

**Department of Health**

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

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Editor

July 16, 1997

The Honorable Don Sundquist, Governor  
and  
Members of the General Assembly  
State Capitol  
Nashville, Tennessee 37243  
and  
The Honorable Nancy Menke, Commissioner  
Department of Health  
Nashville, Tennessee 37247

Ladies and Gentlemen:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Health 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 Health's compliance with the provisions of laws, regulations, contracts, and grants significant to the audit. Management of the Department of Health 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.

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

Very truly yours,

W. R. Snodgrass  
Comptroller of the Treasury

WRS/jr  
96/145

State of Tennessee

# Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit  
**Department of Health**  
For the Year Ended June 30, 1996

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## AUDIT SCOPE

We have audited the Department of Health 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. 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 contracts, supplemental pay, federal equipment records, cellular phones, revenue, contingent and deferred revenue, and Department of Finance and Administration Policy 20. The audit was conducted in accordance with generally accepted government auditing standards.

## AUDIT FINDINGS

### **Payroll Costs Not Distributed to Federal Programs Timely\***

The department did not allocate payroll costs to federal programs to allow for timely draws of federal funds and therefore lost interest on state funds (page 4).

### **Improper Employer-Employee Relationships\*\***

The department continues to establish improper employer-employee relationships through contracts with community services agencies, human resource agencies, and other not-for-profit organizations (page 8).

### **Subgrantees Not Adequately Monitored\*\***

The department did not adequately monitor subgrantees or resolve questioned costs within six months (page 5).

### **Subcontracts Not Specific**

The department's subcontracts with certain entities were not specific enough to ensure subcontractor compliance with contract requirements (page 12).

**Cellular Phone Use and Billings Not Monitored**

Because the department did not monitor cellular phone use and monthly bills, the department paid for cellular phone service for one former employee and for one person who had never worked for the department (page 17).

**Inadequate Revenue Controls\*\***

The department does not safeguard revenue items, restrictively endorse checks, immediately prepare receipts, adequately segregate duties, or periodically account for receipts (page 19).

\* This finding is repeated from the prior audit.

\*\* This finding is repeated from prior audits.

**Additional Ineligible Employees Received Supplemental Pay\*\***

The department inappropriately increased the number of employees receiving supplemental pay (page 14).

**Federal Grant-Funding Information Omitted From Property Records\***

The department did not include vital grant-funding information in the Property of the State of Tennessee (POST) equipment tracking system (page 16).

**PAST FINDINGS NOT ACTED UPON BY MANAGEMENT**

Prior audits have contained a finding about the department’s failure to fully use the indirect cost allocation plan for the recovery of indirect costs from block grants. Management has stated that any policy or procedural change requiring indirect cost funds to be used solely for administrative expenditures would require a budget reorganization. However, the department has not revised its budget to address this issue (page 23).

Further, prior audits have also contained a finding concerning the development and implementation of effective controls to ensure participant eligibility and contractor performance in the Nursing Home Resident’s Grant Assistance Program (page 23).

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“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

**Audit Report**  
**Department of Health**  
**For the Year Ended June 30, 1996**

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# **Department of Health For the Year Ended June 30, 1996**

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## **INTRODUCTION**

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### **POST-AUDIT AUTHORITY**

This is the report on the financial and compliance audit of the Department of Health. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which 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 Health is to promote, protect, and restore the health of Tennesseans by facilitating access to high-quality preventive and primary care services. In order to fulfill this mission, the department comprises six sections: Executive Administration, Bureau of Administrative Services, Bureau of Information Resources, Bureau of Manpower and Facilities, Bureau of Health Services, and Bureau of Alcohol and Drug Abuse Services.

One of the department’s many responsibilities is to provide overall direction to, coordination of, and supervision for the state and local health departments to enable them to meet the health needs of the state’s citizens. The department ensures the quality of medical resources available in the state through the regulation, certification, and licensure of health professionals and health care facilities. The central office works in coordination with four rural and six metropolitan regional offices and 95 county health departments to provide services which protect and promote health and prevent disease and injury. The department also works to improve access to quality health care services in underserved areas of the state and to underserved populations. To decrease the incidence and prevalence of alcohol and other drug abuse and dependence, the department coordinates prevention, treatment, and rehabilitation services. The department is also responsible for preserving and issuing copies of all vital records.

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



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## **AUDIT SCOPE**

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We have audited the Department of Health 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 the Tennessee Single Audit Report for the same period. 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 contracts, supplemental pay, federal equipment records, cellular phones, revenue, contingent and deferred revenue, and recording of federal grant expenditures and revenues (Department of Finance and Administration Policy 20). The audit was conducted in accordance with generally accepted government auditing standards.

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## **OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS**

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

Our audit of the Department of Health 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.

Our audit of the Department of Health 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
- whether 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 the following areas within the Department of Health were material to the CAFR and to the Single Audit: the Special Supplemental Food Program for Women, Infants, and Children (WIC) and the Block Grant for Prevention and Treatment of Substance Abuse (SAPT).

To address the objectives of the audit of the CAFR and the Single Audit, as they pertain to these two major federal financial assistance programs, we interviewed key department employees, reviewed applicable policies and procedures, and tested representative samples of transactions. In addition, we performed analytical procedures to determine the department's compliance with the maintenance-of-effort requirement for the block grant.

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 that the department's procedures for reallocating grant payroll costs, drawing down funds, and monitoring subgrantees are inadequate, as discussed in findings 1 and 2.

**1. Grant payroll cost reallocation and drawdown procedures were not adequate**

**Finding**

As noted in the prior audit, the department did not promptly draw down federal funds because reallocation journal vouchers were processed late. In addition, these journal vouchers were not based on current data. Management concurred with the finding and stated that payroll costs would be reallocated each pay period, and that these reallocations will be estimates based on the most recent time study information available. Management also stated that estimates would be adjusted to actual when the information became available. Although improvements have been made, some allocations were late, and outdated information was used for estimates.

To reallocate certain payroll costs to various federal grants, the department uses a time study to measure the amount of time direct service employees (employees who provide direct services in local and regional health departments) have worked on various programs and activities.

Payroll costs are not drawn for federal programs until a reallocation journal voucher is processed. For four of 12 months, reallocations were processed 35 to 73 days after month's end. The Department of Finance and Administration's Policy 20, *Recording of Federal Grant Expenditures and Revenues*, Attachment 20 - A, "Procedure for the Redistribution of Payroll as it Relates to Grants," parts 2 and 3, states that "payroll costs . . . associated with grants must be redistributed to recover federal revenue on a timely basis . . . the payroll costs must be entered in STARS on a reallocation journal voucher within 30 days of each month-end." Ideally, payroll costs should be reallocated each pay period, but never less than once per month.

Because reallocations of payroll costs were late, federal revenue associated with those payroll costs was not recovered timely. When federal funds are not drawn down promptly, state funds are used to fund federal grant expenditures, resulting in the state's loss of use of, and interest income on, the funds.

In addition, the reallocations were initially calculated using time study data from prior periods, not current periods. Time study data from periods as much as four months prior to the payroll month were used for estimates when data from the prior month would have been more appropriate. The use of data sometimes as old as four months suggests that time study data are not collected promptly.

Because the reallocations were not based on current data, the amount of federal revenue recovered was not correct. Interest may be sought by the federal government for excess funds that were drawn based on estimated amounts. Excess amounts ranging from \$3,563 to \$619,719 were drawn based on estimates, and the reallocations to actual amounts were made 39 to 70 days after the estimated draws were made.

### **Recommendation**

The Director of Fiscal Services should ensure that payroll costs are allocated timely for each pay period and never less than once per month (within 30 days of month-end as required by the Department of Finance and Administration's Policy 20). The accounting manager in the Bureau of Health Services should also ensure that time study information is collected promptly so that reallocations can be based on current-period data or adjusted to actual data timely.

### **Management's Comment**

The department concurs. Payroll costs are reallocated each payroll period on an estimated basis using the latest available actual month's time study as the basis for the estimate. Federal funds are then drawn based on the estimated reallocation. Upon receipt of the actual time study information for that payroll month, the estimated reallocation is corrected to actual, and the federal funds are adjusted accordingly. Steps have been taken to preclude the errors noted in the audit from reoccurring in the future.

## **2. Monitoring of subgrantees is not adequate**

### **Finding**

As noted in the four prior audits, subgrantees of the Department of Health are not adequately monitored. Management concurred with the prior findings, and although improvements have been made, problems still exist.

- a. The Bureau of Alcohol and Drug Abuse Services does not regularly conduct on-site fiscal monitoring reviews of all its subgrantees.
- b. The Bureau of Health Services does not have uniform written procedures for monitoring the fiscal activities of all programs.
- c. Files for subrecipients of grants administered by the Bureau of Health Services were reviewed for evidence of compliance and fiscal monitoring. Of the ten recipients whose files were tested, four were not monitored for compliance with programmatic goals and objectives, and nine were not fiscally monitored.

Office of Management and Budget (OMB) Circular A-128, "Audits of State and Local Governments," requires the department to "determine whether the subrecipients spent Federal assistance funds provided in accordance with applicable laws and regulations." Also, Section 40 of OMB Circular A-102, "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments (Common Rule)," states that the grantee is responsible for monitoring both its own activities and the activities of its subgrantees.

Monitoring also involves obtaining and reviewing subrecipients' audit reports, which are prepared by independent auditors. Some of these reports questioned costs and indicated amounts due to the state. In seven of ten reports tested, the costs questioned were not resolved within six months of receipt of the reports. For five of the seven, the resolution process began from 136 to 842 days after the six-month period ended. For the other two, which were received in September 1995, the resolution process had not begun as of September 1996. Also, the department's review of the audit reports did not include following up on other reported audit exceptions (such as internal control weaknesses).

The "Questions and Answers on Single Audit Provisions," Circular A-128 (Answer 25b), issued March 1991, states that it is the recipient's (Department of Health's) responsibility to "establish a system for follow-up on questioned costs, weaknesses in internal control systems, and other audit exceptions and ensure that appropriate corrective action is taken within 6 months."

The department cannot determine compliance with applicable laws and regulations if it does not monitor subrecipients. Additionally, funds could be used for objectives not associated with the grant or contract, and subrecipient errors and irregularities could occur and not be detected.

### **Recommendation**

The Director of the Bureau of Alcohol and Drug Abuse Services and the Director of the Bureau of Health Services should assign staff specific responsibility for annual program and fiscal monitoring of all subrecipients. Staff should sufficiently document all monitoring and promptly report deficiencies to subrecipients. Significant deficiencies should be reported to the department's Office of Audit and Investigation and to the Comptroller's Office. Recommendations and

deficiencies previously noted should be followed up, and this process should also be documented. New monitoring policies or guidelines should be developed to improve monitoring efforts.

All audit exceptions should be followed up and resolved within six months of the receipt of the subrecipient's audit report.

### **Management's Comment**

The response to the finding is as follows:

- a) The Bureau of Health Services concurs. A monitoring policy was developed near the end of FY 96. The Fiscal Services section of the Bureau of Health Services has since developed a fiscal monitoring tool and procedures that will ensure uniform fiscal monitoring of subgrantees.
- b) The Bureau of Alcohol and Drug Abuse Services (A&D) concurs. A&D staff routinely carry out program reviews on site. Follow-up reports are submitted in writing to each agency, and grantees are required to prepare corrective action plans for any deficiencies. Staff routinely notify the Bureau and the Office of Audit and Investigations of significant deficiencies.

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### **CONTRACTS**

Our objective in the area of contracts was to follow up a past finding management had not acted on and to address issues raised during audits of community services agencies. Our specific objectives were to determine

- whether the department continued to enter into contracts that establish improper employer-employee relationships,
- whether the department's subcontracts for TennCare Outreach services (see below) appropriately delineate that the contracted activities are TennCare related, and
- whether the department ensured that certain TennCare subcontractors complied with the requirements of the department's contract with the Department of Finance and Administration.

TennCare Outreach includes a variety of activities:

- Provides information, assistance with the application process, education concerning proper utilization of the managed care system, and assistance in locating providers for

various types of services for families and individuals who may be eligible for TennCare.

- Assists TennCare in the evaluation of the adequacy and effectiveness of service provided by TennCare managed care organizations through home visits, personal contacts in clinic settings, phone calls, and written communications.
- Analyzes TennCare-specific data from the perspective of population-based indicators.
- Performs assessments to determine the adequacy of TennCare provider networks and consumer satisfaction and concerns about TennCare managed care organizations and TennCare.
- Recruits health care providers into areas with insufficient TennCare providers.
- Assists in the identification of problems which preclude the establishment of a health care delivery system sufficient to meet the needs of TennCare recipients.

We interviewed key department personnel and reviewed contracts, contract payment support, and memorandums. We determined that the department has continued to enter into contracts that create improper employer-employee relationships, as discussed further in finding 3. We also determined that the department's subcontracts for outreach services are not specific enough to ensure that the subcontractors are aware of the relationship to TennCare. This is discussed in finding 4.

### **3. The department continues to establish improper employer-employee relationships**

#### **Finding**

As noted in each audit report since 1986, the Department of Health has entered into contracts with nonprofit organizations and human resource agencies to assist in implementing the Special Supplemental Food Program for Women, Infants, and Children; Infant Follow-Up Services; Prenatal Services; and other programs. Through these contracts, the department has directed nonprofit organizations and human resource agencies to hire and pay certain individuals who perform duties in state facilities and are directly supervised by state officials. These contracts apparently create "employer-employee" relationships between the department and these individuals, but the department has given no consideration to the legal liability implications. The department has, in effect, increased the number of its employees without adding them to the state's payroll. Since these individuals are not employed by the state in authorized positions, the department has assumed the legislative role of creating positions.

The Department of Finance and Administration has approved the contracts, pointing out that Chapter 0620-3-3-.03(b) of the *Rules and Regulations of the State of Tennessee* gives the

Commissioner of Finance and Administration, in consultation with the Department of Personnel, authority to approve contracts for services between state agencies and other entities. However, contracts creating employer-employee relationships are specifically prohibited by the *Rules and Regulations of the State of Tennessee*, Chapter 0620-3-3-.03(b), which states:

It is state policy that employees be hired through the merit system of the Department of Personnel, and that any contract creating an employer-employee relationship is prohibited. Therefore, only contracts with independent contractors, and not contracts representing the hiring of employees, will be approved.

To allow the department to continue to deliver services at the same level, officials from the Departments of Health and Finance and Administration have decided that the department will continue contracting with nonprofit organizations and human resource agencies for personnel and that the department will request, by letter, an exception to Chapter 0620-3-3-.03(b) on any contract establishing this employer-employee relationship. However, even though Chapter 0620-3-3-.08 of the *Rules and Regulations of the State of Tennessee* gives the Commissioner of Finance and Administration the authority to make exceptions to Chapter 0620-3-3-.03(b), there is no authority in the statutes that allows employer-employee relationships such as this.

Although no letter requesting an “exception to Chapter 0620-3-3-.03(b)” could be provided, the department has been entering into this type of contract with the community services agencies (CSAs), formerly community health agencies (CHAs), since they were created in 1989. At that time, the department was the oversight body for the CHAs. In May 1996, oversight was transferred to the Department of Children’s Services. The Department of Health, however, seems reluctant to relinquish its oversight role. Through its contracts with the CSAs for the community development program, the department seems to be increasing its control over the agencies. *Tennessee Code Annotated*, Section 37-5-315 (2), however, states that the department’s contracts with the CSAs “shall not be construed as creating an employer-employee relationship.”

Nevertheless, the department’s following actions strongly suggest an employer-employee relationship:

1. Over time, community development program responsibilities, staff, and equipment were transferred from the CSAs to Department of Health regional offices.
2. Department of Health regional office directors interviewed and recommended individuals to fill vacant community development staff positions in the CSAs.
3. The CSAs continued to be responsible for their equipment inventories; however, program equipment was located in the department’s regional offices.
4. The regional directors were responsible for approving CSA expenditures; however, all costs associated with the community development programs were paid from the

CSAs' budgets even though a portion of the funds did not come from the Department of Health.

This situation provides numerous opportunities for abuse. For example, the department's regional offices could supply their own offices with supplies purchased by the CSAs because the regional directors have the authority to approve CSA expenditures, thus bypassing state purchasing procedures.

The CSAs apparently have not been allowed to control a program for which they retain fiscal responsibility. True responsibility and potential liability rest with the regional offices and, therefore, with the Department of Health.

### **Recommendation**

The Department of Health should not contract with community services agencies, non-profit organizations, and human resource agencies to establish employer-employee relationships. Individuals who are in effect performing state services should be placed on the state payroll system through the proper hiring procedures. When appropriate, the department should establish either professional service or personal service contracts. In addition, either control of the community development program should be returned to the CSAs, or complete fiscal responsibility should be borne by the department.

### **Management's Comment**

The department does not concur.

When a potential litigant is attempting to prove an employer/employee relationship for the purpose of suing the employer for something the "employee" did, certain factors are considered, such as who pays the "employee," who supervises the "employee," and where the "employee" is housed during work hours. Similarly, when an individual is trying to prove he/she is an "employee" for such purposes as claiming benefits, the same or similar criteria are used to determine the relationship.

However, when there is a statute which explicitly states that there is no employer/employee relationship established between two entities doing business together, the above-mentioned criteria do not apply. *Tennessee Code Annotated 37-5-310* pertains to the construction of the statutes which create the Community Services Agencies. Subsection (2) of that statute states that Part 3 of Title 37, Chapter 5, is not to be construed to establish an employer/employee relationship between the Department of Children's Services and a Community Services Agency (CSA) or its contractors. Also, *Tennessee Code Annotated 37-5-302* states that a department of state government may contract with a CSA to provide services for the department, e.g., the Department of Health. Consequently, in light of both of the statutes cited, when the Department of Health contracts with a CSA to for services to be provided by the CSA, and the CSA

designates individuals to provide those services, those individuals do not become employees of the Department of Health, but remain employees of the CSA, other factors aside, due to the provisions of the statutory language.

### **Rebuttal**

**As noted in the finding, the practice of allowing employees of nonstate entities such as the Community Services Agencies to report directly to Department of Health officials/employees in carrying out what can be construed as state programs raises policy and legal issues. We do not believe that these situations should be accepted as a matter of policy. Additionally, it is unclear as to whether *Tennessee Code Annotated*, Section 37-5-315(2), completely insulates the state from legal liability. This legal concern arises from a review of the factors commonly used in determining the existence of an employer-employee relationship. These factors include, most importantly, an entity's or individual's right to hire and fire and the right to control the performance of a job or work. The Department of Health should consult with the Office of the Attorney General concerning the legal ramifications of such employer-employee relationships.**

**In addition, the state apparently has incurred additional cost by contracting with nonstate entities to operate programs. Over the years, the CSAs have operated programs for various departments of the state. In addition to direct program costs, the CSAs have received funding from each state department to defray the costs of administration. These costs included the salaries and benefits of the executive director and the fiscal officer, and costs of travel, supplies, and equipment used by the administrative staff.**

**In prior years the Department of Health provided program funding to the CSAs to be used for a community development program, the focus of which was determined by the CSAs with the department's approval. However, in fiscal year 1996, the Department of Health transferred the responsibility of the program from the CSA to the department's regional offices. When the responsibility for the program was transferred back to the department, the state continued to maintain the administrative funding at the same level as in the past. With state personnel operating this program, it would appear that the administrative funding paid to the CSAs would have decreased. However, the Department of Health did not decrease the administrative funding even though the department now controls the hiring and firing of CSAs community staff and makes the program decisions. It appears that the cost of administering this program has been shifted to the state rather than being borne by the CSA.**

**The state provided the following amounts of administrative funding to the CSAs for the Community Development Program and other programs for the year ended June 30, 1996:**

<b>Davidson County CSA</b>	<b>\$100,000</b>
<b>East Tennessee CSA</b>	<b>\$118,168</b>
<b>First Tennessee CSA</b>	<b>\$114,471</b>
<b>Hamilton County CSA</b>	<b>\$100,000</b>
<b>Knox County CSA</b>	<b>\$100,000</b>
<b>Memphis-Shelby CSA</b>	<b>\$100,000</b>
<b>Mid-Cumberland CSA</b>	<b>\$186,412</b>
<b>Northwest CSA</b>	<b>\$107,691</b>
<b>South Central CSA</b>	<b>\$114,782</b>
<b>Southeast CSA</b>	<b>\$111,144</b>
<b>Southwest CSA</b>	<b>\$114,349</b>
<b>Upper Cumberland CSA</b>	<b>\$112,434</b>

**4. The department’s subcontracts for TennCare Outreach services are not specific**

**Finding**

Under a contract with the Department of Finance and Administration (F&A), the Department of Health was to provide TennCare-related services during fiscal year 1996. The contract specifically listed the types of services to be provided and set forth in an “Allocation Plan for Outreach Identification” the methods the department was to use to identify and report time spent on TennCare Outreach. The funding of the contract was 50% federal-50% state and totaled \$15,000,000.

The Department of Health subcontracted a portion of this contract to the community health agencies (CHAs) (now known as community services agencies or CSAs). The wording of these subcontracts, however, did not clearly establish that the contract activities were related to TennCare Outreach. Furthermore, the subcontracts did not include the “Allocation Plan for Outreach Identification” to help the CHAs account for their activities. For example, in the department’s 1996 fiscal year contract with the East Tennessee CHA, TennCare was not mentioned in the “scope of activity” for the portion of the “Community Development Program” funded 48.86%

with the TennCare funds. In addition, the methods to be used to identify and report time spent on the Community Development Program were not specified in these subcontracts.

The same types of contracts were entered into for fiscal year 1997. Not only do the 1997 fiscal year contracts with the CSAs not mention TennCare in the Community Development Program description, but they also do not indicate that a portion of the funding will be from TennCare dollars.

Even though the department subcontracted the services, it is responsible for compliance with the F&A contract. The contracts between the department and the CSAs do not require that all activities charged to the Community Development Program, and subsequently to the TennCare Program, be adequately supported.

### **Recommendation**

The Director of the Bureau of Health Services should ensure that subcontracts for TennCare-related services are sufficiently detailed to inform the subcontractors of all contract requirements and the portion of federal funding. Since the department is responsible for determining whether subrecipients spend federal assistance funds in accordance with applicable laws and regulations, the director should develop procedures to ensure that only allowable costs are charged to the Community Development Program and ultimately to TennCare.

### **Management's Comment**

We concur. The bureau will ensure that any expenditures against TennCare funding have been appropriately documented.

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### **SUPPLEMENTAL PAY**

Our work in the area of supplemental pay consisted of following up a prior audit finding on which management had not acted. Our objective was to determine whether the department ensured that all supplemental pay recipients met department and *Tennessee Code Annotated* eligibility requirements.

We interviewed key department personnel to gain an understanding of the department's supplemental payroll system and its evolution. We also reviewed department policies, *Tennessee Code Annotated* (Section 68-2-603), supplemental pay records, and memorandum agreements with the counties. We found the department had inappropriately increased the number of employees receiving supplemental pay.

**5. The department inappropriately increased the number of employees receiving supplemental pay**

**Finding**

Certain county health directors and county health officers receive supplemental pay from the counties in which they work. The counties enter into memorandum agreements with the department and remit the supplement plus associated benefit costs to the state in quarterly installments. The total salary amount paid to a state employee is maintained in the state's payroll records to ensure that all payroll taxes are properly withheld, that the employer's share of all benefits is paid, and that the amount of the supplemental pay is recorded in the retirement system and on the employee's federal tax Form W-2. This type of payroll supplement is authorized by Section 68-2-603, *Tennessee Code Annotated*, which states that county health directors and county health officers "shall have compensation paid, all or in part, by the state department of health."

Although there is no provision in the law granting authority for supplemental pay to employees in other positions, the department has allowed other state employees to receive supplemental pay from the counties in which they work. This issue was included in the audit reports for fiscal years 1987 through 1995 which questioned the appropriateness of such payments. Management concurred and stated that no new supplements would be allowed for state employees who were not county health directors or county health officers and that attrition would correct this situation with regard to supplemental payments to other state employees. A statement was issued January 1, 1989, setting forth the department's policy:

Employees (other than county health directors and officers) receiving supplemental pay prior to July 1, 1987, who have been "grandfathered" in by the Bureau of Health Services, will be allowed to continue receiving their supplemental pay.

The department's policy, however, does not comply with *Tennessee Code Annotated*, Section 68-2-603, because it allows some employees who are not county health directors or county health officers to receive payroll supplements.

In violation of its own policy, the department added ten ineligible employees who began receiving supplemental pay during the last nine fiscal years. The ten employees were not receiving supplemental pay at July 1, 1987; in fact, three of the employees were not hired until after that date. Seven of the ten employees were still employed by the department as of June 30, 1996. For two of these seven, supplemental pay was stopped in November 1996 when the situation was discussed with department personnel. The other five are still receiving the pay supplements. Departmental personnel stated that these employees were "grandfathered" in between July 1, 1987, and January 1, 1989 (the date the policy was adopted); however, two were not "grandfathered" in until after January 1, 1989.

An inequitable compensation practice, especially one in violation of *Tennessee Code Annotated*, may expose the department and the state to lawsuits from employees who do not receive pay supplements but who perform duties identical to employees who do. Attrition will not correct this problem as long as additional employees are allowed to receive supplemental pay.

### **Recommendation**

The Commissioner should ensure that all department policies comply with *Tennessee Code Annotated*.

The Director of the Bureau of Health Services should ensure that the department complies with *Tennessee Code Annotated* and with the department's written policy concerning supplemental pay. No additional ineligible employees should receive supplemental pay. Supplemental pay should be discontinued for employees who were not "grandfathered" in by the department's policy.

### **Management's Comment**

The department concurs with this finding and recommendation. The Director of the Bureau of Health Services now reviews and approves all supplemental pay requests. Only those requests complying with the *Tennessee Code Annotated* and the Department's written policy concerning supplemental pay will be approved.

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## **FEDERAL EQUIPMENT RECORDS**

Our review of federal equipment records consisted of a follow-up of a prior audit finding to determine whether it had been resolved. The objective of this review was to determine whether the department properly and consistently recorded grant-funding information in the state's property records.

We tested a nonstatistical sample of federally funded equipment purchases to determine whether the grant information (grant number and percentage of federal funds) was entered into the property system. The information was not entered consistently, as discussed in finding 6.

**6. The department did not always record grant-funding information in the state's property records**

**Finding**

As noted in the prior audit, grant information (grant number and percentage of federal funds) was not entered into POST (Property of the State of Tennessee), the state's property and equipment-tracking system, for seven of 36 (19%) federally funded equipment purchases tested. Management concurred with the finding and stated that steps have been taken to ensure that equipment purchase orders contain the required grant information so that it can be entered into the POST system. Although the department has made improvements, the problem still exists.

The department must be able to distinguish between state and federal property. The U. S. Department of Health and Human Services' "Public Health Service (PHS) Grants Policy Statement (Rev. April 1, 1994)," states that in certain cases grantees should report income earned from the sale of equipment purchased with grant funds on the Federal Financial Status Report (pages 8-10): "PHS has the right to require transfer of the equipment including title, to the Federal Government or to an eligible third party" (pages 8-14). If the equipment is damaged beyond repair, lost, or stolen, the recipient may be accountable to PHS for "an amount equal to the Federal share of the original equipment times the fair market value." If equipment purchased with federal grant funds is not identified as such in the property records, the department's ability to transfer equipment, dispose of equipment, or reimburse the federal government in accordance with federal laws and regulations is greatly diminished.

**Recommendation**

Employees who initiate equipment purchases that are to be funded with federal funds should include critical grant information on the face of the purchase documents. The Director of the Division of General Services should ensure that staff consistently follow the procedures developed to ensure that the required grant information is entered into POST.

**Management's Comment**

The department concurs. A memorandum has been sent to all bureaus and divisions within the department requiring that all purchase requests for equipment reflect the source of funding, percentage of each funding source, and federal grant number, if applicable. The Division of General Services uses this information to enter appropriate information into POST.

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## CELLULAR PHONES

Our objectives in reviewing cellular phone monitoring procedures include determining

- whether cellular phone use was adequately monitored, and
- whether the department had established written policies and procedures for monitoring cellular phone use.

We interviewed key personnel to determine whether cellular phone use was monitored and whether any written procedures for monitoring were in place. We also reviewed cellular phone statements for evidence of monitoring. We found no written procedures and inadequate monitoring of the statements.

### **7. The department did not adequately monitor cellular phone use**

#### **Finding**

The Department of Health did not adequately monitor cellular phone use and did not establish policies and procedures for such monitoring. As a result, the department paid approximately \$400 for cellular phone service from January to November 1996 for a former employee and an employee of another department. Charges prior to January 1996 could not be determined because of a lack of detailed billings.

In addition, one phone was available to various Bureau of Administrative Services employees. During the audit period, the cellular phone was also used by the Director of the Bureau of Health Services. Since there was no system to document the users and the dates of use, it was impossible to determine which employees made calls on certain days.

Lack of adequate cellular phone monitoring can result in unauthorized use, nonbusiness use, and extra expenses for the department.

#### **Recommendation**

The Director of the Bureau of Information Resources should ensure cellular phone bills are monitored by appropriate departmental personnel. Monitoring should include a timely review of the bills to ensure that the charges are made for authorized employees, that charges are reasonable and necessary, and that there is follow-up of any discrepancies found.

In addition, the Directors of the Bureau of Information Resources and the Bureau of Administrative Services should establish and implement written policies and procedures for monitoring cellular phone use.

toring and maintaining cellular phones. These written policies should provide procedures for ensuring that service is paid for only those phones assigned to current department employees.

### **Management's Comment**

The department concurs that adequate monitoring of cellular phone service was not enforced during the audit period. Subsequently, the department has developed a written policy to cover cellular phone issuance, usage, and monitoring of monthly bills. Each month, a copy of the cellular phone bill will be sent to the section director for review and approval by both the individual cellular phone user and their immediate supervisor. Discrepancies will be noted on an attached log along with detailed explanations and actions taken. The log and approved copy of the cellular phone bill will be returned to the department's Telecommunications Coordinator where they will be reviewed and maintained for a period of three years.

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### **REVENUE**

Our objectives in reviewing the revenue controls and procedures focused on determining whether

- departmental controls ensured that transactions were properly supported, that receipts agreed with amounts deposited, that deposit slips were completed properly, that departmental records were reconciled with STARS, and that funds were properly controlled and deposited intact;
- revenue functions were adequately segregated in the department;
- the Department of Finance and Administration's policy for timely deposit of funds received had been followed;
- proper support for journal vouchers was maintained; and
- the department complied with applicable federal rules, regulations, and guidelines when federal funds were involved.

We interviewed key department personnel to gain an understanding of the department's procedures for and controls over receiving, receipting, controlling, safeguarding, and depositing funds. We also reviewed supporting documentation and tested nonstatistical samples of revenue transactions. Through our interviews and review of records, we found that many of the department's internal controls either were not effectively designed or were not in place.

**8. For the sixth consecutive year, the department's revenue procedures and controls are inadequate**

**Finding**

As noted in the five prior audits, the department's revenue procedures are inadequate. Although improvements have been made, control weaknesses were noted in the areas of segregation of duties, safeguarding of revenue items, restrictive endorsement of checks, procedures for receipting, accounting for receipts, proper documentation of revenue reconciliations, and timely deposits.

- a. The Administrative Services Assistant (ASA) at Health Services Information stated that no receipt or cash receipt listing is prepared when the mail is opened. Health Services Information personnel place funds received in an unsecured bin before writing receipts and endorsing checks. (An auditor observed that checks totaling approximately \$1,100 were in an unsecured bin on June 24, 1996.) The ASA also stated that individual receipt numbers for the prenumbered cash receipt books are not accounted for periodically.
- b. At the West Tennessee regional office, the ASA and the secretary in Children's Special Services Division stated that one employee opens the mail, writes receipts, restrictively endorses checks, and posts to the department's accounting records, and another employee prepares the deposit and takes the deposit to the bank. At the Communicable Disease Center, the secretary stated that the employee who opens the mail also endorses checks, writes receipts, prepares the deposit, and takes the deposit to the bank. Also, based on discussion with the accountant in the administrative area, one employee prepares the deposit and takes it to the bank.
- c. According to the Director of the Special Supplemental Food Program for Women, Infants, and Children (WIC) at the Chattanooga-Hamilton regional office,
  - WIC vendor reclaims (reimbursements for overcharges on WIC-approved foods) are left unsecured when someone other than the director opens the mail,
  - no receipt or cash receipt listing is prepared when the mail is opened,
  - the employee who opens the mail and writes receipts also prepares the deposit,
  - individual receipt numbers for the prenumbered cash receipt books are not accounted for periodically, and
  - deposits are not made timely.

- d. The ASA at the Bureau of Information Resources stated that checks are not restrictively endorsed immediately upon receipt.
- e. According to personnel in Health Related Boards, no receipt or cash receipt listing is prepared when the mail is opened, and individual receipt numbers for the prenumbered cash receipt books are not accounted for periodically. In addition, reconciliations are not signed or dated by the preparer or an independent reviewer.
- f. According to personnel in General Environmental Health, individual receipt numbers for the prenumbered cash receipt books are not accounted for periodically.
- g. At the Milan Health Department, personnel stated that no receipt or cash receipt listing is prepared when the mail is opened. One employee writes receipts, prepares the deposit, and takes the deposit to the bank.

The clerk at the Humboldt Health Department stated that the employee who opens the mail also restrictively endorses checks, writes receipts, and prepares the deposit. Neither the Milan nor Humboldt Health Department requires that deposits be made twice a week as stated in the exception to the Department of Finance and Administration's Policy 25, "Deposit Practices Policy."

### **Recommendation**

The Director of Administrative Services should assign staff specific responsibility for ensuring that all revenues are properly controlled and should monitor staff's efforts. Written procedures for correctly accounting for receipts, safeguarding assets, segregating duties, reconciling accounts, preparing receipts or receipt listings, and endorsing revenue items should be developed, implemented, and monitored.

### **Management's Comment**

The department concurs. The Director of Administrative Services and the Director of Audit and Investigations shall work together in developing appropriate procedures.

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## **CONTINGENT AND DEFERRED REVENUE**

Our objectives in reviewing contingent and deferred revenue controls and procedures and subaccount balances focused on determining whether

- contingent/deferred revenue accounts were used for the intended purpose,

- transactions were properly supported,
- only applicable items were recorded as contingent or deferred revenue and in the proper amounts,
- revenue was transferred from contingent/deferred to earned when the applicable criteria were met,
- the department had complied with applicable federal rules, regulations, and guidelines when federal funds were involved, and
- large variances between current and prior-year ending balances could be reasonably explained.

We interviewed key department personnel to gain an understanding of the department's procedures for and controls over deposits into the subaccounts and transfers of earned revenue. We reviewed supporting documentation and tested nonstatistical samples of transactions. We also compared June 30, 1996, subaccount balances with balances reported at June 30, 1995, and obtained explanations for significant variances. We noted no significant deficiencies.

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**DEPARTMENT OF FINANCE AND ADMINISTRATION POLICY 20, "RECORDING OF FEDERAL GRANT EXPENDITURES AND REVENUES"**

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 objectives focused on determining 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;
- the department had negotiated an appropriate indirect cost recovery plan, and indirect costs were included in drawdowns, and
- the department used 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 and expenditure transactions, drawdowns, and reports submitted to the federal government. We also reviewed payroll cost reallocations and the Schedules of Federal Financial Assistance. We determined that the department does not always reallocate the payroll costs to federal programs timely and is not consistent in how it estimates the reallocations. These problems were discussed in finding 1.

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## **PRIOR AUDIT FINDINGS**

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Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Department of Health filed its report with the Department of Audit on December 10, 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 Health has corrected previous audit findings concerning timely completion of allocations of charges to federal programs and controls to detect dual participation in the WIC and CSF programs.

### **REPEATED AUDIT FINDINGS**

The prior audit report contained findings concerning grant payroll cost reallocation and drawdown procedures, monitoring of subgrantees, passing of OIR overcharges on to federal programs, recording of grant-funding information in the state property records, and internal controls over revenue. These findings have not been resolved and are repeated in the applicable sections of this report.

In addition, two issues noted as past findings not acted upon by management in the prior audit report have been included as findings in the current audit report. These findings concern supplemental pay and the continued use of improper employer-employee relationships.

### **PAST FINDINGS NOT ACTED UPON BY MANAGEMENT**

Prior audits of the Department of Health have contained findings about the drawdown and use of indirect cost funds and the development and implementation of effective controls in the Nursing Home Resident's Grant Assistance Program.

## Draw Down and Use of Indirect Cost Funds

The Department of Health has not fully used the departmental indirect cost allocation plan for the recovery of indirect costs from block grants. Management uses eligible indirect costs for program expenditures and spends a large portion of previously recovered indirect costs for program services.

The department enters into an annual agreement with the Division of Cost Allocation in the U. S. Department of Health and Human Services specifying the terms of the indirect cost allocation plan. The plan identifies departmental, bureau, divisional, and statewide indirect costs. The departmental, bureau, and divisional indirect costs are those incurred at a particular level for a common purpose, which benefit more than one program, function, or activity, and therefore are not directly assignable to a single program, function, or activity. Statewide indirect costs are the costs of central governmental services distributed through the statewide cost plan that are not otherwise treated as direct costs. Using the indirect cost allocation plan, the department can allocate total indirect costs by bureau or by division.

When indirect costs are not systematically drawn as a part of the program's operating costs, they are, in effect, hidden and must be paid from other sources. Although the allocation of indirect costs may actually shift the use of available federal funds from program operations to administrative overhead, the allocation is essential to present fairly the costs of administering the programs. Likewise, when earned indirect costs are used to fund program services, the true level of state expenditures incurred to fund the program is hidden, and state funds are used to fund activities at the departmental level. The decision whether additional state funds should be used for federal programs is more appropriately addressed through the legislative budget process than by departmental determination.

Management has concurred with the finding, stating that the department's policy is to maximize the utilization of all available federal grant dollars and that the budget is predicated and reflective of these efforts. Furthermore, management has stated that any policy or procedural change requiring indirect cost funds to be used solely for administrative expenditures would necessitate a budget reorganization within the department that would have to be approved by the Commissioner of Finance and Administration and the legislature through the Appropriation Request process. However, the Department of Health has not revised its budget to address this issue.

## Administrative Controls for the Nursing Home Resident's Grant Assistance Program

The Department of Health has not established adequate administrative controls over the Nursing Home Resident's Grant Assistance Program to ensure participant eligibility and contractor performance, nor has the department set per diem limits.

The program's intent is to provide a small amount of assistance to nursing home residents whose care is not paid by a state or federal program and who are income eligible.

A private contractor is responsible for maintaining a systematic process to provide financial support for eligible individuals. However, neither the department nor the contractor verifies the accuracy of information on the applications or on the documents each nursing home completes to certify the number of days residents did not receive other assistance and to report the average per diem expense. In addition, the department does not monitor the program contractor.

If patient eligibility and contractor performance are not monitored, funds could be disbursed to ineligible participants.

Management concurred in part with the finding, stating that as the program was planned and designed, the department believed certain controls would not be cost-effective nor reasonable. Management also stated that although there are some very broad eligibility requirements in the law establishing this program, certain other financial eligibility information verification is left to the discretion of the department. When designing the program, the department chose not to further verify participant eligibility or the accuracy of information reported by nursing homes. Management agreed that the department could develop and implement procedures to more accurately verify participant eligibility and the accuracy of information reported by nursing homes, but stated that it was not appropriate to do so particularly in the early stages of developing the program, given the population involved, the intent of the program, and the relatively small grant amounts available. Management said the department would look at this situation further to determine if additional, more formal procedures were needed to adequately monitor the program contractor. However, no additional procedures have been established.

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## OBSERVATIONS AND COMMENTS

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### **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 Health filed its compliance report and implementation plan on July 3, 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 national 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.

## **OIR OVERCHARGES**

The Office for Information Resources (OIR) in the Department of Finance and Administration continues to charge the Department of Health for leased computer equipment the department no longer has. Despite the requests by the department to stop the charges, OIR continues to automatically charge the department's allotment codes and cost centers for this surplus equipment each month, using front-end billing journal vouchers. Because OIR's detailed list of charges did not list equipment tag numbers before June 1995, the department could not determine precisely what equipment it was being billed for each month. OIR made changes to the billing format to include tag numbers; however, Department of Health personnel determined that the tag numbers used are not always accurate.

OIR changed its billing format again after June 30, 1996, and stated in a memo that even though "there are several changes in the billing processes, . . . there is still a lot of work to be done to complete the reporting and to provide . . . access to the detail [sic] information." However, OIR continues to charge the department for equipment it does not have and has made no attempt to reimburse the department for the excess charges.

Some of the allotment codes and cost centers automatically charged by the monthly front-end billing journal vouchers are used exclusively for federal grants, and some have been charged for a portion of the surplus equipment. Because the department could not isolate these costs, it was unable to determine which grants and what amounts were charged and are still being charged. According to Office of Management and Budget, A-87, "Cost Principles for State and Local Governments," charges must be "necessary and reasonable for proper and efficient administration of the grant program." The department, therefore, may face questioned costs for these equipment charges.

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## APPENDIX

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### DIVISIONS AND ALLOTMENT CODES

Department of Health divisions and allotment codes:

343.01	Executive Administration
343.03	Administrative Services
343.04	Information Resources
343.05	Manpower and Facilities
343.07	Emergency Medical Services
343.08	Laboratory Services
343.10	Health Related Boards
343.12	Chronic Renal Disease
343.13	Hemophilia
343.39	Division of General Environmental Health
343.44	Alcohol and Drug Services
343.45	Health Services
343.47	Maternal and Child Health
343.48	Division of Special Services
343.49	Communicable Disease Control
343.50	HSA Medical Programs
343.52	Population Based Services
343.53	WIC Supplemental Foods
343.54	Community Health Agencies
343.60	Local Health Services
343.70	Nursing Home Grant Assistance Program



