



DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of Inspector General  
Office of Audit Services

OCT 6 2006

REGION IV  
61 Forsyth Street, S.W., Suite 3T41  
Atlanta, Georgia 30303

Report Number: A-04-03-03025

Mr. Darin J. Gordon, Deputy Commissioner  
Bureau of TennCare  
Tennessee Department of Finance and Administration  
310 Great Circle Road  
Nashville, Tennessee 37243

Dear Mr. Gordon:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG), report entitled "Contracting Practices for Tennessee Home and Community-Based Services for Mentally Retarded Persons" covering July 1, 2000, through June 30, 2002. A copy of this report will be forwarded to the HHS action official noted below for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

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If you have any questions or comments about this report, please do not hesitate to contact me or Mary Ann Moreno at (904) 232-2687 extension 17 or through e-mail at [Mary.Moreno@oig.hhs.gov](mailto:Mary.Moreno@oig.hhs.gov). To facilitate identification, please refer to report number A-04-03-03025 in all correspondence.

Sincerely,

Peter J. Barbera  
Regional Inspector General  
for Audit Services, Region IV

Enclosures – as stated

**Direct Reply to HHS Action Official:**

Roger Perez, Regional Administrator  
Centers for Medicare & Medicaid Services, Region IV  
Department of Health and Human Services  
61 Forsyth Street, S.W., Room 4T20  
Atlanta, Georgia 30303-8909



# ***Office of Inspector General***

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# *Notices*

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## **OAS FINDINGS AND OPINIONS**

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed, as well as other conclusions and recommendations in this report, represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the HHS divisions will make final determination on these matters.

## **EXECUTIVE SUMMARY**

### **BACKGROUND**

#### **Home and Community-Based Services Waiver Authority**

Under the administration of the Tennessee Department of Finance and Administration, Tennessee's single State Medicaid agency, TennCare, oversees two Section 1915(c) waivers to provide home and community-based services (HCBS) to Medicaid beneficiaries with mental retardation and developmental disabilities. Under 1915(c) waiver authority, States can provide services not usually covered by the Medicaid program, as long as these services are required to keep a person from being institutionalized.

#### **Division of Mental Retardation Services**

The Division of Mental Retardation Services (DMRS), a separate division of the Tennessee Department of Finance and Administration, provides facility-based, long-term care for persons with mental retardation in three Medicaid-based intermediate care facility/mental retardation centers throughout the State. In addition, DMRS is responsible for managing and operating the HCBS waivers under the contractual supervision of the State Medicaid agency. In this capacity, DMRS contracts with local entities to provide HCBS to approximately 4,300 mentally retarded and developmentally disabled individuals in the community.

#### **Claims for Federal Reimbursement**

The 11 contracts we audited from a list of 135 contracts totaling approximately \$300 million represented \$19.7 million in expenditures (Federal share \$9.9 million) between July 1, 2000, and June 30, 2002.<sup>1</sup>

### **OBJECTIVE**

Our objective was to determine whether the State Medicaid agency complied with Federal and State regulations in awarding and monitoring contracts for the HCBS mental retardation and developmental disabilities program in the State of Tennessee.

### **SUMMARY OF FINDINGS**

The State Medicaid agency, through DMRS, did not comply with Federal and State regulations in awarding and monitoring HCBS contracts. Of the 11 judgmentally selected HCBS contracts we reviewed, none completely complied with regulations. (See Appendix A.)

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<sup>1</sup>Although the State Medicaid agency incurred these costs in State fiscal years (SFY) 2001 and 2002, a disagreement between the State Medicaid agency and DMRS delayed Tennessee's claim for Federal reimbursement until they settled the disagreement in SFY 2004.

The regulatory violations occurred because the State Medicaid agency did not establish adequate procedures to monitor DMRS's contracting activities, and DMRS lacked sound administrative controls over the contracting process. By not following Federal and State regulations governing the awarding and monitoring of contracts, the State agency had no assurance that the 4,300 mentally retarded and developmentally disabled beneficiaries received the intended HCBS benefits.

## **RECOMMENDATIONS**

The State Medicaid agency should:

1. establish a system of procedures and controls that ensures all HCBS contracts are awarded using a process that follows Federal and State regulations and CMS program guidelines and
2. increase its contracting and monitoring oversight to include tracking documents through the award process, maintaining contracting records, establishing a system to ensure that contracts are monitored in a timely manner, and retaining monitoring reports.

## **STATE COMMENTS**

The State Medicaid agency concurred with our conclusions and recommendations. The State said it has improved its overall contract management since the audit period and has greatly improved its use of competitive contracting. In addition, the State said that DMRS has established both a Quality Assurance unit to oversee and monitor sub-contracts for HCBS and an internal audit division. The State's comments are included in their entirety as Appendix B.

## **OFFICE OF INSPECTOR GENERAL RESPONSE**

We concur with the State's comments and the corrective actions being taken.

**TABLE OF CONTENTS**

**INTRODUCTION..... 1**

    BACKGROUND ..... 1

        Medicaid Program..... 1

        Tennessee’s 1915(c) Waivers ..... 1

        Claims for Federal Reimbursement ..... 2

    OBJECTIVE, SCOPE, AND METHODOLOGY ..... 2

        Objective ..... 2

        Scope..... 2

        Methodology ..... 3

**FINDINGS AND RECOMMENDATIONS..... 3**

    CONTRACTS EXCEEDING \$100,000 WITHOUT PROPER APPROVAL ..... 4

        Federal and State Regulations Encourage Competitive Bidding ..... 4

        Contracts Exceeding \$100,000 Not Approved ..... 5

    INSUFFICIENT PROCUREMENT RECORDS..... 5

        Federal Criteria ..... 5

        Required Procurement Records and Files Not Maintained..... 5

    MISSING CONTRACT CLAUSES AND PROVISIONS..... 5

        Federal Criteria ..... 5

        State Medicaid Agency Failed to Include Required Contract Clauses and Provisions..... 6

    INADEQUATE MONITORING..... 6

        Federal and State Criteria..... 6

        Non-Compliance of Monitoring Requirements ..... 7

    INADEQUATE CONTRACTING PROCEDURES ..... 8

        State Medicaid Agency ..... 8

        Division of Mental Retardation..... 8

    EFFECT OF NON-COMPLIANCE WITH FEDERAL AND STATE REGULATIONS..... 9

    RECOMMENDATIONS ..... 9

    STATE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE. 9

        State Comments ..... 9

        Office of Inspector General Response ..... 9

**APPENDIXES**

- A – REGULATORY NONCOMPLIANCE OF 11 REVIEWED CONTRACTS
- B – STATE COMMENTS

# INTRODUCTION

## BACKGROUND

### Medicaid Program

In 1981, Congress authorized the waiver of certain Federal requirements to enable a State to provide home and community-based services (HCBS) to individuals who would otherwise require care in a skilled nursing facility, require care in an intermediate care facility, or need intermediate care facility/mental retardation services reimbursable by Medicaid. The waivers, referred to as 1915(c) waivers, are named after the section of the Social Security Act that authorizes them.

### Tennessee's 1915(c) Waivers

The Tennessee Department of Finance and Administration oversees both TennCare (the State Medicaid agency) and the Division of Mental Retardation Services (DMRS). The State Medicaid agency contracted with DMRS to manage and operate two Section 1915(c) waivers that provide HCBS to approximately 4,300 mentally retarded and developmentally disabled individuals in the community.

Under 1915(c) waiver authority, States can provide services not usually covered by the Medicaid program, as long as these services are required to keep a person from being institutionalized. Services covered under waivers include: case management, homemaker, home health aide, personal care, adult day health, habilitation, respite care, "such other services requested by the State as the Secretary may approve," and "day treatment or other partial hospitalization services, psychosocial rehabilitation services, and clinic services (whether or not furnished in a facility) for individuals with chronic mental illness."<sup>1</sup>

DMRS provides facility-based, long-term care for persons with mental retardation in three intermediate care facility/mental retardation centers throughout the State. Under the 1915(c) waiver, DMRS has the authority to award and monitor HCBS contracts. The Centers for Medicare & Medicaid Services (CMS) provided the Department of Health and Human Services (HHS), Office of Inspector General (OIG) with a list of 135 HCBS contracts DMRS awarded during State fiscal year (SFY) 2002. Budgeted funds for these 135 contracts totaled approximately \$300 million.

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<sup>1</sup>U.S. Department of Health and Human Services. "Understanding Medicaid Home and Community Services: A Primer." Available online at <http://aspe.hhs.gov/daltcp/reports/primer.htm>. Accessed April 16, 2003.

## **Claims for Federal Reimbursement**

The 11 contracts we audited from a list of 135 contracts totaling approximately \$300 million represented \$19.7 million in expenditures (Federal share \$9.9 million) between July 1, 2000, and June 30, 2002.<sup>2</sup>

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

### **Objective**

Our objective was to determine whether the State Medicaid agency complied with Federal and State regulations in awarding and monitoring contracts for the HCBS mental retardation and developmental disabilities program in the State of Tennessee.

### **Scope**

CMS requested that we perform audits of three separate issues relating to the HCBS program in Tennessee:

- allowability of costs,
- awarding and monitoring of contracts, and
- delivery of services.

This report discusses the awarding and monitoring of contracts. We will discuss the remaining issues in separate reports.

Based on CMS concerns and the materiality of HCBS contracts awarded by DMRS, we judgmentally selected a sample of 11 contracts for review from the listing of 135 contracts provided by CMS. These 11 contracts represented \$19.7 million in expenditures (Federal share \$9.9 million) between July 1, 2000, and June 30, 2002.

We did not assess the State Medicaid agency's overall internal controls; we limited our review to gaining an understanding of those controls related to Medicaid funding and to the operation of HCBS waivers.

We performed our audit at the State Medicaid agency and DMRS in Nashville, Tennessee.

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<sup>2</sup>Although the State Medicaid agency incurred these costs in SFY 2001 and 2002, a disagreement between the State Medicaid agency and DMRS delayed Tennessee's claim for Federal reimbursement until they settled the disagreement in SFY 2004.

## **Methodology**

To accomplish our objective, we:

- reviewed Federal and State laws and regulations and CMS program guidelines;
- interviewed officials from CMS, the State Medicaid agency, DMRS, Mental Health, and the Tennessee Department of Audit;
- obtained an understanding of the State's contracting policies and procedures;
- obtained an understanding of the State's monitoring activities;
- reviewed 11 contracts and monitoring documentation at DMRS;
- obtained accounting documents from DMRS and the State Medicaid agency; and
- calculated costs paid by DMRS and subsequently claimed by the State Medicaid agency.

We conducted our audit in accordance with generally accepted government auditing standards.

We issued a draft report to the State Medicaid agency on August 10, 2006, and requested the State Medicaid agency provide us with their written comments on the draft report. The State Medicaid agency concurred with the recommendations in the draft report and agreed to take the necessary corrective actions. We have included the State's comments in their entirety as Appendix B.

## **FINDINGS AND RECOMMENDATIONS**

The State Medicaid agency, through DMRS, did not comply with Federal and State regulations in awarding and monitoring HCBS contracts. Of the 11 judgmentally selected HCBS contracts we reviewed, none completely complied with regulations. (See Appendix A.) The regulatory violations we identified fall into the following categories:

- entering into a contract exceeding \$100,000 without CMS approval (8 of 11 contracts);
- maintaining insufficient procurement records to provide a:
  - basis for selecting a contractor (6 of 11 contracts),
  - justification for lack of competition (6 of 11 contracts), and
  - cost or price analysis (11 of 11 contracts);

- missing required contract clauses affording remedies:
  - for breach of contract (1 of 11 contracts) and
  - for access to records by the Comptroller General (1 of 11 contracts); and
- inadequate monitoring by DMRS and the State Medicaid agency (11 of 11 contracts).

These regulatory violations occurred because the State Medicaid agency did not establish adequate procedures to monitor DMRS’s contracting activities, and DMRS lacked sound administrative controls over the contracting process. By not following Federal and State regulations governing the awarding and monitoring of contracts, the State agency had no assurance that the 4,300 mentally retarded and developmentally disabled beneficiaries received the intended HCBS benefits.

**CONTRACTS EXCEEDING \$100,000 WITHOUT PROPER APPROVAL**

**Federal and State Regulations Encourage Competitive Bidding**

Pursuant to Federal regulations (45 CFR § 74.43), “All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. . . .”

Tennessee regulations (Section 0620-3-3-.03(1)(a-b)) state that the default method of procurement is competitive bidding:

Except as otherwise provided in these rules, contracts representing the procurement of services shall be made on a competitive basis. . . . To be competitive, a procurement method must include a consideration and comparison of potential contractors, based upon both cost and quality. . . .

One of the methods CMS uses to monitor free and open competition is to approve all contracts that exceed \$100,000. In response to the 1994 revisions of 45 CFR § 74, the Director of the Medicaid Bureau issued a December 4, 1995, letter to the State Medicaid Directors requiring pre-award approval from CMS for contracts in excess of \$100,000. The letter stated:

Pre-award review and approval of a State’s proposed contracts and related procurement documents . . . will be required when any of the following conditions apply: . . . .

2. The procurement is expected to exceed the small purchase threshold fixed at 41 U.S.C. 403(11) (currently \$100,000) and is expected to be awarded without competition or only one bid or offer is received in response to a solicitation.

## **Contracts Exceeding \$100,000 Not Approved**

Of the 11 contracts we reviewed, the State Medicaid agency entered into 8 contracts exceeding \$100,000 without gaining pre-award approval from CMS. These eight contracts ranged from \$100,800 to \$7.9 million. (See Appendix A.)

## **INSUFFICIENT PROCUREMENT RECORDS**

### **Federal Criteria**

When purchasing services with Medicaid funds, Federal regulations (45 CFR § 74.45) require “[s]ome form of cost or price analysis [to] be made and documented in the procurement files in connection with every procurement action. . . .”

In addition, Federal regulations (45 CFR § 74.46) also require procurement records and files for purchases in excess of the simplified acquisition threshold (currently \$100,000) to include the following:

- (a) Basis for contractor selection, (b) justification for lack of competition when competitive bids or offers are not obtained, and (c) basis for award cost or price.

### **Required Procurement Records and Files Not Maintained**

Of the 11 contracts selected for review, 8 exceeded the \$100,000 simplified acquisition threshold:

- Six contracts lacked an explanation supporting the basis for contractor selection, and, of those, four exceeded \$100,000. (See Appendix A.)
- Six contracts lacked justifications and requests for non-competition, and, of those, four exceeded \$100,000. (See Appendix A.)
- All 11 contracts lacked evidence of a cost and price analysis, and, of those, 8 exceeded \$100,000. (See Appendix A.)

## **MISSING CONTRACT CLAUSES AND PROVISIONS**

### **Federal Criteria**

Federal regulations (45 CFR § 74.48) require contracts that exceed the \$100,000 simplified acquisition threshold to include certain clauses or provisions:

- . . . (a) Contracts in excess of the simplified acquisition threshold shall contain contractual provisions or conditions that allow for administrative, contractual, or legal remedies in instances in which a contractor violates or breaches the contract terms, and provide for such remedial actions as may be appropriate. . . .

(d) All negotiated contracts (except those for less than the simplified acquisition threshold) awarded by recipients shall include a provision to the effect that the recipient, the HHS awarding agency, the U.S. Comptroller General, or any of their duly authorized representatives, shall have access to any books, documents, papers and records of the contractor which are directly pertinent to a specific program for the purpose of making audits, examinations, excerpts and transcriptions.

### **State Medicaid Agency Failed to Include Required Contract Clauses and Provisions**

One of the contracts worth over \$100,000 included neither of the following required clauses:

- a clause allowing for administrative, contractual, or legal remedies if a contractor violates or breaches the contract terms (Appendix A) and
- a clause allowing for the recipient, the HHS awarding agency, the U.S. Comptroller General, or any of their duly authorized representatives to access any books, documents, papers, or records of the contractor that are pertinent to a specific program for the purpose of making audits and examinations. (See Appendix A.)

### **INADEQUATE MONITORING**

#### **Federal and State Criteria**

Pursuant to Federal regulations (45 CFR § 74.51(a)), each State department or agency is responsible for efficiently managing and monitoring contracts into which it enters:

Recipients are responsible for managing and monitoring each project, program, sub-award, function or activity supported by the award. Recipients shall monitor sub-awards to ensure that sub-recipients have met audit requirements as set forth in Sec. 74.26.

Federal regulations (45 CFR § 74.51) also require the State Medicaid agency and DMRS to report on program performance for contracts:

. . . (b) The HHS awarding agency will prescribe the frequency with which the performance reports shall be submitted. . . . [P]erformance reports will not be required more frequently than quarterly or less frequently than annually. . . .

(d) Performance reports shall generally contain, for each award, brief information on each of the following:

- (1) A comparison of actual accomplishments with the goals and objectives established for the period, the findings of the investigator, or both . . . .
- (2) Reasons why established goals were not met, if appropriate.
- (3) Other pertinent information including, when appropriate, analysis and explanation of cost overruns or high unit costs.

Furthermore, Tennessee regulations require all State agencies to establish an Annual Contract Management Plan addressing the general management of service contracts for which they are responsible. This plan should include an explanation of how contract management staff will review and supervise contractor performance, contractor progress, and contract compliance (Chapter 0620-3-8-.04).

As defined in Tennessee regulations, “contract management” is:

. . . a [S]tate department or agency’s on-going continuum of processes for administering and reviewing the performance of each service contract for efficiency, cost effectiveness, and service providers accountability and results (Chapter 0620-3-8-.04).

Contract management may include, but is not limited to:

- allocating adequate staff and resources to contract management;
- reviewing contractor performance in terms of progress and compliance with contract provisions; . . .
- maintaining records of each contract that document activities such as procurement, management, and sub-recipient monitoring, if applicable; and
- evaluating contract results in terms of the achievement of organizational objectives (Chapter 0620-3-8-.04).

### **Non-Compliance of Monitoring Requirements**

We found no evidence of monitoring activities by the State Medicaid agency for any of the 11 contracts we reviewed. (See Appendix A.) Invoices were the only documentation we found in the 11 official contract files. We repeatedly met with DMRS officials to obtain monitoring documentation for these contracts. However, these attempts failed to locate any monitoring documentation.

Tennessee State auditors also noted that the State Medicaid agency was not diligent in its monitoring duties. Their audit of the Department of Finance and Administration for the year ending June 30, 2002, concluded that the State Medicaid agency's monitoring of the HCBS waiver programs was inadequate. The State auditors asserted that the State Medicaid agency had yet to "develop a formal monitoring plan (including the necessary policies and procedures) to ensure that all the required areas are adequately monitored and that other procedures are performed to provide the required [F]ederal assurances."

## **INADEQUATE CONTRACTING PROCEDURES**

The above contracting violations occurred because the State Medicaid agency did not establish adequate procedures to monitor DMRS's contracting activities, and DMRS lacked sound administrative controls over the contracting process.

### **State Medicaid Agency**

The interagency agreement between the State Medicaid agency and DMRS delegates the oversight of HCBS operations to DMRS and requires the State Medicaid agency to "supervise" DMRS. Key provisions require the State Medicaid agency to:

- monitor and review DMRS's policies and procedures for implementation and coordination of the waiver services [and]
- provide quality assurance monitoring to evaluate performance of DMRS. . . .

However, the State Medicaid agency's monitoring of DMRS's contracts was limited to a cursory review of the contracts prior to signing them. Compounding the lack of a formal monitoring system was the lack of assigned personnel. Only one permanent State Medicaid agency employee was assigned monitoring functions and responsibilities during our audit period. State Medicaid agency officials readily admitted that this staffing level was inadequate and have subsequently increased the monitoring staff to six permanent positions.

### **Division of Mental Retardation**

DMRS's monitoring efforts were limited to reviewing invoices paid to the providers of the contracted services. These invoices contained information such as travel expenses and professional expenses required in the contract. DMRS's monitoring efforts failed to include any assessments of the performance of each of the contracts in relation to the contract's stated goals and objectives.

## **EFFECT OF NON-COMPLIANCE WITH FEDERAL AND STATE REGULATIONS**

By not following Federal and State regulations governing the awarding and monitoring of contracts, the State agency had no assurance that the 4,300 mentally retarded and developmentally disabled beneficiaries received the intended HCBS benefits.

## **RECOMMENDATIONS**

The State Medicaid agency should:

1. establish a system of procedures and controls that ensures all HCBS contracts are awarded using a process that follows Federal and State regulations and CMS program guidelines and
2. increase its contracting and monitoring oversight to include tracking documents through the award process, maintaining contracting records, establishing a system to ensure that contracts are monitored in a timely manner, and retaining monitoring reports.

## **STATE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE**

The State's comments on our draft report, as well as our response, are summarized below. The full text of the State's comments is included as Appendix B.

### **State Comments**

The State Medicaid agency concurred with our conclusions and recommendations. The State said it has improved its overall contract management since the audit period and has greatly improved its use of competitive contracting. In addition, the State said that DMRS has established both a Quality Assurance unit to oversee and monitor sub-contracts for HCBS and an internal audit division. The State's comments are included in their entirety as Appendix B.

### **Office of Inspector General Response**

We concur with the State's comments and the corrective actions being taken.

# **APPENDIXES**



STATE OF TENNESSEE  
**BUREAU of TENNCARE**  
310 Great Circle Road  
NASHVILLE, TENNESSEE 37243

September 12, 2006

Mr. Peter J. Barbera  
Regional Inspector General for Audit Services  
Department of Health and Human Services  
Office of Inspector General  
61 Forsyth Street, S.W., Suite 3T41  
Atlanta, GA 30303

**RE: Report Number A-04-03-03025**

Dear Mr. Barbera:

Please find attached our response to the above referenced report issued by your office entitled "Contracting Practices for Tennessee Home and Community Based Services for Mentally Retarded Persons" covering July 1, 2000, through June 30, 2002.

We appreciate the opportunity to respond to these findings identified by your office during this audit period. Should you have any questions regarding the responses we are submitting, feel free to contact Scott Pierce, Chief Financial Officer, or myself at 615-507-6000.

Sincerely,

A handwritten signature in black ink, appearing to read "Darin J. Gordon".

Darin J. Gordon  
Deputy Commissioner

DJG/cm

Attachment

cc: Scott Pierce, Chief Financial Officer



STATE OF TENNESSEE  
BUREAU of TENNCARE

**Response to Office of Inspector General report A-04-03-03025**

- 1. The State Medicaid agency should establish a system of procedures and controls that ensure all HCBS contracts are awarded using a process that follows Federal and State regulations and CMS program guidelines.**

We concur. The State has made strides in overall contract management since the audit period. The agency meets all statutory regulations set forth by the Department of Finance and Administration, Office of Contracts Review and the Fiscal Review Committee of the Legislative branch of state government. The agency has greatly improved its use of competitive contracting as well as including all required documentation for non-competitively awarded contracts. The State will further strive to include all breach of contract language, gain pre-approval from CMS on contracts over \$100,000, and include a clause allowing the US Comptroller to have access to records and documents within any future contracts.

- 2. The State Medicaid agency should increase its contracting and monitoring oversight to include tracking documents through the award process, maintaining contracting records, establishing a system to ensure that contracts are monitored in a timely manner, and retaining monitoring reports.**

We concur. The Division of Mental Retardation, a contractor of the state Medicaid agency, has established a Quality Assurance unit to oversee and monitor sub-contractors for HCBS services. Furthermore, the Division has created a unit which monitors all sub-recipient contracts per state policy 22. The division further established an internal audit division. The Division also complies with all requirements of the Department of Finance and Administration, Office of Contract Review and the Fiscal Review Committee of the Tennessee General Assembly.

TennCare has a Utilization Review Section within the Division of Developmental Disability Services that actively reviews medical records to assure not only documentation to support the services billed exists, but also that the provider is compliant with programmatic requirements.

Submitted by:   
Darin J. Gordon, Deputy Commissioner

9/12/2006  
Date