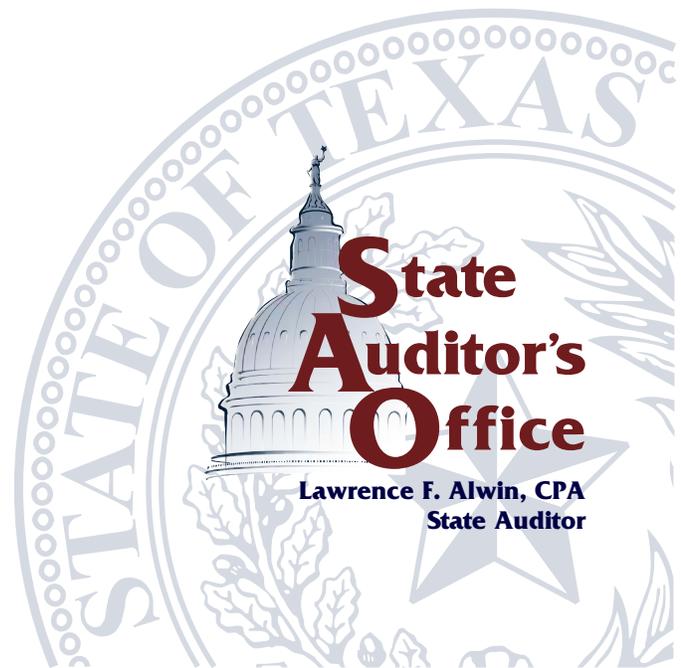


An Audit Report on

# The Department of Health's Monitoring of Program Service Contractors' Financial Operations

April 2004

Report No. 04-029



# The Department of Health's Monitoring of Program Service Contractors' Financial Operations

## Overall Conclusion

As of the beginning of our audit, the Department of Health (Department) still had not corrected long-standing deficiencies in its monitoring of program service contractors' financial operations. Although audits conducted during each of the last four years have identified the Department's failure to adequately conduct required monitoring of program service contractors' financial operations, the Department still had not addressed this issue.

The contractors we reviewed were providing program services. However, because of its poor record keeping, one contractor could not determine whether it had collected all registration fees for its Tobacco Prevention and Control program and did not report \$62,082 of program income to the Department. As a result, the Department's payments to the contractor should have been reduced by \$62,082, or the Department should have allowed the contractor to provide additional program services with an equivalent value.

We identified financial control weaknesses that resulted in another contractor's violating federal and state requirements by incorrectly allocating program income among its Tuberculosis Prevention and Control, Immunization, Family Planning, and Maternal and Child Health programs. This is significant because its contract required that program income generated in a particular program must be allocated only to that program. This contractor also incorrectly reported \$12,013 in total program income for all of these programs, when it should have reported \$18,101 in total program income.

The lack of financial controls at another contractor led it to make at least \$19,694 in disallowed and questionable administrative expenditures (as identified by the Department during a desk review), which also was a violation of federal and state requirements. In addition, during the fiscal year 2003 single audit, an independent auditor reported that the Department had not conducted financial monitoring at 104 (80 percent) of the 130 program service contractors tested.

It is critical that the Department monitor contractors' financial operations so that it can identify improper use of program funds and noncompliance with certain federal and state requirements. Monitoring specifically identifies waste, misuse, or misappropriation of program funds, which ultimately diminish the level of services clients receive.

### Background Information

The Department's records indicate that it paid 26,038 vendors \$1.157 billion from September 2002 through May 2003. In our attempt to identify the contract population, we identified payments to 607 program service contractors and 1,251 administrative service contractors; together, these contractors received \$700 million (61 percent) of the Department's total payments to vendors during fiscal year 2003.

The Department's financial compliance monitoring division is responsible for monitoring the majority of the program service contractors. However, the Department has been cited for its failure to adequately conduct financial monitoring of its program services contractors during each of the last four years.



Weaknesses in the risk assessment process the Department uses to identify contractors for potential financial monitoring also led to the Department's excluding at least 100 contractors from consideration for financial monitoring. In addition, although the Department has implemented its Contract Development System, it has not included all contracts in that system as Department staff had recommended and as the consultant that prepared the Department's business practices evaluation report reiterated. As a result, the Department is unable to easily identify the full extent of its contracting activities. This impairs the Department's ability to completely account for all of its contract liabilities and to prepare accurate financial information. While the full extent of the Department's contracting is unknown, we estimated that in fiscal year 2003 the Department had at least 2,200 program service contracts, on which it paid \$200 million.

We also found that the Department amended 37 of its program service contracts after those contracts had already expired. The Department made some of these amendments to accommodate contractors that had not spent funds in keeping with the terms of their contracts or that had provided more services than their contracts required them to provide. Amending expired contracts (instead of establishing new contracts) increases the risk that the Department will not be able to hold contractors to the terms of these contracts.

The Department's failure to perform adequate financial monitoring also must be addressed when the Health and Human Services Commission assumes responsibility for financial monitoring under the ongoing consolidation of health and human service agencies required by House Bill 2292 (78th Legislature, Regular Session).

## ***Summary of Objectives, Scope, and Methodology***

Our objectives were to determine whether the Department enforces financial accountability by (1) ensuring that contractors provide the services for which they request payment, (2) ensuring that contractors follow state and federal requirements related to contract and grant management activities, and (3) having controls in place to ensure that it receives payment from performing contracts.

The scope of our audit covered contract payments made to program service contractors from September 1, 2002, to May 31, 2003. The audit was limited to contract payment and financial monitoring processes. Our scope did not include the Women, Infants, and Children (WIC) program. According to the Department, the WIC program represented more than 40 percent of the funds it passed through to contractors in fiscal year 2003. The Department also reports that it performs financial and program monitoring of WIC contractors every two years.

The audit methodology consisted of collecting information and documentation, performing selected tests and other procedures, analyzing and evaluating the results of the tests, and conducting interviews with the Department's management and staff. This audit did not include a review of information technology.

Prior Reports on the Department of Health		
Author	Report Name	Release Date
State Auditor's Office	State of Texas Financial Portion of Statewide Single Audit Report for the Year Ended August 31, 2003 (SAO Report No. 04-555)	March 2004
Independent Auditor	State of Texas Federal Portion of Statewide Single Audit Report for the Year Ended August 31, 2003	February 2004
State Auditor's Office	An Audit Report on the Department of Health's Implementation of a Business Improvement Plan (SAO Report No. 03-023)	March 2003
Independent Auditor	State of Texas Federal Portion of Statewide Single Audit Report for the Year Ended August 31, 2002	February 2003
Independent Auditor	State of Texas Federal Portion of Statewide Single Audit Report for the Year Ended August 31, 2001	February 2002
Elton Bomer, Consultant	Texas Department of Health Business Practices Evaluation	August 2001
State Auditor's Office	The 2000 Statewide Single Audit Report (SAO Report No. 01-555)	April 2001
State Auditor's Office	An Audit Report on Financial Management at the Department of Health (SAO Report No. 01-021)	March 2001

# *Detailed Results*

## *Chapter 1*

### ***The Department Does Not Adequately Monitor Its Program Service Contractors' Financial Operations and Is Unable to Easily Determine the Full Extent of Its Contracting Activities***

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As of the beginning of our audit, the Department of Health (Department) still had not corrected long-standing deficiencies in its monitoring of program service contractors' financial operations. Although the contractors we reviewed were providing program services, we identified financial control weaknesses at some of them that could prevent the maximization of program services. For example, because of its poor record keeping, one contractor could not determine whether it had collected all registration fees for its Tobacco Prevention and Control program and did not report \$62,082 of program income to the Department. As a result, the Department's payments to the contractor should have been reduced by \$62,082, or the Department should have allowed the contractor to provide additional program services with an equivalent value.

We identified financial control weaknesses that resulted in another contractor's violating federal and state requirements by incorrectly allocating program income among its Tuberculosis Prevention and Control, Immunization, Family Planning, and Maternal and Child Health programs. This is significant because its contract required that program income generated in a particular program must be allocated only to that program. This contractor also incorrectly reported \$12,013 in total program income for all of these programs, when it should have reported \$18,101 in total program income.

The Department has been cited by an independent auditor or the State Auditor's Office for not conducting a sufficient number of financial monitoring visits at program service contractors in fiscal years 2000, 2001, 2002, and 2003. For example, an independent auditor reported that the Department had not conducted financial monitoring at 104 (80 percent) of the 130 program service contractors tested for fiscal year 2003. It is critical for the Department to ensure that these funds are properly safeguarded from waste, misuse, or misappropriation so that it can maximize the level of services clients receive.

Weaknesses in the risk assessment process the Department uses to identify contractors for potential financial monitoring also led the Department to exclude at least 100 contractors from financial monitoring consideration. In addition, the Department is unable to easily determine the full extent of its contracting activities because it does not maintain comprehensive information systems for its contracts. Although Department staff and the consultant the Department hired to evaluate its business practices recommended that the Department use a common database for all contract reporting and budgeting information, the Department has not done so. This also impairs the Department's ability to completely account for its entire contract liabilities and to prepare accurate financial information. While the Department was unable to provide a complete and accurate list of its contracts, we estimated that in

fiscal year 2003 the Department had at least 2,200 program service contracts, on which it paid \$200 million.

We also found that the Department amended 37 of its program service contracts after those contracts had already expired. The Department made some of these amendments to accommodate contractors that had not spent funds in keeping with the terms of their contracts or that had provided more services than their contracts required them to provide. Amending expired contracts (instead of establishing new contracts) increases the risk that the Department will not be able to hold contractors to the terms of these contracts.

Chapter 1-A

## The Department Still Has Not Corrected Long-standing Deficiencies in Its Monitoring of Program Service Contractors' Financial Operations

### Audit Reports Have Cited the Department for Not Conducting Sufficient Financial Monitoring

- In 2004, an independent auditor reported that the Department had not conducted financial monitoring during fiscal year 2003 at 104 (80 percent) of the 130 contractors tested.
- In 2003, an independent auditor reported that the Department had not conducted financial monitoring during the past two years at 114 (74 percent) of 154 contractors tested. The independent auditor also reported that the Department had monitored only 9 of the 54 contractors it had identified as high-risk contractors in fiscal year 2002.
- In 2002, an independent auditor reported that the Department did not have adequate controls over subrecipient monitoring for three of the five grants tested during fiscal year 2001.
- In 2001, the State Auditor's Office reported that the Department had not conducted financial monitoring at 2 (11 percent) of the 18 contractors the State Auditor's Office tested.

The State's Single Audit reports for fiscal year 2000 through fiscal year 2003 have cited the Department for not conducting sufficient financial monitoring of its program service contractors each year (see text box for additional details). Nevertheless, the Department still has not adequately addressed this issue. It is critical that the Department monitor contractors' financial operations so that it can identify improper use of program funds and noncompliance with certain federal and state requirements. Monitoring specifically identifies waste, misuse, or misappropriation of program funds, which ultimately diminish the level of services clients receive.

We reviewed 21 program service contracts at 14 of the Department's contractors and identified varying levels of financial operations. Although the Department had not conducted financial monitoring at most of these contractors during the last two years, the contractors

we reviewed were providing program services. However, the types of financial weaknesses we identified at these contractors could impair the maximization of program services. For example:

- One contractor had weak controls over the registration fees for the conferences it held for its Tobacco Prevention and Control program during fiscal year 2002. Because of its poor record keeping, the contractor could not determine whether it had collected all registration fees for this program. In addition, this contractor did not report \$62,082 of program income to the Department. Program income should be deducted from the contractor's request for reimbursement; therefore, the Department's payments to the contractor should have been reduced by \$62,082, or the Department should have allowed the contractor to provide additional program services with an equivalent value. Failure to report program income is a violation of the Department's contract provisions.
- Another contractor incorrectly reported program income for its Tuberculosis Prevention and Control, Immunization, Family Planning, and Maternal and Child

Health programs. This is a violation of federal regulations and of the provisions in the contractor’s contract with the Department. The Department’s contract specifically states that program income “should be used to further the program’s objectives ... and it shall be spent on the same project in which it was generated.” Additionally, this contractor underreported its total program income for five programs by \$6,087. That amount was 33 percent of the \$18,101 amount the contractor should have reported.

- The lack of financial controls at another contractor led the contractor to make at least \$19,694 (7 percent of its \$262,500 contract) in disallowed and questionable administrative expenditures that did not provide services to its clients. The Department identified these control weaknesses during a desk review and requested repayment of the \$19,694. The Department also required the contractor to provide additional detailed financial information and documentation (such as a detailed general ledger and current bank statement) with its monthly payment requests. Although the Department identified these issues at this contractor through a desk review, relying on desk reviews does not constitute sufficient financial monitoring. On-site financial monitoring provides a greater depth of coverage because it can allow the Department to review the contractor’s processes, controls, and financial records more extensively.

Additionally, we determined that this contractor did not monitor its subcontractors.

**The Department’s process for selecting program service contractors to monitor purposely and erroneously excluded a significant number of contractors from consideration.**

When the Department selects program service contractors at which to conduct financial monitoring, it focuses only on what it categorizes as grants (also referred to

**Programs Associated with the Contracts We Reviewed**

The contractors we reviewed provided services for the following programs:

- Title X
- HIV Ryan White
- STD/HIV
- HIV Prevention
- Texas Birth Defects Monitoring Division
- Service Delivery Integration
- Primary Health Care
- Emergency Medical Service—County Assistance
- Tobacco Prevention and Control
- Immunization
- Tuberculosis Prevention and Control
- Genetics
- Family Health—Fee-for-service

as Category 40 contracts) in its Contract Development System (CDS). However, approximately 25 percent of the funding associated with Category 40 contracts is not labeled as Category 40 funding and, therefore, would not be subject to financial monitoring (see Chapter 1-B for additional information regarding weaknesses in the Department’s contract tracking systems). Examples of the specific programs with contracts that are excluded from financial monitoring include the Service Delivery Integration, Tuberculosis Prevention and Control, and Audiology programs.

In addition, we found that the Department’s manual risk assessment process does not include all the Category 40 contracts. The Department completed the risk assessment manually because CDS, which the Department had planned to use in its risk assessment, was not capable of assisting with assigning the function properly. In preparing the risk assessment, the Department excluded 190 of the 1,058 Category 40 contracts in CDS from this process. Those 190 contracts totaled approximately \$16 million. Some of these contracts were excluded because they were not fully executed until after the risk assessment was

completed; however, the contractors had already begun providing services even though they did not have fully executed contracts.

The Department's payment process for program service contractors sometimes makes it difficult for the Department to analyze payments for potential discrepancies.

The Department sometimes combines two or more monthly reimbursements to contractors into one payment. This practice prevents the Department from analyzing historical payment information to identify fluctuations in payment amounts that might indicate financial discrepancies. For example, one contractor submitted a request for reimbursement that included expenses for March and September, but the Department coded the entire \$215,132 reimbursement for September. We also noted that the Department charged \$132,586 of the \$215,132 reimbursement to the incorrect appropriation year. Three other payments in our sample also included payments for multiple months.

**The Department has adequate controls to ensure that it receives payments on interagency contracts.**

While the Department should improve its processes for paying program service contractors, we found that it had adequate controls to ensure that it received payments for three interagency contracts we reviewed. However, the Department still has not yet corrected an error made in 2001 that caused its fund balance for the Refugee Health Screening program associated with this contract to be understated by \$681,001. In addition, the Department billed both Medicaid and the Refugee Health Screening program for \$21,967 for certain services it provided. The Department should have billed only Medicaid.

The majority of the funds associated with the interagency contracts we reviewed are passed through to contractors and, therefore, are also subject to the financial monitoring weaknesses discussed in this report.

## Recommendations

The Department should:

- Review its risk assessment process to ensure that all contracts that should be considered for financial monitoring are included in the risk assessment. It should also consider automating the risk assessment process to avoid erroneously omitting contracts.
- Ensure that all non-Category 40 contracts also receive financial monitoring.
- Increase its financial monitoring activities to ensure that contractors are expending funds for only allowable costs and are complying with contract, state, and federal regulations that help to maximize services.
- Pay contractors from proper appropriation year funding sources.
- Properly classify the period of service when combining more than one month of funding in payments to contractors.

- Ensure that the fund balances associated with programs related to its interagency contracts are accurate, and ensure that it bills the correct entities for services it provides through these contracts.

#### Management's Response

- *TDH will work with the Office of the Inspector General (OIG) to ensure complete information on all contracts to be considered for financial monitoring is available to determine the population for the risk assessment. TDH will implement procedures to ensure any contract that is not fully executed until after the assessment is conducted is provided to the Office of Inspector General for inclusion in the next risk assessment. TDH will request the OIG to document any justification for exclusion of certain contracts as a result of programmatic monitoring that provides stringent controls and a high-level of accountability.*

*Person Responsible: Bureau Chief for Financial Services, TDH*

*Date: June 1, 2004*

- *TDH agrees that non-Category 40 contracts (fee for services, professional services, and administrative contracts) should be considered for financial monitoring and will work with the Office of Inspector General to assess the risk for these contracts and an appropriate level of monitoring. The risk of inappropriate expenditures is low in this type of contract since each payment is tied to a specific deliverable or services, and the rate is set at the beginning of the contract term. Additionally, TDH centralized accounts payable effective June 1, 2003, to provide better controls for fee for services, professional services, and administrative contract payments. The use of payable receiving reports and formal procedures has improved accountability and further reduced risk of inappropriate expenditures.*

*Category 40 subrecipient contracts that fund client services on a cost reimbursement basis have historically represented the type of contracts reviewed and scheduled for on-site monitoring or desk reviews by TDH's financial monitors. These contracts are prepared with categorical budgets, and are subject to Uniform Grant Management Standards (UGMS) and Office of Management and Budget (OMB) cost circulars. Contractor expenditures are tied to a budget category rather than a specific rate as in a fee for service contract, and these contracts require more intensive monitoring.*

*Person Responsible: Bureau Chief for Financial Services, TDH*

*Date: June 1, 2004*

- *TDH has taken a number of steps to increase subrecipient monitoring. In FY 2003 and early FY 2004, TDH increased monitoring staff, provided additional travel funds for on-site visits and prepared a request for information (RFI) to solicit limited scope audits. These efforts resulted in triple the number of on-site audits conducted in the first quarter of FY 2004 when compared to the same period in FY 2003. It is anticipated that the consolidation of the compliance and*

*audit functions across the Health and Human Services agencies will result in an increase in monitoring in continuation of our goals.*

*Responsible Person: Chief Financial Officer, TDH*

*Date: July 1, 2003*

- *The SAO noted that TDH's Accounts Payable section "sometimes combines two or more monthly reimbursements to contractors in one payment"; this also resulted in a payment being processed from the wrong appropriation year funding source. To address internal controls and provide for better accountability, the accounts payable function was centralized in June 2003. TDH has implemented policies and procedures to limit the number of errors by accounting staff. In the recent Statewide Financial Audit, the SAO noted that since the centralization of Accounts Payable in June 2003, no coding errors were found in the auditor's sample.*

*Responsible Person: Chief Financial Officer, TDH*

*Date: June 1, 2003*

- *An error was made in 2001 that caused the Refugee Health Screening program's fund balance to be understated by \$681,001. This error occurred in the lapsing of the Fiscal Year 2001 funds and TDH has since processed a journal adjustment in February 2004 to correct the fund balances. Proper procedures for recording lapsed funds will be reviewed with staff to prevent future errors.*

*TDH billed both Medicaid and Refugee Health Screening programs for \$21,967 for certain services provided. Since Medicaid has up to 180 days to accept or reject the claim, the TDH correction was pending until March 2004. TDH will process a correction and refund to the Refugee Screening program by April 30, 2004, based on Medicaid's approval of the claim.*

*Responsible Person: Bureau Chief for Financial Services, TDH*

*Date: May 1, 2004*

## The Department Is Unable to Easily Determine the Full Extent of Its Contracting Activities

### Excerpt from the Department's Business Practices Evaluation

"The [Department's] Contract Improvement Team adopted policies that standardized contract management practices.... They recommended the creation of the Contract Development System that has been implemented as the common database for all contract reporting and budgeting information.... The department should aggressively pursue these initiatives."

Source: *Texas Department of Health Business Practices Evaluation*, August 31, 2001

The Department is unable to easily determine the full extent of its contracting activities and to ensure that it properly monitors its contracts because it does not maintain a comprehensive information system for all of its contracts. Although the Department has implemented CDS, it has not included all contracts in that system as Department staff had recommended and as the consultant that prepared the Department's business practices evaluation report reiterated (see text box for additional details).

The Department was unable to provide us with a complete list of its contracts and the related contract dollars. This weakens the Department's ability to ensure that it has identified and

considered all program service contracts for potential financial monitoring. It also impairs the Department's ability to completely account for all of its contract liabilities, prepare accurate financial information, and generate comprehensive contracting information for internal and external review.

The Department uses several systems to track its contracts. It generally uses CDS to track program service contracts, interagency contracts, and all performing contracts.

The Department also uses its Health and Human Services Administrative System (HHSAS) to track the administrative contracts. However, the Department tracks some program service contracts, such as contracts for the Women and Infant Children (WIC) program, in HHSAS. Although CDS and HHSAS contain differing information and the Department does not reconcile the information in these systems, our tests found that CDS and HHSAS captured the majority of the payments tied to contract dollars.

### Excerpt from Internal Audit Report #200120A Texas Center for Infectious Disease - Follow Up

The internal audit report stated that:

"TCID purchasers initially entered into the contract with the contractor for \$10,315 on September 20, 2001. On November 30, 2001, TCID purchasers revised the contract upward to \$53,000.... We also noted that the contract had been revised to \$74,000 and the contractor has billed at least \$30,000 in addition to the \$74,000 paid."

However, as of April 1, 2003, regional directors or associate commissioners can no longer enter into contracts.

In addition, we found that the Department cannot ensure that CDS and HHSAS contain *all* contracts because (1) certain programs use their own systems to track contracts and (2) prior to April 1, 2003, the Department's regional directors and associate commissioners could enter into professional services contracts for medical services that were not always entered into

any system. While the Department's policy allows regional directors to enter into service contracts not to exceed \$5,000, in 2001 the Department's internal auditor identified one contract into which a regional director had entered that had an amended amount of \$74,000 (see text box for additional details).

Not having an accurate and complete accounting of its contracts also prevents the Department from encumbering (or reserving) funds to pay its program service contractors. In fiscal year 2003, the Department paid contractors \$142 million from unencumbered funds (excluding Medicaid payments). Encumbering funds is a prudent financial practice that helps ensure that contractors can be paid with appropriate funding sources.

## Recommendations

The Department should:

- Identify all of its contracts, and develop policies to capture data for each contract.
- Encumber funds for all contractual obligations to prevent the overobligation of any funding source. Develop and implement policies and procedures that will provide a complete and accurate account of all contracts.
- Improve controls over the contracting authority of its regional offices and hospitals, and require that all regional contracts, as well as amendments, be entered into a central information system for contracts.

## Management's Response

- *As TDH is merged with two other agencies into the Department of State Health Services (DSHS), a review will be done of existing systems, including the Contract Development System. Two of the legacy agencies that will form DSHS have data warehouses. TDH will work with information technology staff and these legacy agencies to either utilize these data warehouses or develop a new common database for all DSHS contracts.*

*Responsible Person: Chief Financial Officer, Department of State Health Services*

*Date: December 31, 2004*

- *Certain TDH programs have been granted waivers in order to process and track their contracts and related expenditures in systems other than the Contract Development System (CDS) as long as the systems provide the same (or greater) accountability and access to contract information.*

*For example, the Kidney Health Care (KHC) program uses the Automated System for Kidney Information Tracking (ASKIT) to process patient and provider enrollment and to process medical and travel Claims. All claims are paid according to the program requirements that are built into the ASKIT system to include provider and patient eligibility for allowable services, and according to the allowable rates. KHC provides a quality control review of all claims before files are sent to fiscal for payment. Providers must meet all KHC enrollment requirements for participation and payment. The KHC ASKIT system tracks all providers by type (i.e. hospitals, physicians, dialysis, etc.) and program status (account pending, informational, vendor hold, etc.). The system also tracks payments made to each provider by service-type, dollar amounts, payment codes/identifiers, clients, unit costs, and date of services. The payments reports are reviewed on a daily basis as well as expenditure reports. KHC also does program audit of medical billings, services provided and claim payments to providers according to schedule of annual audit plan. KHC provides monthly projections on anticipated expenditures for the biennium and meets monthly with the CFO to review those projections and the underlying assumptions.*

*TDH will formalize procedures to review and document these exceptions.*

*Responsible Person: Fiscal Director, TDH*

*Date: June 1, 2004*

- *In response to the Business Practices recommendations and prior audit findings the Purchasing and Contracting area has re-written their policies and procedures in order to standardize and centralize their functions. For example, regional directors are no longer authorized to enter into or sign service contracts. The policy, effective February 1, 2003, requires all regional service contracts to be signed by the director of the Purchasing and Contracting Services Division at the central office in Austin.*

*This new procedure for standardization of contracting means all contracts must process through the Purchasing and Contracting staff. This provides for central control so that all regional office and hospital contracts are entered into CDS. In addition, the centralization of Accounts Payable provides for additional controls to monitor that purchase orders or contracts are in place prior to payment.*

*Responsible Party: Chief Financial Officer, TDH*

*Date: February 1, 2003*

Chapter 1-C

## **The Department Inappropriately Amends Expired Contracts**

The Department did not follow its rules and guidelines when it amended 37 of its program service contracts after those contracts had already expired. Most significantly, it diminished its ability to maximize the use of program funds when it amended five of those contracts to approve \$1.1 million in retroactive reallocations within originally approved contract budgets. In addition, the Department amended two contracts where more services were provided than contractually required. In general, amending expired contracts (instead of establishing new contracts) increases the risk that the Department will not be able to hold contractors accountable.

The original amounts of the 37 contracts totaled approximately \$9.6 million, and the amount of the amendments the Department made to these contracts after their expiration totaled approximately \$2.1 million (this included only \$220,221 in net increased funding and \$1.9 million in retroactive reallocations within originally approved contract budgets). Examples of the amendments the Department made to the 37 expired contracts include:

- Amendments to five expired contracts totaling \$1.1 million because contractors spent contract funds in a manner that conflicted with the terms of their contracts. For example, one contractor spent \$1.08 million that was originally budgeted for equipment and subcontractors to fund other expenses (such as approved expenses for the Health Alert Network). Another contractor used \$4,185 allocated for salaries to purchase a digital camera, projector, and laptop computer without obtaining prior Department approval and without providing an evaluation of the need for this equipment as required by contract provisions. Rather than denying

payment on these expenditures, the Department retroactively amended these expired contracts to make these expenditures allowable.

- Amendments to two expired contracts that originally totaled \$49,478 to increase the contract amounts by a total of \$9,113. In these cases, the Department amended the expired contracts because the contractors provided more services than their contracts required them to provide.
- Amendments to 12 expired contracts that originally totaled \$2.6 million to increase the contract amounts by a total of \$342,701 (13 percent) or extend the contract period. In most of these cases, the funding source had extended the funding period, but the Department reacted by amending the amounts and terms of the expired contracts (instead of executing new contracts). This practice could enable the Department to circumvent requirements to open its contracts to competitive bidding. The Department amended three of these contracts for periods of one year, which was the same length as that of the original contracts.

## Recommendations

The Department should:

- Refrain from amending expired contracts. If it wishes to continue contracting with specific entities, the Department should establish new contracts with these entities.
- Require contractors to negotiate with the Department before the expiration of their contracts if they wish to provide more services than their contracts require them to provide or if they do not expect to complete work within the originally specified timeframe.
- Require contractors to obtain prior approval from the Department in order to shift funds budgeted for one budget category to another budget category. The Department should not retroactively approve these changes through contract amendments.
- Process contract amendments in a timely manner.

## Management's Response

- *TDH agrees that expired contracts should not be amended. TDH will implement policies and procedures that ensure the agency's contracts contain language that identifies a mechanism to amend, realign and/or extend contracts when there is a business need to do so. In the specific cases noted in bullet three of Chapter 1-C, eight of the contracts were amended as a result of TDH receiving a supplemental Notice of Grant Award (NGA) from a federal funding source which stipulated that the project period was being extended. Any unexpended funds were to be awarded and expended on existing projects.*

*Responsible Person: Chief Financial Officer and Chief Operating Officer, TDH*

*Date: July 1, 2004*

- *As stated above, TDH agrees that expired contracts should not be amended and has ended this practice effective April 1, 2004. TDH will work with Health and Human Services (HHSC) Procurement and Contracting staff to implement policies and procedures for contract amendments or new contracts should they be required prior to the expiration of the contract.*

*Responsible Person: Chief Financial Officer and Chief Operating Officer, TDH*

*Date: July 1, 2004*

- *TDH agrees that prior approval from the Department should be provided in order to shift funds from one budget category to another. TDH will work with HHSC Procurement and Contracting staff to develop policies and procedures. TDH would note that some categorical budget changes are allowed within the scope of the contract, in compliance with the federal grant authority.*

*Responsible Person: Chief Financial Officer and Chief Operating Officer, TDH*

*Date: July 1, 2004*

- *TDH agrees that contract amendments should be processed in a timely manner and will implement procedures to negotiate additional services or contract extensions prior to expiration of the contacts. The SAO identified thirty-seven (37) amendments that were processed after contract expiration. For the time period 9/1/02 through 8/31/03, a total of twenty-seven (27) amendments were processed after contract expiration. Throughout that same time period, three thousand two hundred ten (3,210) contract documents were processed.*

*Responsible Person: Chief Financial Officer and Chief Operating Officer, TDH*

*Date: July 1, 2004*

# Appendix

## Objectives, Scope, and Methodology

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### Objectives

Our objectives were to determine whether the Department of Health (Department):

- Enforces financial accountability by ensuring that contractors provide the services for which they request payment.
- Follows state and federal requirements related to contract and grant management activities.
- Has controls in place to ensure that it receives payment from performing contracts.

We conducted this audit to satisfy the requirements of Rider 2, page II-30, of the General Appropriations Act (77th Legislature). Rider 2 required the Department to implement a business improvement plan that covered contract and grant management and required the State Auditor's Office to monitor the implementation of that plan.

### Scope

The scope of our audit covered the contract and grant management process limited to the payment and monitoring processes. The contract payments made to program service contractors from September 1, 2002, to May 31, 2003, were included in this scope. We excluded contracts for certain programs (such as Medicaid and the Special Supplemental Nutrition Program for Women, Infants and Children) because they were covered through other external audits. Our audit of contract amendments included two amended contracts between the Department and the Management Advisory Services group within the State Auditor's Office.

We did not review the procurement and development process.

### Methodology

The audit methodology consisted of collecting information and documentation, performing selected tests and other procedures, analyzing and evaluating the results of the tests, and conducting interviews with the Department's management and staff.

Information collected included the following:

- The Department's fiscal year 2003 payments through May 31, 2003, obtained from the Health and Human Services Administrative System (HHSAS)
- The Department's fiscal year 2002 and 2003 contract information from the Contract Development System (CDS) and HHSAS
- The Department's fiscal year 2003 financial monitoring risk assessment data

- The Department's payment vouchers and related documents
- The Department's contractors' financial and service information
- The Department's general provisions and related attachments

Procedures and tests conducted included the following:

- Analyzed fiscal year 2003 payment data from HHSAS
- Conducted site visits to the Department's contractors, which included obtaining payment and service support, and interviewed Department and contractor staff to substantiate the appropriateness of the payments and services provided
- Performed an analysis of the Department's risk assessment process to determine whether the contracts in CDS were included in the financial monitoring risk assessment

Criteria used included the following:

- Department policy and procedure manuals
- Code of Federal Regulations
- Uniform Grant Management Standards
- Department general provisions and program-related attachments

### **Other Information**

We conducted fieldwork from April 2003 through January 2004. This audit was conducted in accordance with generally accepted government auditing standards; there were no significant instances of noncompliance with these standards.

The following members of the State Auditor's staff performed the audit work:

- Angelica Martinez (Project Manager)
- Richard Maxwell (Assistant Project Manager)
- Jeff Grymkoski
- Wei Wang
- Leslie Ashton, CPA (Quality Control Reviewer)
- Joanna B. Peavy, CPA (Audit Manager)
- Frank Vito, CPA (Audit Director)

## *Distribution Information*

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### **Legislative Audit Committee**

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair

The Honorable Tom Craddick, Speaker of the House, Joint Chair

The Honorable Steve Ogden, Senate Finance Committee

The Honorable Thomas "Tommy" Williams, Member, Texas Senate

The Honorable Talmadge Heflin, House Appropriations Committee

The Honorable Brian McCall, House Ways and Means Committee

### **Office of the Governor**

The Honorable Rick Perry, Governor

### **Members of the Texas Board of Health**

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Dr. Mario R. Anzaldúa, Board Member

Ms. Mary E. Ceverha, Board Member

Mr. Raymond Hannigan, Board Member

Ms. Margo S. Scholin, Board Member

### **Department of Health**

Dr. Eduardo Sanchez, Commissioner of Health

### **Health and Human Services Commission**

Mr. Albert Hawkins, Executive Commissioner