 1996, collections, recoupments, and correcting adjustments had reduced the amount to \$18 million, however, no definite plans have been made for further recovery. In addition, management expressed doubt about the ability to collect some of these amounts because of provider bankruptcy.

The state is required to remit the federal share (approximately two-thirds) of cost settlements to the federal grantor within 60 days of settlement. Since the bureau had not collected from these providers, the state remitted the federal share (totaling approximately \$18,200,000 as of June 30, 1996) using state dollars. Subsequent collections have reduced this amount to \$11,700,000 at December 31, 1996.

Recommendation

The Assistant Commissioner for the TennCare Bureau should ensure that a plan is developed for recovering cost settlements from providers.

Management's Comment

We concur. Since the inception of TennCare, the TennCare staff has aggressively pursued reducing the outstanding cost settlement balances through additional correspondence, legal assistance, and writing-off the uncollectible accounts. The outstanding cost settlements to date have been significantly reduced and continue to be reduced. Between June, 1996 and December, 1996, the outstanding cost settlement balance over 60 days old was reduced by approximately \$10 million. The balance of aged cost settlements at June 30, 1997 was \$17.4 million. Aggressive efforts are currently being made to obtain payment from the responsible provider. If a provider has filed bankruptcy and the court upholds the bankruptcy, we then request the write-off of the respective outstanding debts. We have sent most providers notification of their delinquent balances due. We are exploring the potential of attaching Medicare payments through HCFA or through other payments in the state system, for providers who do not make payments after the second notice. For those outstanding cost settlements that are not resolved by collection, bankruptcy, or other methods, we will forward to the legal staff for possible court action.

5. Controls over manual checks need strengthening

Finding

As noted in the prior audit, the TennCare Bureau needs to continue to improve controls over manually prepared checks. In fiscal year 1996, these checks totaled approximately \$233 million.

The TennCare Management Information System (TCMIS) calculates and accounts for various transactions. These transactions include nursing home payments, capitation payments to managed care organizations, and payments to other providers such as the Departments of Children's Services and Mental Health and Mental Retardation. Capitation payments are monthly payments to managed care organizations to cover TennCare enrollees in their plans. The payments to other providers are calculated on a fee-for-service basis using enrollee-specific data such as length of enrollment, service provided, and payment rate.

Delayed Reporting

Most checks such as payments to nursing homes are generated through TCMIS each Friday. However, the bureau occasionally bypasses the system and prepares checks manually, generally under the following circumstances:

- A managed care organization wants immediate reimbursement for withheld capitation payments.
- There is not enough time to enter the payment information for such things as medical education or uncompensated care. Since the system does not automatically generate these types of payments, they must be initiated manually. The process to enter the information sometimes delays issuance by a week. If the payment is needed sooner or management does not wish to wait, a manual check is issued.

Because TCMIS is not linked with the State of Tennessee Accounting and Reporting System (STARS), Department of Finance and Administration staff must enter TennCare accounting information based on TCMIS reports. Manually prepared checks, however, are not reflected in TCMIS reports for up to two weeks. Consequently, the bureau must inform department accountants of all manual checks issued. In an effort to improve controls, the fiscal agent began in April 1996 to notify the bureau, departmental accountants, and the Department of Treasury by memorandum of any manual checks issued.

If the department is not promptly notified of manually prepared checks, the check may not be recorded in STARS timely. The Cash Management Improvement Act Agreement between the State of Tennessee and the Secretary of the Treasury, United States Department of the Treasury, Section 6.1.1, states, "The State shall request Federal funds in accordance with the appropriate cut-off times...to ensure funds shall be received and credited to a State account by the times specified." If checks are not recorded in STARS timely, federal funds may not be drawn in compliance with the cash management act, and state funds will have to be used to cover the checks.

Poor Segregation of Duties

The TennCare Bureau has assigned responsibility for preparing these checks to a company which acts as the fiscal agent. The fiscal agent, however, has not sufficiently segregated manual check-preparation duties. One employee has access to the manual check stock and signature stamp. Conceivably this employee could control the process from beginning to end and issue a check for unauthorized purposes.

Currently, the only compensating control is a reconciliation of checks issued and cleared each month. This reconciliation involves records from the Department of the Treasury and from the Department of Finance and Administration's Division of Accounts and Office of Budget and Finance. This reconciliation ensures that TennCare's and Treasury's records of checks issued and cleared correspond with STARS. However, the monthly reconciliations are not completed

in a timely manner. As of August 1996, reconciliations had been performed through October 1995. An additional compensating control would be daily reconciliations of all authorized checks issued with authorized payments in the Department of the Treasury's Account Reconciliation Package (ARP) system. As a result of the prior-year finding, the Department of the Treasury provides the fiscal agent daily reports to assist in this reconciliation. However, neither the TennCare Bureau nor the fiscal agent uses these reports.

Effective internal controls require that no one person have the ability to control the entire check-issuance process and that reconciliations of accounting records with bank activity be timely. When duties are not properly segregated, unauthorized transactions could occur. If reconciliations are not performed timely, unauthorized or unrecorded transactions could go undetected for some time.

Recommendation

The Assistant Commissioner for TennCare should seriously consider either using the automated clearing house process to make all payments to MCOs and providers or using STARS to issue checks outside of normal TCMIS processing to ensure that expenditures are recorded timely and that transactions are approved by management. Checks processed through STARS are available overnight, and the Director of Accounts has the ability to issue manual checks if immediately needed. The Assistant Commissioner for TennCare should consult with other officials in the Department of Finance and Administration to determine which method is preferable. If after strong consideration management decides not to use either of these methods, they should implement controls to ensure that manual checks issued are recorded immediately in STARS and should ensure that duties for manual check issuance are adequately segregated. Each month, the Department of the Treasury, the Division of Accounts, and the Office of Business and Finance should reconcile checks issued and cleared with ARP, STARS, and TCMIS records. In addition, the TennCare Bureau should perform daily reconciliations of all authorized checks issued with authorized payments in the Department of the Treasury's Account Reconciliation Package (ARP) system.

Management's Comment

Department of Finance and Administration

We concur. In addition to the new procedures implemented as a result of the last audit, we have substantially reduced the use of manual checks for anything other than voids and reissues for stale-dated checks, payment for garnishments or levies, and reissues for provider taxes. We have continued the process of daily notification of any manual checks issued for these purposes. However, since most manual checks are now for void and reissues, normally there is no impact to the daily draw of federal funds. If a check is a reissue of a stale-dated check that was voided previously to this checkwrite, the draw would be affected; therefore, the daily notification report continues to be necessary. We have also worked with Treasury to

obtain monthly reports that will help in the reconciliation process. We have notified EDS of the need for separation of duties for the access to the manual check stock and the access to the signature stamp.

Department of the Treasury

We concur. The Treasurer's ARP system produces a variety of daily balance and reconciliation reports as well as an automated monthly reconciliation which are provided to the TennCare Bureau and its agent to compare with check issuance records. We feel that proper daily utilization of these ARP reports by the TennCare Bureau and/or its agent would provide more effective control over the issuance of manual checks than would the monthly reconciliation, and would provide assistance in detecting unauthorized or unrecorded transactions as well as assistance in the monthly reconciliation of check issuance records to STARS and ARP. The Treasurer's Office continues to provide training to the TennCare Bureau and the TennCare agent on the daily ARP reporting. We continue to maintain daily control ledgers over all ARP accounts and have taken measures to improve upon the timeliness of the monthly reconciliations to STARS.

The Treasurer's Office also recommends that the TennCare Bureau convert its recurring payments to the Automated Clearing House (ACH) Credit payment method. This would provide improved funds management for the depository banks and the state and decrease the costs for such payments.

6. Reserve Fund Pool payment procedures were inadequate

Finding

The Reserve Fund Pool (RFP) was not adequately managed. In 1996, the Reserve Fund Pool contained \$45 million—\$30 million of that had been carried forward from previous years. TennCare made payments from the pool to compensate primary care providers whose TennCare caseload exceeded the average caseload and physicians whose practice consisted of at least 10% TennCare patients for malpractice insurance.

During the audit period, \$30 million—\$10 million of this amount was state dollars—was paid from the Reserve Fund Pool to a contracted agent who was to make payments to qualifying providers. However, when TennCare disbursed the funds on September 29, 1995 (the last business day of the federal fiscal year), it had not yet determined which providers should receive payments and at what rates the providers should be paid. The \$30 million increased the expenditure base for the federal fiscal year in anticipation of a proposed block grant. (The program was not changed at a block grant.) Meanwhile, the contractor was allowed to earn interest on these funds until the first payments were made in December 1995. TennCare's decision to disburse \$30 million to a fiscal agent at least two months before the

contracted agent could perform services under the contract was not fiscally sound: The state lost interest on the \$10 million it used to fund these payments.

On October 5, 1995, TennCare mailed surveys to providers to gather data that would be used to determine the rates. In December, after compiling the data from the surveys and calculating the rates, TennCare notified the contractor to disburse the funds. (Auditors later determined after recalculations that the rates were incorrect.)

After over \$23 million was disbursed to providers, TennCare sampled the surveys for accuracy. In a sample of 105 providers, the data used to determine the pool payments to 22 of these providers (21%) appeared “substantially overstated.” (TennCare decided to reduce the fiscal year 1997 Reserve Fund Pool payments to these providers.) Eleven of the 105 (10%) submitted supporting documentation that was “incomplete, unacceptable, or otherwise questionable,” and five did not respond to the request for additional information. (No further action was taken in regard to these providers.) Despite the high percentage of discrepancies noted in the sample, no other surveys were reviewed.

TennCare did not request reimbursement of the remaining \$6,219,037 until May 3, 1996. The contractor returned the funds on May 20, 1996. As a result, the contractor, not the state, earned interest on these funds.

Despite the problems with the prior surveys, TennCare used a similar method to disburse \$17,940,325 in Reserve Fund Pool payments in the first six months of fiscal year 1997. The surveys used this time were modified to attempt to clarify the type of data requested. TennCare, however, did not test any of the responses to the second survey for accuracy. According to TennCare, no further payments are planned.

Recommendation

Disbursements should be made only when accurate and reliable support for the expenditures has been received. Funds should be kept in state interest-bearing accounts and not forwarded to a third-party fiscal agent until the agent can perform the contracted services. The interest lost on these funds should be recovered from the contractor and the federal portion returned to the grantor. Complete records and supporting documentation for all expenditures should be maintained in accordance with state and federal laws and regulations.

Management’s Comment

We concur. When the Reserve Fund Pool methodology was originally developed, it was anticipated that the information necessary to perform the calculations for the distribution of the pool would be available in the encounter processing subsystem. However due to delays in the refinement of that data, an alternative approach was necessary. Surveys were designed to obtain consistent TennCare caseload information from each provider to support the distribution

of the Reserve Fund Pool. The process was primarily manual. This process has been discontinued and funds are no longer available for the Reserve Fund Pool.

We do not agree that interest is due from the contractor since there was no such provision in the Letter of Agreement. There was a delay in requesting the reimbursement of the outstanding balance while we made additional payments and adjustments. We requested and received the return of the outstanding balance once we were reasonably sure that all payments and adjustments had been made.

7. Policies and procedures for TennCare's premium accounts are not adequate

Finding

As noted in the prior audit, the TennCare Bureau has failed to develop adequate policies and procedures to ensure the accuracy of the accounts receivable records in the TennCare Management Information System (TCMIS). Management concurred with the prior audit finding and stated that changes were being implemented. Although improvements have been made, policies and procedures are still not adequate. Problems were noted with the write-off of accounts discharged in bankruptcy, the resolution of accounts with credit balances, and reporting.

Bankruptcies

Although the bureau has procedures for adjusting individual accounts for bankruptcy, approximately 500 bankruptcy adjustments have not been processed. Individuals disenrolled for failure to pay premiums, or who voluntarily leave TennCare but have account balances, must pay any amount owed prior to re-enrollment unless their balances were discharged in bankruptcy. If balances discharged in bankruptcy remain in the system, accounts receivable balances may be inflated. Additionally, eligible individuals who have filed bankruptcy may encounter difficulty re-enrolling if amounts discharged in bankruptcy are still in TennCare's records.

Credit Balances

The bureau also has not developed policies and procedures for periodically reviewing and resolving credit balances resulting from premium overpayments by enrollees. According to a May 21, 1996, memorandum from the Office of Audit Services, at the end of April the cumulative total of the credit balances in TCMIS was \$1,173,000, affecting over 17,000 TennCare accounts. One hundred twelve accounts had a credit balance of \$1,000 or more. The memorandum also noted that 5,189 recipients were making premium payments even though none were required. Although monthly statements are discontinued when no premium is due, TennCare does not notify recipients when no further payment is required. As a result, some enrollees continue to pay premiums, creating credit balances. Generally, these credit balances are not resolved unless they are over \$1000 or the enrollee contacts TennCare.

Reporting

The magnitude of the uncollectible amounts and credit balances distorts the accounting records. When accounting data are not accurate and complete, the reliability of any reports produced is questionable. Inaccurate records and unreliable reporting hinder effective fiscal management.

Recommendation

To ensure the accuracy of accounting records and permit the development of accounts receivable reports, the Assistant Commissioner and Fiscal Director should establish policies and procedures for writing off uncollectible accounts and monitoring accounts with credit balances. Also, steps should be taken to reduce the backlog of unprocessed bankruptcy adjustments.

Management's Comment

We concur. We have now developed procedures for processing bankruptcy cases. Efforts are being made to keep the bankruptcy posting backlog to a minimum. Cases have occurred, however, where we have not received cases timely from the Attorney General's Office. When this happens, it is difficult to be current with a large volume sent at one time. Reports have been designed for the notification of balances due TennCare and refunds due enrollees for amounts over \$1,000 to be received quarterly. We are developing a process to review these balances due or payable and once these reports become minimal, we will address those balances less than \$1,000.

8. TennCare should seek clarification of grant requirements

Finding

Modifications to TennCare's grant requirements are often necessary because TennCare is a new approach to Medicaid for both the state and the Health Care Financing Administration (HCFA). However, the intent or meaning of some requirements becomes unclear with the changes. The rate for psychiatric services is one such case.

When TennCare began, mental health services were not immediately moved into a managed care setting as were other health services. As a result, the state requested permission from HCFA to continue to pay for some mental health services on a fee-for-service basis. The November 18, 1994, approval letter from HCFA states:

For both the Children's Plan and the SPMI [seriously and persistently mentally ill], retroactive payments to January 1, 1994, will be permitted on

a fee-for-service (FFS) basis, subject to the State’s processing these claims through the State Medicaid Management Information System that was in place prior to January 1, 1994, at the previously existing rates (emphasis added)

TennCare interpreted this waiver as allowing the state to continue to adjust SPMI and Children’s Plan rates for psychiatric hospitals and community mental health centers for inflation as it had done under Medicaid. Additionally, during fiscal year 1995, TennCare adjusted these rates to cover additional costs, such as capitalization of fixed assets and property taxes, and enhanced the rates by a Medicaid “disproportionate share factor” to help cover hospital charity costs. Prior to TennCare, these costs and the disproportionate share factor were not a part of the rates.

TennCare should have sought guidance from the grantor before adjusting the rates. If HCFA does not agree with TennCare’s interpretation, the state could be required to return the additional payments to HCFA plus interest and penalties.

On July 1, 1996, TennCare implemented the TennCare Partners Program to provide mental health services in a managed care setting, ending the fee-for-service payment method for SPMI services. The Children’s Plan continues to be paid with the adjusted rates on a fee-for-service basis.

Recommendation

The Assistant Commissioner for TennCare should ensure that HCFA is contacted to determine whether the revised rates are allowable. The Assistant Commissioner should also ensure that all policies or programs and resulting payments comply with grant requirements. If these requirements are unclear or if a substantial change is made, TennCare should seek guidance from the grantor before implementing the change.

Management’s Comment

We agree that all policies and programs and resulting payments should comply with grant requirements. When the rates mentioned in the audit were indexed it was certainly management’s understanding and belief that this indexing was consistent with HCFA’s approval of the continuation of a fee-for-service agreement. These rate increases were made consistent with other rate setting procedures.

9. TennCare’s computer system does not prevent overpayments to certain providers

Finding

TennCare sometimes overpays providers caring for enrollees who are both TennCare and Medicare recipients. Medicare recipients are required to pay a coinsurance and deductible to the provider for services they receive. If the patient is also Medicaid eligible, Medicare bills TennCare instead of the patient for the coinsurance and deductible. According to departmental rules, the total amount paid by all parties (Medicare, patient, and TennCare) cannot exceed the fee limitations set by TennCare. However, testwork revealed that TennCare’s computer system always pays the entire deductible billed for outpatient hospitalization services regardless of how much Medicare or the patient paid or any limitations set by the Medicaid fee schedule.

Recommendation

The Assistant Commissioner for TennCare should ensure that the Director of Information Services makes the necessary changes to the system to bring the method of payment into compliance with departmental rules, or amend the rules.

Management’s Comment

We concur. We will review our current rules to determine if they need to be revised to agree with our current operating procedures.

10. TennCare has failed to comply with state law relative to the promulgation of rules, has failed to follow its own rules, and has failed to revise its rules

Finding

The Bureau of TennCare has ignored several of the departmental rules it created or has acted before rules were developed. Among the reasons the bureau cited for bypassing the rules were that some of the rules were out-of-date and no longer addressed the situation and that adherence to some of the rules was not feasible.

Tennessee Code Annotated prescribes the method for adopting departmental rules. Except for emergency or public-necessity rules, an agency must publish its proposed rule in the Secretary of State’s monthly administrative register and include the time and place of a hearing on the rule. The legality of all proposed rules, including emergency and public-necessity, must be approved by the Attorney General and Reporter before the rule can be filed with the

Secretary of State. Emergency and public-necessity rules are effective upon filing with the Secretary of State and other rules are effective 75 days after filing.

- a. The public-necessity rule pertaining to the 1996 TennCare premium rate increase was not properly filed with the Department of State prior to implementation (Rule 1200–13–12–.05). According to bureau personnel, the new rates were implemented in two stages—on February 1 and March 1, 1996. However, the rates were not filed and fully approved until March 12, 1996.

Tennessee Code Annotated, Section 4-5-216, states that if an agency rule is not adopted in compliance with the provisions of the code, that rule shall be void and of no effect and shall not be effective against any person or shall not be invoked by the agency for any purpose. It is possible that TennCare improperly billed enrollees for the first two months of the premium rate increases.

- b. The bureau did not comply with Rule 1200–13–12-.08(10) pertaining to the Reserve Fund Pool (RFP). The rule states that encounter data, such as enrollee and procedure performed, from managed care organizations will be used to determine which providers will receive incentive payments and how much those payments will be. However, because these data were not available, the bureau asked providers to submit data about their TennCare caseloads and then used 1993 Medicaid data to make these determinations. The bureau later discovered significant problems with the survey data as discussed in finding 6.
- c. Even though the bureau has contractually obligated itself to make adverse selection payments to managed care organizations and has made \$60 million in such payments, the bureau has not established rules concerning these types of payments. The contracts, which obligate the state to pay up to \$40 million annually, do not specifically describe how the payments will be calculated; they only state that the payments will be made using a formula developed by TennCare and approved by Health Care Financing Administration.
- d. The bureau is paying some providers more than is allowed in departmental rules. The method used to calculate outpatient hospitalization payments to providers caring for enrollees who are both TennCare and Medicare recipients sometimes results in payments that exceed limits. (See finding 9 for more details.)
- e. The bureau has not revised its rules to include changes in the method it uses to determine payments to universities for graduate medical education.
- f. The rules pertaining to the Home and Community Based Services (HCBS) waiver program have not been revised to reflect changes in the program. For example, TennCare no longer pays provider claims based on a per diem rate.

Generally, rules are used to state a department's position on important matters, provide standard definitions of technical words and phrases, and define regulations and policies that affect parties outside state government, such as enrollees. Departmental rules, therefore, are to be developed in an open forum, using due process, so that the interests of all concerned parties can be considered. If due process is not followed in developing departmental rules, there is no assurance the rule is equitable, feasible, and legal.

Recommendation

The Assistant Commissioner should exhibit a strong commitment to the importance of up-to-date rules, the necessity of complying with rules, and the legal requirements for promulgating rules. The Assistant Commissioner should ensure that there is an effective process for ensuring that departmental rules are fully approved and properly filed before they are implemented. TennCare management and staff should comply with the bureau's rules, and the Assistant Commissioner should take appropriate measures including a system for monitoring relevant program changes to ensure that the rules are revised to remain current.

Management's Comment

We concur.

- a. A significant amount of work must be done prior to a premium rate change. For example, we must obtain HCFA approval. Additionally, we must develop specifications and modify the computer system in advance of a premium change. There is also a significant amount of administrative activity developing the text of notices and notifying the enrollees and advocacy groups prior to the actual implementation of a rate change. Finally, we must update our rules with respect to premium amounts charged.

All of these activities were accomplished prior to implementation of the rate change with the exception of the actual signing of the public necessity rules. The rules were properly prepared and submitted in advance of the rate changes in a manner consistent with Tennessee Code Annotated Section 71-5-134 which was amended in 1993 to allow the Bureau of TennCare to promulgate public necessity rules pursuant in order to comply with or to implement the provisions of any federal waiver or state plan amendment obtained pursuant to Section 71-5-134 and the amendments to Section 71-5-102 -- 71-5-106.

It is a correct finding to state that the Bureau of TennCare implemented the change in premiums without having public necessity rules in place. However, it is incorrect to assume that the premium changes were made without public input. Prior to the implementation of the premium increases, the upcoming premium change was discussed before the TennCare Oversight Committee. The rate change was also

discussed with Consumer Advocacy Groups and notice of the premium increase was sent to enrollees on two (2) separate occasions prior to the rates changing. The Bureau of TennCare filed notice of rulemaking to make the premium changes permanent and conducted a rulemaking hearing in accordance with state law. The Bureau was prepared to accept and consider any comments from the public during the hearing on the premium increase rules, but no comments were offered. Promulgation of public necessity rules allows an agency to quickly implement rules and program changes but does not afford the public an opportunity to comment on the rules. Only a rulemaking hearing, of the type conducted by TennCare, provides the opportunity for public input.

We concur that it is unwise to implement significant program changes without the benefit of the support of properly promulgated rules to support the change and it is our intent that proper rulemaking requirements be followed every time. In this particular case, the Bureau made a conscious effort to properly promulgate public necessity rules but the rules were delayed over concerns that ultimately did not materialize. The Bureau had already provided much more notice of the change to the persons that would be affected by the change than would be required had the public necessity rules been processed timely, hence there was no damage or injustice done to the TennCare enrollees.

- b. We will determine if the current rule should be revised.
- c. The adverse selection payments are a contractual issue between the state and the 11 managed care organizations participating in the TennCare program. No provider, enrollee or other person can receive any portion of these funds. Therefore, we have not promulgated rules. We will review to determine if rules are needed.
- d. We acknowledge that the HCBS rules need to be revised. We will review and revise them to reflect the current reimbursement methodology.
- e. HCFA has approved the current methodology in a letter dated June 25, 1996. We will review and revise the current rules to reflect the current payment methodology.
- f. We acknowledge that the HCBS rules need to be revised. We will review and revise them to reflect the current reimbursement methodology.

In addition we have requested that the Department's General Counsel review TennCare policies to assure that they are appropriately reflected in Rules.

11. Medicaid refunds were not returned to the federal grantor promptly

Finding

As noted in the two prior audits, the department has not promptly used the amounts recovered from third parties to reduce federal drawdowns. Although management concurred with the prior finding, the situation has not improved.

The Cash Management Improvement Act Agreement holds the state liable for interest on refunds from the date the refund is credited to a state account until the date the refund is subtracted from drawdowns. Based on reports provided by the department, refunds totaling \$9,544,119.87 were deposited in fiscal year 1996. Refunds, however, cannot be used to reduce drawdowns until the deposits are entered into STARS. Our review of \$636,935.73 of refund deposits disclosed that \$616,621.04 was not keyed into STARS within one day.

Recommendation

The Assistant Commissioner for TennCare should ensure that the refunds are promptly entered into STARS, assign specific responsibility for correcting the delay, and monitor operations to ensure corrective action is implemented.

Management's Comment

We concur. However, the response remains the same as for the FY95 Audit. The procedures used by the fiscal staff to draw federal funds for the TennCare program are in compliance with the Department of Finance and Administration, Policy 20, Section 2-204 which states "Federal drawdowns must be made utilizing the STARS grant module (available on the STARS report Number 832) unless the grant language specifies use of check clearance patterns." Efforts are made by fiscal staff to insure that deposits are made promptly. Certifications of deposit are prepared for each deposit, keyed into STARS and sent to the Division of Accounts for processing. Drawdown report #832 reflects the refund once the certification of deposit is processed or released by the Department of Finance and Administration's Division of Accounts. Since the TennCare fiscal staff has now moved to the same location as the program operations, perhaps this timelines will become less significant. Also, beginning July 1, 1997, the certification of deposit will be completed and keyed by the TennCare fiscal staff which will eliminate the delay caused by the deposit being performed at another location.

OFFICE FOR INFORMATION RESOURCES EQUIPMENT PROCEDURES

Our objectives in reviewing the Office for Information Resources' (OIR's) controls over equipment and the accompanying procedures include determining whether

- changes to the plan for allocation of data processing costs are reasonable and justified;
- total costs and recovery amounts agree with the working trial balance;
- amounts billed to other agencies for OIR services and equipment are correct and adequately supported;
- property and equipment are adequately safeguarded and properly inventoried; and
- the financial statement amounts related to equipment and depreciation are fairly stated and properly supported.

We interviewed key department personnel to gain an understanding of OIR's procedures for and controls over making changes to the cost allocation plan, billing for OIR services and equipment, and calculating depreciation expense shown in the financial statements. We reviewed supporting documentation and tested nonstatistical samples of equipment items and depreciation expense. As a result of our work, we determined that OIR's equipment inventory procedures need improvement as discussed in finding 12.

12. OIR equipment inventory procedures need improvement

Finding

The Office for Information Resources (OIR) leases telecommunications and computer equipment to numerous state agencies. On February 3, 1989, the department issued procedures related to the leasing agencies' accountability for OIR equipment. These procedures stipulate that leasing agencies are responsible for the equipment, and on-site personnel are considered custodians of the equipment. Also, the procedures require personnel at each leasing agency to perform a year-end inventory of OIR equipment and report the results to OIR. Currently, the Accounting and Information Services group in the department's Office of Business and Finance is responsible for maintaining the OIR inventory records.

The division began a conversion from an internal inventory system to the Property of the State of Tennessee System (POST) in October 1995 and completed the conversion in January 1996. Because of this conversion, the division did not request leasing agencies to inventory OIR equipment in fiscal years 1995 and 1996.

Because no inventory has been performed in two years, the current equipment locations on POST are not reliable or up-to-date. For 18 of 43 applicable items tested (42%), the confirmed location did not agree with the location on POST. Eight of the 18 items were in a location different from the location on POST, and the other ten could not be located. Also, for 15 of 36 applicable items tested (42%), the state tag number did not agree with the tag number shown in OIR's inventory records. In these cases, the equipment was either not properly tagged or could not be located.

In addition to the problems noted above, testwork at the Department of Health and the Department of Safety revealed that although agency personnel attempted to review the OIR billings, the billings did not contain the information necessary to verify their accuracy. More detailed billing information, such as tag numbers, item descriptions, and locations, is available on INFOPAC (a tool to view reports and other information on the state's mainframe), but this information is taken from OIR's inventory records which are inaccurate.

Performance of a year-end inventory of equipment leased to the agencies would help ensure that the locations listed on POST are accurate. Also, improved inventory procedures would help OIR identify current or potential billing problems.

Recommendation

Management of the Office of Business and Finance should ensure the leasing agencies perform a year-end inventory of leased equipment annually. Management should ask the agencies to locate all items for which they are billed. The locations, tag numbers, and descriptions should be compared to POST, and any necessary adjustments made promptly by the Office of Business and Finance personnel.

Management's Comment

We concur. The Office of Business and Finance (OBF) confirms the existence and location of OIR equipment on an annual basis with each department and agency. However, because of the conversion to the new POST inventory system, the annual confirmation was not done for the fiscal year ended June 30, 1996. After reconciling the June 30, 1996, inventory balances of the old system with the new POST system, equipment confirmations were sent to all departments and agencies in November 1996. Responses have been received from 41 of the 60 agencies involved (68%). We have contacted the remaining agencies for their response and have been updating the inventory records with the data received from these confirmations.

We will continue to work with the departments and agencies to provide them with the reports and information needed to review and update their OIR inventory records.

DIVISION OF RESOURCE DEVELOPMENT AND SUPPORT

Our objectives in reviewing the procedures of the Division of Resource Development and Support include determining whether

- the monitoring reports were adequately supported by division working papers;
- the division's monitoring procedures were proper; and
- the division's billings to user departments were reasonable and properly documented.

We interviewed key department personnel in the Division of Resource Development and Support and reviewed a sample of billings to gain an understanding of the division's procedures and controls over the monitoring of subrecipients and the related billings to the user departments.

As a result of our work, we determined that the division's procedures and basis for allocation of costs need improvement as discussed in finding 13.

13. The Division of Resource Development and Support's billing procedures need improvement

Finding

The Department of Finance and Administration's Division of Resource Development and Support provides program evaluations of, and fiscal review services for, the department's subgrantees and those of the Departments of Human Services, Health, and Children's Services to comply with federal subgrantee monitoring requirements. Although the division has provided these services since 1992, it has no formal written agreement with these departments outlining the method or basis to be used in determining the cost allocation to the departments and the type of report to be issued to the departments as a result of the reviews. The current billing method used by the division was agreed upon by the Departments of Human Services, Health, and Finance and Administration. Department of Human Services (DHS) officials have indicated that the method was agreed upon in the beginning of the monitoring arrangement with the expectation that DHS's share of the billings would decline as the division began monitoring other departments' contracts. The division has since begun monitoring for other departments and Department of Finance and Administration programs, but DHS's share of the billing has not declined. Since all or part of the cost billed to the departments is passed on to the federal grants they administer, it is necessary to reevaluate the method used to bill for the division's services to keep unallowable costs from being charged to federal grant programs.

The division has separate cost centers for program evaluation and fiscal review services. Costs associated with program evaluations and fiscal reviews performed for department-administered programs (Criminal Justice Program and Tennessee Commission on National and Community Services) are billed at \$36.16 per hour for program evaluations and \$40.90 per hour for fiscal review services. But all other costs associated with program evaluations and fiscal reviews are allocated to the other departments using a ratio-based approach. In determining the ratio, the division obtains a listing of all the departments' contracts with subgrantees and selects contracts for program evaluation and/or fiscal review. Any contract in the population is subject to selection; however, the division does not perform program evaluation or fiscal review services for all contracts in the population in any given year. The amounts billed to the departments are based on a ratio of each department's contracts to the total population of contracts. Therefore, the ratio used represents work that could be performed, not actual work done. As a result, one department could pay for monitoring services it did not receive, and another department could receive services for which it was not billed. A percentage of these costs is passed on to federal grants at these departments and is appropriate provided the billings represent actual efforts expended in monitoring contracts. The department was not able to demonstrate that the billing method now in place approximates the actual effort spent monitoring contracts.

The division is able to bill the Department of Finance and Administration-administered programs based on actual work performed because detailed time records are kept for program evaluations and fiscal reviews of these programs. These records include the contract number for which the service was performed, the type of activity performed (planning, report preparation, etc.), the division employee who performed the activity, and the actual amount of time spent on the activity. The division, however, does not maintain the same level of detailed time records for work performed for the Departments of Human Services, Health, and Children's Services. Therefore, the division could not support the total amount billed to these departments.

Recommendation

The agency should provide program evaluation and fiscal review services based on written agreements with the departments to whom the services are provided. The agreement should include a listing of current programs requiring monitoring services, the types of services to be provided, the federal requirements supported by the monitoring work, and the basis to be used in determining any ratios for billing. In addition, the agreement should address the type of output document or report the division will issue to the departments. The division should keep adequate records to support activities performed for all programs.

Management's Comment

We concur. All billing methods should be reviewed on a periodic basis and improvements made if needed.

As of February 1, 1997, Resource Development and Support (RD&S) began billing departments based on the actual time spent on contract monitoring and related activities. As part of a department-wide initiative, RD&S has implemented an activity-based management system to account for the time spent by each employee on every activity at 30-minute intervals. This labor distribution system, which reflects actual time spent on a specific grant or activity, is being used to bill all departments and agencies (including divisions/departments within and outside F&A) for all services performed. The new system has the ability to provide reports that reflect the name of the agency monitored, the number of hours spent, period covered, and any other charges billed to any department for work done.

In addition, RD&S is preparing a formal agreement with the departments being provided contract monitoring services. This agreement will describe the types of services to be performed, the type of report to be issued, and the method of and types of costs to be included in the billings. The agreement will be signed by the affected departments.

STATE BUILDING COMMISSION CONTRACTS

Our objective in reviewing the controls and procedures over State Building Commission contracts focused on determining whether

- the department's controls ensured that contracts were properly approved;
- the department's controls were adequate to ensure that vendors complied with contract terms;
- the department's controls and procedures ensured that funds were available and properly encumbered; and
- the department complied with the State Building Commission's policies and procedures.

We interviewed key department personnel responsible for the administration and accounting for State Building Commission contracts and reviewed a sample of contract payments and project files.

As a result of our work, we had no findings related to the State Building Commission's contracts.

DIVISIONS OF REAL PROPERTY MANAGEMENT AND CAPITAL PROJECTS MANAGEMENT

Our objectives in reviewing the controls and procedures over the Divisions of Real Property Management and Capital Projects Management focused on determining whether

- the department’s controls and procedures were adequate to ensure that a complete inventory was maintained of all state-owned and -leased real property; and
- the department’s controls and procedures ensured that contracts were awarded only to reputable building contractors whose experience demonstrates their ability to perform construction projects properly.

We interviewed key department personnel and reviewed controls and procedures over the state’s inventory of real property and the awarding of state construction contracts. A sample of real estate transaction files was tested to determine if a complete inventory is maintained for all state-owned property.

As a result of our work, we had no findings related to the Divisions of Real Property Management and Capital Projects Management.

DEPARTMENT OF FINANCE AND ADMINISTRATION POLICY 20, “RECORDING OF FEDERAL GRANT EXPENDITURES AND REVENUES”

The Department of Finance and Administration Policy 20 requires that state departments whose financial records are maintained on the State of Tennessee Accounting and Reporting System (STARS) fully utilize the STARS grant module to record the receipt and expenditure of all federal funds. Our testwork focused on whether

- appropriate grant information was entered into the STARS Grant Control Table upon notification of the grant award, and related revenue and expenditure transactions were coded with the proper grant codes;
- appropriate payroll costs were reallocated to federal programs within 30 days of each month-end using an authorized redistribution method;
- the department made drawdowns at least weekly using the applicable STARS reports; and

- the department utilized the appropriate STARS reports as bases for preparing the Schedules of Federal Financial Assistance and reports submitted to the federal government.

We interviewed key personnel to gain an understanding of the department's procedures and controls concerning Policy 20. We reviewed supporting documentation and tested nonstatistical samples of grant awards, revenue expenditure transactions, drawdowns, and reports submitted to the federal government. We also reviewed the Schedule of Federal Financial Assistance. As a result of our work, we had no findings related to the Department of Finance and Administration's Policy 20.

ARLINGTON DEVELOPMENTAL CENTER

On October 25, 1995, the Division of State Audit received information regarding allegations of improprieties occurring during the period January 1994 through October 1995 at Arlington Developmental Center, located in Arlington, Tennessee. Division of State Audit staff conducted a review of the allegations from November 1, 1995, through April 26, 1996. The objectives of the review were to

- determine the nature and extent of any impropriety by employees at Arlington Developmental Center,
- to refer our findings to the Office of the Attorney General and the District Attorney General, and
- to submit our findings to the center and recommend appropriate actions to correct any deficiencies.

We examined relevant documents and interviewed direct care providers, supervisory staff, and management personnel.

As a result of our review of the activities at Arlington Developmental Center, we determined that maintenance employees took items for personal use (part a), state purchasing procedures were circumvented (part b), four employees were hired based on bogus diplomas or no documentation of graduation (part c), controls over residents "trust fund bank" were insufficient (part d), and sick and compensatory leave practices were inappropriate (parts e-g).

The finding discussed below was referred to the Office of the Attorney General and Reporter and the Commissioner of the Department of Finance and Administration on October 17, 1996. This finding was also referred to the District Attorney General for the Thirtieth Judicial District, Memphis, on November 12, 1996.

14. Management failed to safeguard assets and adequately oversee the operations of the center

Finding

Arlington Developmental Center management failed to ensure that internal operations of the center were carried out in a fiscally responsible manner. Center policies and procedures were either not effectively communicated to staff or were disregarded by staff with the consent of some supervisory personnel. This lack of management control over center operations has led to numerous allegations of improprieties involving staff and management and does not ensure the adequate safeguarding of assets. Instances of improper activities or questionable practices detected during our review that directly relate to management's lack of adequate oversight included the following:

- a. Maintenance employees admitted taking items for personal use.

Eleven maintenance employees, including two supervisors, admitted improperly taking items for personal use over the last ten years. The items still had value and should have been disposed through the surplus property process. The center does not have adequate controls over surplus items and maintenance building materials.

The two supervisors were allowed to resign effective April 19, 1996. On April 11, 1996, eight maintenance employees received warning letters, and one employee, the current facility director, received a clarification of policy letter.

- b. Center staff divided purchases to circumvent state purchasing policies and procedures.

On four occasions, center staff divided large purchases in order to make them appear to be individually less than \$1,000. This violated purchasing policies and procedures and circumvented the involvement of the Department of General Services. The purchases involved items such as beds, dressers, and rugs. In addition to dividing purchases, bids were not obtained as required for two of the purchases, and for one of the purchases, center staff did not obtain approval from the Department of General Services to purchase items available on statewide contract from other sources.

- c. Three former developmental technicians obtained employment based on bogus high school diplomas, and one did not have documentation of high school graduation.

Center personnel office staff failed to detect three bogus high school diplomas and also failed to verify the high school graduation of a fourth employee who did not submit a diploma. The three copies of the diplomas appeared to have been altered from the originals. The alterations were obvious and should have been detected by personnel staff.

The employment of all four individuals had been terminated before we initiated our review. On February 1, 1996, the personnel director was transferred to the center's procurement section. On the same day the center hired a new personnel director.

- d. Controls over the residents' "trust fund bank" are insufficient.

In August 1995, the fiscal office established a resident "trust fund bank" from which a resident could withdraw up to \$15 a day until the resident had depleted his or her trust fund account. Although staff refer to a "trust fund bank," in actuality it is an imprest petty cash fund of \$200 which an Account Technician I maintains in a cash box in the accounting office. The center does not ensure that cash, once disbursed to the residents, is adequately safeguarded and secured against theft or loss. This is particularly true for residents whose ability to communicate and care for themselves is severely impaired. The need for residents to have cash up to \$15 per day is not evident.

- e. A developmental technician was allowed to take sick leave while incarcerated.

A developmental technician falsely represented to his supervisor that he was sick from December 16, 1994, through February 15, 1995, when, in fact, he was incarcerated. One center supervisor knew of his incarceration from its inception but failed to notify her supervisor or any other employees at the center and attempted to conceal his inappropriate actions by entering the words "Employee III" on four "exception reports," official documents for recording employee absences. Both employees have been terminated from the center.

- f. A developmental technician was allowed to accumulate and use unofficial compensatory time.

A developmental technician was allowed to work extra shifts without signing in and without her supervisors' recording her overtime on the official overtime authorization form. With the approval of two of her supervisors, the developmental technician allegedly worked extra shifts and allegedly accumulated at least 61.15 hours of unofficial compensatory time from January to March 1994.

The developmental technician took three days of unofficial compensatory leave on November 4 through 6, 1994. Two of her shift supervisors admitted signing the departmental technician's name to the attendance report on those three dates to make it appear that she was at work, and three other shift supervisors admitted not recording the developmental technician as absent on the exception report even though they knew that she was absent.

On June 11, 1996, the center informed the developmental technician that her claim to accumulate and convert 61.15 hours of unofficial compensatory time to official compensatory time had been disallowed because these hours did not agree with the

time unofficially recorded by her supervisors and could not be accurately supported. The center also informed the developmental technician that she would be suspended without pay for one day for falsification of official documents. Furthermore, three of the five developmental technician supervisors who allowed the accumulation and use of unofficial compensatory time received a one-day suspension without pay for negligence in performing their duties. One of the developmental technician supervisors had resigned her position with the center before our review of the matter was initiated. The remaining developmental technician supervisor was given an oral warning instead of suspension because even though she did not properly record the developmental technician as absent on one exception report, she did record on the exception report that the employee was on unofficial compensatory leave.

- g. A team leader attempted to have unofficial compensatory time recorded to her official time sheet.

A team leader contended that she had accumulated 165.1 hours of compensatory time over 41 days from July through November 1995 and attempted to have these hours recorded on her official time sheets on December 14, 1995, by completing 41 overtime authorization forms and submitting them to her supervisor for approval. A team leader is responsible for the oversight of resident housing units.

The team leader's supervisor responsible for approving her time sheets signed all 41 overtime authorization forms for the team leader at one time, after the dates in question, signifying he had personally verified the hours worked. However, the supervisor admitted that he had not verified the team leader's hours and was not in a position to verify them. He further acknowledged that he had not required the team leader to provide supporting documentation and that he had relied solely on her representation.

The team leader at first contended that the beginning and ending times she had submitted were true and accurate, but later admitted that she had indicated ending work shift times she knew were incorrect. She also admitted altering a center activity log. Moreover, specific time represented on the overtime authorization forms she submitted overlapped with specific time she worked at a local retail department store on 12 of the 41 days for a total of 10.7 hours.

The team leader's claim for the unofficial hours was disallowed by the center, and she was allowed to resign from the center effective June 1, 1996.

Recommendation

The superintendent should assign specific responsibility for key control activities. The superintendent should also design and implement a system for effectively monitoring these activities and compliance with related controls. The superintendent should monitor these matters and take appropriate corrective action including personnel action when they detect any noncompliance with the controls or other problems.

The superintendent should ensure that staff understand and adhere to the center's policies and procedures, purchasing policies and procedures set by the Department of General Services, and the laws of the State of Tennessee.

The superintendent should ensure that resident and center assets are safeguarded and secured against theft or loss.

The superintendent should ensure that all employees are formally informed of their responsibility to report their hours and their health status truthfully and that supervisors are formally informed of their responsibility to report suspected improprieties promptly to management for appropriate action.

The superintendent should be alert to indications of fraud, abuse, and illegal acts and should initiate prompt and thorough examinations when necessary and take appropriate personnel action.

The commissioner should share this report with the superintendents of the other developmental centers and take steps to ensure that the same issues or related issues are appropriately addressed by the superintendents of those centers. This would include implementation of appropriate control and monitoring systems.

Management's Comment

- a. We concur. Every supervisor in the maintenance department has been replaced since the problems occurred. Parts inventory is now under lock and key and accessible only through a work order. Tools are individually logged and assigned to workers and inventoried periodically and upon the employee's departure.
- b. We concur. A direct purchase agreement has been obtained to allow local purchase of items under \$5,000. A procedure for developing specification and taking competitive bids for "homelike" furniture for individual homes has been put into place.
- c. We concur. Prospective employees in relevant job classes are now required to present an original of their highest degree obtained. Notation is made on the personnel copy that the original was examined for authenticity.
- d. We do not concur. Access to resident trust funds is monitored by the reimbursement officer, the account technician, and the unit social worker for any unusual activity. Withdrawals are only upon the signature of the program manager (team leader). The amount and frequency of withdrawals is directly related to the citizen's independence. Most citizens never make a withdrawal. Most withdrawals are for \$5.00. Only a handful of citizens make withdrawals as often as twice a week. These individuals all hold jobs and should have personal access to their money.

Auditor's Comment

As noted in Management's Comment, withdrawals are only upon the signature of a team leader. However, the center has not established controls to account for expenses incurred or to safeguard the money once disbursed. Thus, as stated in the finding, the center does not ensure that cash, once disbursed to the residents, is only spent for the resident's intended purposes or is secured against theft or loss. The "trust fund bank" appears to place at greater risk than necessary the funds of residents, whose ability to communicate and care for themselves is severely limited.

- e. We concur. The center will continue to deal severely with any incidence of fraud or deceit.
- f. We concur. The center now initiates direct one-to-one training by timekeeping personnel upon the first indication that a supervisor may not be completely familiar with the details of the timekeeping system.
- g. We concur. The center now initiates direct one-to-one training by timekeeping personnel upon the first indication that a supervisor may not be completely familiar with the details of the timekeeping system.

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Department of Finance and Administration filed its report with the Department of Audit on December 23, 1996. 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 Finance and Administration has corrected previous audit findings concerning the procedures for recording land in the land inventory system, controls over the OIR supply inventory, the calculation of OIR depreciation expense, the statewide policy on maintenance benefits provided to state employees, federal drawdowns for the TennCare Medical Assistance Program, and inadequate protection of TIS datasets. The resolution of previous audit findings related to the Department of Children's Services is discussed as part of a separate report issued on that department.

The prior audit of the Department of Finance and Administration, for the year ended June 30, 1995, contained a finding regarding lack of a statewide contingency plan to provide continuity of administrative, clerical, and business functions if any of the state's many offices and related work areas should be damaged or destroyed. Although the department has not fully complied with the recommendations in this finding, the department has formed a business resumption committee and has established guidelines for such a plan. Because of the progress made in developing the new plan, the finding will not be repeated in this report. Subsequent audits will continue to monitor this situation to determine if continued progress is being made.

REPEATED AUDIT FINDINGS

The prior audit report also contained findings concerning inadequacies in procedures for verifying TennCare enrollees' eligibility, controls over TennCare manual checks, promptness of return of Medicaid refunds to the grantor, and policies and procedures for TennCare premium accounts receivable. These findings have not been resolved and are repeated in this report.

OBSERVATIONS AND COMMENTS

TITLE VI OF THE CIVIL RIGHTS ACT OF 1964

Tennessee Code Annotated, Section 4-21-901, 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, 1994, and each June 30 thereafter. For the year ending June 30, 1996, the Department of Finance and Administration filed its compliance report and implementation plan on June 28, 1996.

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 State Planning Office in the Executive Department was assigned the responsibility of serving as the monitoring agency for Title VI compliance, and copies of the required reports were filed with the State Planning Office for evaluation and comment. However, the State Planning Office has been abolished. The Office of the Governor is currently evaluating which office in the Executive Branch will be the new monitoring agency.

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 Finance and Administration's divisions and allotment codes:

317.01	Executive Offices	317.09	Capital Projects Management
317.02	Division of Budget	317.10	Real Property Management
317.03	Office for Information Resources	318.65	TennCare Administration
317.04	Insurance Administration	318.66	TennCare Services
317.05	Division of Accounts	318.67	Waivers and Crossover
317.06	Criminal Justice Administration	318.68	Long-term Care
317.07	Division of Resource Development and Support	355.00	State Building Commission

