Tennessee State Veterans' Homes Board

For the Year Ended
June 30, 2000

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
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John G. Morgan
Comptroller

October 30, 2001

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Board of Directors
Tennessee State Veterans' Homes Board
345 Compton Road
Murfreesboro, Tennessee 37130

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee State Veterans' Homes Board for the year ended June 30, 2000. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance disclosed certain deficiencies, which are detailed in the Results of the Audit section of this report. The board's management has responded to the audit findings; the responses are included following each finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/mb
01/087

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit
Tennessee State Veterans' Homes Board
For the Year Ended June 30, 2000

AUDIT OBJECTIVES

The objectives of the audit were to consider the board's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, and contracts; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

INTERNAL CONTROL FINDINGS

Accounts Receivable Practices Are Not Adequate**
The Tennessee State Veterans' Homes Board's accounts receivable balances do not portray a complete picture of the current receivable activity or the true amount the board must attempt to collect. The board has not promptly refunded Medicaid overpayments, and the management company has not properly reduced the rate adjustments for certain Medicaid-eligible veterans (page 9).

Internal Control for Fixed Assets Is Not Adequate**
Equipment records are inadequate to integrate annual inventory results into the general ledger, and a clear capitalization policy is not in place (page 16).

Internal Control for Purchasing Is Not Adequate*
The board facilities do not have an adequate segregation of duties relating to purchasing, the board's policies and procedures over purchasing are not being followed, and service contract approvals required by state law are not being obtained (page 18).

Receipt of Goods and Services Was Not Documented*
The verification of receipt was not consistently documented (page 21).

Internal Control for Donations to the Tennessee Veterans Home Foundation, Inc., Is Not Adequate
Foundation cash receipting duties are not segregated to provide internal control (page 21).

State Funds Are Being Commingled With Management Company Funds
The board gives cash for veterans' homes expenses to the management company before those expenses have been paid by the management company (page 23).

Petty Cash Policies Are Inadequate and Are Not Being Followed
The petty cash policy does not address what types of purchases can be made through petty cash funds. The policies and procedures that have been adopted are not being followed (page 24).

Resident Trust Fund Petty Cash Is Vulnerable to Misappropriation
Resident trust fund petty cash duties are not segregated, and approvals for withdrawal are not appropriate (page 25).

Cash Receipts Were Vulnerable to Misappropriation**
Cash receipting duties are not segregated to provide internal control (page 27).

COMPLIANCE FINDINGS

Accounts Receivable Practices Are Not Adequate**
The board has not promptly refunded Medicaid overpayments, and the management company has not properly reduced the rate adjustments for certain Medicaid-eligible veterans (page 9).

Foundation Affairs Are Not Separate
Employees of the board handle cash receipting and financial records for the foundation (page 20).

Management Fee Expense Was Not Adjusted Timely
The management fee expense was not adjusted timely for prior-year audit adjustments, affecting the management fee calculation (page 26).

Two of the reportable conditions described above were considered material weaknesses:

- Accounts Receivable Practices Are Not Adequate
- Internal Control for Fixed Assets Is Not Adequate

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. The material weakness regarding accounts receivable practices is also considered material noncompliance.

* This finding is repeated from the prior audit.
** This finding is repeated from prior audits.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

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

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Audit Report
Tennessee State Veterans' Homes Board
For the Year Ended June 30, 2000

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Tennessee State Veterans' Homes Board
For the Year Ended June 30, 2000

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee State Veterans' Homes Board. 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 Tennessee State Veterans' Homes Board was established in 1988 under the provisions of Title 58, Chapter 7, *Tennessee Code Annotated*. This statute authorizes the creation of public homes for veterans throughout the state to provide support and care for honorably discharged veterans who served in the United States armed forces. The board operates two facilities - one in Murfreesboro and one in Humboldt - and has plans to build a third facility in East Tennessee. The board has the authority to employ an executive director and other employees; to incur expenses as may be necessary for the proper discharge of the board's duties; to establish policies regarding the rates for patient care in a state veterans' home; and to incur debts, borrow money, issue debt instruments, and provide for the rights of the holders of the debt instruments.

The board consists of ten members. The Commissioner of the Tennessee Department of Veterans Affairs serves *ex officio* as a voting member of the board. The remaining nine members are appointed by the Governor, three from each of the three grand divisions of the state. The Governor appoints a member of the board to serve as chairman. Each board member must be a citizen of the state and an honorably discharged veteran.

ORGANIZATION

As of November 1, 1994, the board contracted with ServiceMaster Diversified Health Services, L.P., (Diversified) to manage both the financial and clinical operations of the Murfreesboro facility as well as those of the Humboldt facility upon its opening. This subsidiary of ServiceMaster was purchased by Forest Hill Group on September 1, 2000, and was renamed BEP Services.

BEP Services employs an administrator to oversee daily operations of each facility. The administrator then hires the managerial staff including the Director of Nursing, Business Office Manager, Director of Medical Records, Director of Social Services, Food Services Manager, Activities Coordinator, Housekeeping Superintendent, Maintenance Supervisor, and all other facility employees. Although these employees are hired by the administrator from BEP Services, they are employees of the board.

An organization chart is on the following page.

AUDIT SCOPE

The audit was limited to the period July 1, 1999, through June 30, 2000, and was conducted in accordance with government auditing standards generally accepted in the United States of America. Financial statements are presented for the year ended June 30, 2000, and for comparative purposes, the year ended June 30, 1999. The Tennessee State Veterans' Homes Board has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report.*

OBJECTIVES OF THE AUDIT

The objectives of the audit were

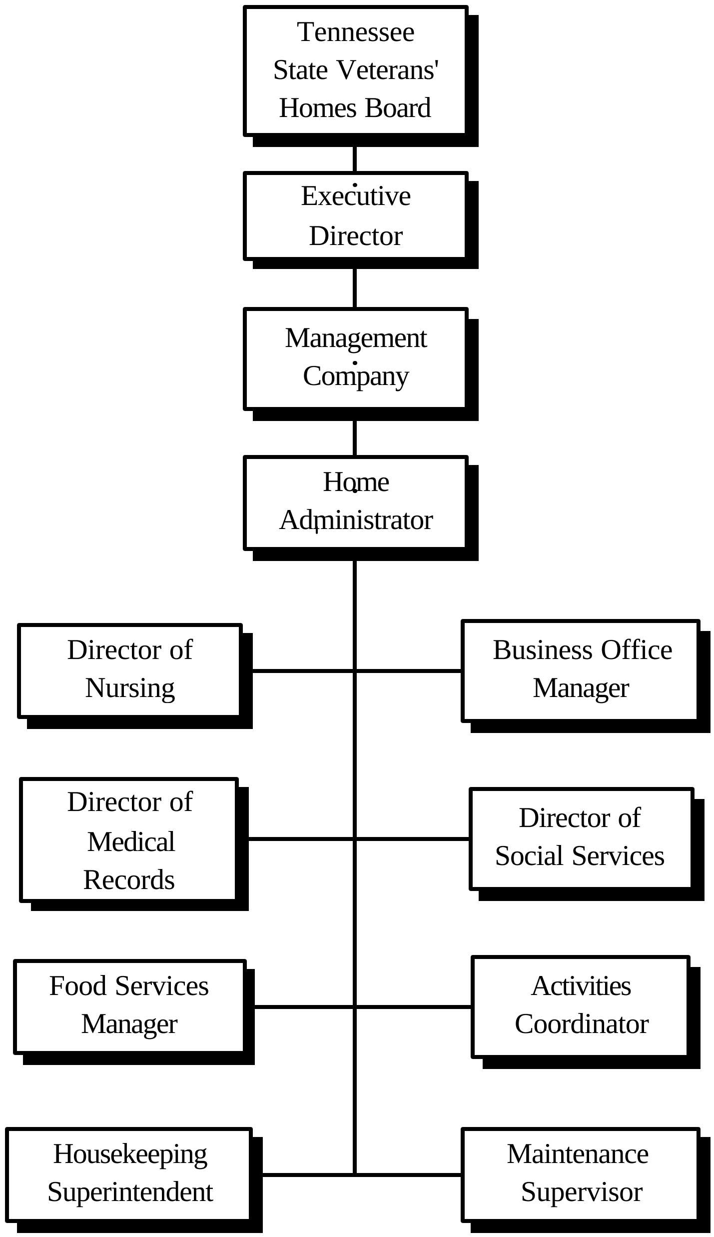
1. to consider the board's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;

2. to determine compliance with certain provisions of laws, regulations, and contracts;

3. to determine the fairness of the presentation of the financial statements; and

4. to recommend appropriate actions to correct any deficiencies.

Tennessee State Veterans' Homes Board



PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The board filed its report with the Department of Audit on February 22, 2001. A follow-up of all prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDING

The current audit disclosed that the board has corrected a previous audit finding concerning prompt receipting and depositing of foundation donations.

REPEATED AUDIT FINDINGS

The prior audit report also contained findings concerning accounts receivable practices and controls over equipment, cash receipting, purchasing, and payables. These findings have not been resolved and are repeated in this report.

OBSERVATIONS AND COMMENTS

On May 31, 2001, the Forest Hill Group filed for reorganization of the company under Chapter 11 of the Bankruptcy Code. In August 2001, the board was informed that BEP Services would no longer be providing long-term care services. The board has contracted with a temporary management company while initiating the formal bid process for a permanent management company. The change in management companies is not expected to significantly affect the operations of the veterans' homes.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Tennessee State Veterans' Homes Board's financial statements for the year ended June 30, 2000, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by government auditing standards generally accepted in the United States of America. Material weaknesses and reportable conditions, along with recommendations and management's responses, are detailed in the findings and recommendations.

Compliance

The results of our audit tests disclosed an instance of noncompliance that is required to be reported under *Government Auditing Standards*. This instance of material noncompliance and other instances of noncompliance, along with recommendations and management's responses, are included in the findings and recommendations.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the Tennessee State Veterans' Homes Board's financial statements.

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COMPTROLLER OF THE TREASURY
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Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

June 1, 2001

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the financial statements of the Tennessee State Veterans' Homes Board, a component unit of the State of Tennessee, as of and for the year ended June 30, 2000, and have issued our report thereon dated June 1, 2001. We conducted our audit in accordance with government auditing standards generally accepted in the United States of America.

Compliance

As part of obtaining reasonable assurance about whether the board's financial statements are free of material misstatement, we performed tests of the board's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed the following instance of noncompliance that is required to be reported under *Government Auditing Standards*:

- Medicaid overpayments are not refunded promptly and certain Medicaid rate adjustments have not been properly reduced.

This instance of noncompliance is described in finding number 1 of the Findings and Recommendations section of this report.

We also noted certain other instances of noncompliance that we have included in the Findings and Recommendations section of this report.

- Foundation affairs are not separate
- Management fee expense was not adjusted timely

Less significant instances of noncompliance have been reported to the board's management in a separate letter.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the board's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the board's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements.

The following reportable conditions were noted:

- Accounts receivable practices are not adequate
- Internal control for fixed assets is not adequate
- Internal control for purchasing is not adequate
- Receipt of goods and services was not documented
- Internal control for donations to the Tennessee Veterans Home Foundation, Inc. is not adequate
- State funds are being commingled with management company funds
- Petty cash policies are inadequate and are not being followed
- Resident trust fund petty cash is vulnerable to misappropriation
- Cash receipts were vulnerable to misappropriation

These conditions are described in the Findings and Recommendations section of this report.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider the following to be material weaknesses:

- Accounts receivable practices are not adequate
- Internal control for fixed assets is not adequate

We also noted other matters involving the internal control over financial reporting that we have reported to the board's management in a separate letter.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee, the board of directors, and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/mb

FINDINGS AND RECOMMENDATIONS

1. Accounts receivable practices are not adequate

Finding

As noted in the prior three audits, the Tennessee State Veterans' Homes Board's accounts receivable balance still does not portray a complete picture of the current receivable activity or the true amount the board must attempt to collect. The board has not promptly refunded Medicaid overpayments. The management company has not properly reduced the rate adjustments for certain Medicaid-eligible veterans, and there are several unexplained negative receivable balances not associated with the Medicaid overpayments or rate adjustments for Medicaid-eligible veterans. In addition, the estimate for uncollectible accounts is not based on the accounts receivable collection history of the facilities.

The board concurred with the prior findings regarding the reduced rate adjustments for certain Medicaid-eligible veterans and writing off uncollectible accounts. The board followed through on its comment that a write-off would be submitted for approval. The board's comments also indicated that the management company had analyzed all accounts receivable, that adjustments were made, and that its "current policy regarding the repayment of Medicaid overpayments is in place and will prevent the same problem from recurring in the future." However, the problem still exists.

The board did not concur with the prior findings regarding Medicaid overpayments. The board indicated that it requested the Governor's review of this issue. As discussed later in this finding, the board has implicitly recognized its liability to the Medicaid program through its actions. In addition, at the board's request, the Commissioner of the Department of Health previously researched the issues raised by the board and responded to the board on October 14, 1997, that the $282,062.42 was "due and payable to the TennCare [Medicaid] program." If the Governor chooses to release the board from this obligation, the state will still be responsible for refunding the federal percentage to the U.S. Department of Health and Human Services.

Background

All residents of a board facility are charged a standard rate for each day that they reside in the facility. To meet these charges, a resident may be eligible for assistance from Medicaid if the resident is both medically and financially eligible. Assistance from the Medicaid program consists of both a contractually established reduction in the standard rate (to the "Medicaid rate") and assistance payments from the U.S. Department of Health and Human Services via the Tennessee Department of Finance and Administration. Formerly these payments came through the Tennessee Department of Health. In assessing a resident's financial eligibility for Medicaid assistance, the resident's ability to contribute to his or her cost of care is evaluated. The resident's calculated contribution to his or her cost of care is referred to as the patient liability amount. Many Medicaid-eligible residents have limited sources of income and may have no patient liability, or the amount may be very minimal.

For example, assume the standard rate is $92 per day, and the Medicaid rate is $80 per day. The resident's account would typically be charged the standard rate of $92, and if the resident were eligible for Medicaid assistance, the account would then be reduced by $12 to equal the Medicaid rate. If the Medicaid-eligible resident has a calculated patient liability amount of $10, this amount would be collected from the resident, and the Medicaid program would pay the difference of $70.

In addition, veterans are eligible for reimbursement from the U.S. Department of Veterans Affairs (VA) for each day they reside in a Tennessee Veterans' Home facility. This per diem amount is used to offset the veteran's costs before any other resources are applied. The per diem is not income to the veteran, and therefore is appropriately not considered in calculating a veteran's financial eligibility for Medicaid assistance and is not a contribution toward the calculated patient liability amount.

Medicaid overpayments are not refunded promptly

In the example above, if the VA per diem amount were $40, the resident's receivable account would be overcollected by $40 as shown below.

Activity in Receivable Account	Total	Cumulative Total
Standard rate	$92	$92
less the adjustment to reduce the standard rate to the Medicaid rate of $80	12	80
less the patient liability payment	10	70
less the Medicaid assistance payment	70	0
less the VA per diem payment	40	(40)
is equal to a credit balance (or overcollection) in the receivable account	($40)	($40)

If a veteran is eligible for Medicaid assistance, the Medicaid assistance payment to the facility must be reduced by the VA per diem amount. (Medicaid is considered the payer of last resort.) The Tennessee State Veterans' Homes Board has not promptly reduced the veteran's Medicaid assistance payment and refunded the current overpayments to Medicaid (estimated to be $907,686.18 at June 30, 2000), and has not repaid $282,062.42 due to the Medicaid program for overpayments occurring before 1994.

The Division of Medicaid, General Rule 1200-13-1-.04, subsection (2)(a)(1) of *Rules of the Tennessee Department of Health,* states,

> If third party payment is less than the Medicaid allowable, Medicaid will pay the difference between the third party payment and the Medicaid allowable. No further claim shall be allowed against the recipient and/or the recipient's responsible party(s) for Medicaid services.

After an audit finding reported by the Comptroller's Office in the June 30, 1992, audit report, the Department of Health established a mechanism for the board to refund the excess Medicaid assistance payments received by filing a "void adjustment" after both the VA per diem and Medicaid assistance payments are collected. Although the mechanism is cumbersome (a separate void adjustment must be filed on every veteran for every month that Medicaid assistance payments are received), it appears to accomplish the objective of returning the excess funds to the Medicaid program.

The Murfreesboro facility began processing void adjustments to return overpayments to the Medicaid program in 1993. However, the void adjustment process is not completed promptly. Currently, it may take many months before the transaction is completed. Two of nine residents tested (22%) did not have a timely void adjustment. According to Section 1200-13-1-.04, subsection (3), *Rules of the Tennessee Department of Health*, "Providers receiving third party payments following Medicaid payment shall notify and refund Medicaid within 60 days of receipt of the third party payment. The refund to Medicaid shall be the lesser of the third party or Medicaid payment."

When the Humboldt facility opened in February 1996, it was tentatively instructed by the Department of Health not to implement the void adjustment process at that time. Subsequently, the facility received a letter from the Commissioner of the Department of Health dated October 14, 1997, stating,

> . . . the procedures currently in place at the Murfreesboro facility should now be used by the Humboldt facility each month in order to minimize an outstanding liability in the future. All documentation for residents at the Humboldt facility since its opening should now be sent to the TennCare Bureau along with the corresponding payments.

The facility did not comply with this instruction until February 1998. At that time, the Executive Director instructed the facility to begin a monthly repayment process by submitting the current month's void adjustments and two to three of the oldest months' void adjustments. This procedure was to continue until the entire amount was repaid. The facility prepared the specified void adjustments in February but subsequently failed to systematically follow up with additional void adjustments. In February 1999, the facility began preparing void adjustments on a monthly basis. However, 12 of 12 residents tested (100%) did not have timely void adjustments.

When the VA per diem and the Medicaid assistance payments have both been received and the void adjustments have not been processed, the veteran's receivable account has been overcollected and therefore has a negative or "credit" balance. The estimated credit balance's at June 30, 2000, were $780,703.59 and $126,982.59 for the Humboldt and Murfreesboro facilities, respectively.

Before the implementation of the void adjustment process, the Department of Health did not have an established mechanism for the board to return excess Medicaid funds. On December 25, 1992, and April 16, 1993, $178,856.42 and $23,109.57, respectively, were withheld from Medicaid payments to the board. These amounts were deductions from the total amount due to the board and were not attributed to specific residents. Evidently, these amounts were withheld based on communication between the Department of Health and the board's Executive Director at that time. The amount due to the Medicaid program attributable to the dates of service between the opening of the Murfreesboro facility in 1991 and the inception of the void adjustment process in 1993, net of the two repayments mentioned above, is $282,062.42. This amount is recorded on the board's financial statements as a payable to the Department of Health, and the auditors have indicated to management in the past several audits that repayment to the department should be addressed.

Although the board has implicitly recognized its liability to the Medicaid program through its actions, beginning with the two repayments mentioned above, the board has questioned whether these monies are actually due back to the Medicaid program. A meeting was held with Department of Health staff, Veterans Affairs staff, Comptroller's staff, and representatives from the Tennessee State Veterans' Homes Board. Concerns were heard from the board members, and the Department of Health staff agreed to research the possibility of regulations that might eliminate the balance due to the Medicaid program.

After researching the issues raised by the board, the Commissioner of the Department of Health responded to the board on October 14, 1997. The Commissioner cited Section 4055.80 of the *Medicare and Medicaid Guide* as quoted above and requested "payment of the $282,062.42, which has been determined due and payable to the TennCare [Medicaid] program." This repayment has not yet been made.

Certain Medicaid rate adjustments have not been properly reduced

Although most Medicaid-eligible veterans have a minimal patient liability amount, some have a more substantial patient liability amount. When the VA per diem amount is combined with a more substantial patient liability amount, the total may exceed the Medicaid rate. When the Medicaid rate is exceeded, the resident's accounts receivable balance becomes negative, effectively reflecting an overpayment in the resident's account, when there is no overpayment due to the resident.

In the example cited previously, if the Medicaid-eligible veteran has a patient liability amount of $48 instead of $10, the activity in his receivable account is as follows:

Activity in Receivable Account	Total	Cumulative Total
Standard rate	$92	$92
less the adjustment to reduce the standard rate to the Medicaid rate of $80	12	80
less the patient liability payment	48	32
less the VA per diem payment	40	(8)
(the Medicaid program is not billed for an assistance payment)	0	0
is equal to a credit balance (or overcollection) in the receivable account	($8)	($8)

The VA per diem amount is a fixed amount for all veterans. The patient liability amount is established in the Medicaid eligibility process and represents an amount that the patient can reasonably be expected to pay. Therefore, the only amount that can be reduced to prevent the "overpayment" is the adjustment that reduces the standard rate to the Medicaid rate. The adjustment should equal the difference between the standard rate, the patient liability amount, and the VA per diem amount, leaving the resident's account with a zero balance. In the example above, the adjustment should be reduced to $4 instead of $12. Because this calculation could be different for each veteran resident with a more substantial patient liability amount, the management company's accounts receivable system cannot automatically perform the calculation and make the reduction to the adjustment amount. At Humboldt, 4 of 13 residents selected (31%) did not have the accounts receivable adjustments to reduce the negative balances to the residents' account. The management company has not made the necessary manual adjustments to correct these types of overpayments, resulting in an estimated credit balance of $12,200.40 and $10,708.67 for the Humboldt and Murfreesboro facilities, respectively.

Numerous other credit balances exist for Medicaid-eligible recipients

There are other credit balances for Medicaid recipients that do not appear to be related to the Medicaid overpayments or the additional revenue for certain Medicaid-eligible recipients when the patient liability plus the VA per diem exceeds the Medicaid rate. These estimated unexplained credit receivable balances are $40,217.07 and $63,233.58 for the Humboldt and Murfreesboro facilities, respectively.

Allowance for doubtful accounts is not based on actual receivables

The management company does not use an analysis of the facilities' accounts receivable collection history when establishing the amount to be included in the allowance for doubtful accounts. According to management, the allowance is based on the industry standard from several years ago.

Conclusion

Without promptly refunding Medicaid overpayments recorded as payments on behalf of the residents and without properly reducing certain Medicaid rate adjustments to the residents' accounts, the residents' subsidiary accounts have an inappropriate negative or "credit" balance incorrectly reflecting that refunds are due to those residents. As the credit balances grow in number and amount, the total accounts receivable balance becomes more distorted, and financial decision making or monitoring may be affected. Credit balances are included in total accounts receivable, causing the receivable balance on the board's monthly financial statements to appear to be lower than the amount the board actually must attempt to collect. Decision-making may also be affected if the allowance for doubtful accounts is not based on the facilities' actual accounts receivable collection history.

The board has contracted with a management company, ServiceMaster Diversified Health Services, L. P., since November 1, 1994. The contract was assigned to BEP Services, L. P., on September 1, 2000. The management company manages and supervises the day-to-day operations of the facilities; thus, the resolution of these discrepancies will be the management company's responsibility. Resolution will include dedicating time and attention for review and analysis of the previous activity in the residents' subsidiary accounts. Because of the unique nature of the operations and funding structure within a veterans' facility, a standardized computer accounting system may not be able to accommodate all types of accounts receivable transactions. Additional effort may be necessary to manually process certain accounts receivable transactions.

Recommendation

The management company should carefully evaluate the accounts receivable practices. Any necessary policies and procedures should immediately be developed, documented, and implemented. The policies and procedures should ensure that void adjustments are routinely processed to refund overpayments of Medicaid assistance within 60 days of receiving the VA per diem. The policies and procedures should also establish adequate accounting practices to prevent the recording of "overpayments" of accounts receivable from excessive Medicaid rate adjustments for veteran residents with substantial patient liability amounts. The policies should include a periodic review of all credit balances. The management company should carefully supervise operations to ensure compliance with the policies and procedures.

The Tennessee State Veterans' Homes Board should immediately direct the management company to refund the $282,062.42 due to the Medicaid program for overpayments occurring before the void adjustment process began. In addition, the management company should ensure that outstanding void adjustments for overpayments are processed timely. If additional manual processing of certain transactions is required, the management company should ensure that sufficient staff is available and adequately trained to perform these functions. Also, the management company should analyze the facilities' collection history when establishing the amount to be included in the allowance for doubtful accounts.

The Tennessee State Veterans' Homes Board should take appropriate measures to monitor the actions of the management company, determine whether sufficient attention has been directed toward resolving these discrepancies, and take appropriate action if these conditions do not improve.

Management's Comment

We concur as to the facts presented for the time period in question. The management company developed a policy and procedure approved by the board to address the proper handling of overpayments that has been in place since March 2000. This policy provides that void adjustments will be processed within 90 days of receiving VA per diem rather than the 60 days recommended by the audit report. This amount of time is considered necessary by management because of the time required to bill Medicaid for the same dates of service covered by a given VA per diem payment, then to collect from Medicaid, and finally to process a void adjustment on the next Medicaid billing. Void adjustments are currently being made in accordance with Board policies. We will be setting up a tracking procedure to ensure void adjustments are processed within our policy of 90 days of receiving the per diem. The board on a monthly basis will review credit balances.

Regarding the recommendation to prevent "overpayments" in A/R, we reviewed our practices and have determined that it is feasible to make the suggested changes with the new accounting software now installed in Murfreesboro. Provided this same software is installed at the Humbolt facility, the problem ("overpayments") described in the audit report should be virtually eliminated. We concur that the policies should provide for a periodic review of all credit balances, and, accordingly, we will make the necessary changes to insure compliance in this area going forward. We will consider the facilities' collection history when establishing and adjusting accruals to the allowance account for bad debts.

We do not concur with the recommendation that the board should immediately direct the management company to refund the $282,062.42 for overpayments occurring before the void adjustment process began. The board has requested in writing that the Governor review this issue. We have not received a response.

Auditor's Comment

As mentioned in the finding, according to the *Rules of the Tennessee Department of Health*, "Providers receiving third party payments following Medicaid payment shall notify and refund Medicaid within 60 days of receipt of the third party payment." The establishment of a policy that adjustments will be processed within 90 days of receipt is in violation of this rule. The policy should be revised to require a 60-day turnaround.

In addition, although the board does not concur that the Medicaid overpayments resulting from the VA per diem payments should be refunded to the Medicaid programs, as discussed in the finding, the board has implicitly recognized this liability since December 25, 1992, when the first funds were withheld from a Medicaid payment to the board. The board has continued to recognize this liability by routinely processing void adjustments.

At the board's request, the Commissioner of the Department of Health researched the issues raised by the board and responded to the board on October 14, 1997, that the $282,062.42 was "due and payable to the TennCare [Medicaid] program." The board requested that the Governor reverse the Department of Health's position on February 5, 1999. It is apparent that the Governor has chosen not to release the board from the obligation. The board should immediately refund the amount that the Commissioner of the Department of Health determined was due and payable.

2. Internal control for fixed assets is not adequate

Finding

Significant deficiencies continue to exist in internal control for fixed assets. These deficiencies include an inability to correlate the results of physical inventories with accounting records; the absence of property tags on over half of the equipment items; inaccurate equipment listings; donated items that are not recorded on equipment listings or accounting records; the failure to remove lost, stolen, cannibalized, or obsolete equipment; and incomplete policies and procedures for capitalizing equipment. Also, because unused or obsolete equipment is not sold or otherwise disposed of, an unnecessary expense has been incurred to rent trailers to store this equipment.

Similar deficiencies have been reported in prior findings in the last three audit reports. Management has concurred with the previous findings and recommendations and promised corrective action. As a result of the prior findings management has begun performing annual inventories of equipment, designated a property officer, and clarified the dollar value and useful life to be used for capitalizing equipment. However, these actions have been far short of what is needed to eliminate the deficiencies in internal control for equipment.

Fixed asset records continue to be inadequate. The current recordkeeping system does not allow for a reconciliation between the physical inventories taken at the facilities and the accounting records maintained by the management company. In the physical inventory records, the main identifying feature is the property tag number. The accounting records for fixed assets maintained at the management company include a description, asset number, cost, acquisition date, and depreciation. The asset number is a randomly assigned number that is not the same as the property tag number. The only shared attribute between the inventory records and the fixed asset records is the description. Because of the generic nature of the descriptions, reconciling the two listings would include a great deal of guesswork. In addition, many items do not have property tags. During an auditor observation, 135 of 267 equipment items observed (51%) did not have a property tag attached.

Testwork was performed to observe several equipment items listed on the management company's fixed asset records. Because of the lack of property tag numbers on management company records, it was impossible to positively identify any of the items that were sought; however, items that met the description listed were identified, with the following exceptions. At the Humboldt facility, 16 printers were counted when the listing included only 2, and 20 'four drawer' legal filing cabinets were counted when the listing included only 19. At the Murfreesboro facility, 142 mattresses were listed, but only 120 were located at the facility; 17 computers were counted when the listing included only 15; 16 printers were counted when the listing included only 10; and only 8 linen carts were counted when the listing included 14.

Also, items donated by the foundation totaling $10,371 were not recorded in the management company records. One donated item was recorded on the general ledger but not the fixed asset records and therefore was not appropriately depreciated. One donation was recorded as a decrease in an expense instead of as a donation.

In addition, it was noted that there had not been any equipment removed from the Humboldt equipment listing in the past three years and from the Murfreesboro equipment listing in the past two years. Therefore, the listings could have equipment listed that is no longer at the facilities due to loss, theft, cannibalization, or other disposition. Additionally, the storage spaces that were viewed at both facilities were full of unused equipment which had not been sold or surplused. Murfreesboro rents trailers in order to store this equipment.

Finally, the written procedures for property, furniture, and equipment are not adequate. The procedures do not address the process for incorporating additions into the accounting records, the types of items to be capitalized, or method for valuing additions to the listing. In order to create consistency and comparability between years, the policies need to be comprehensive.

Without reconciling the annual physical inventories to the management company's fixed asset records, the misstatement of fixed assets because of loss or theft could go unnoticed. If the description is the only identifying item that is included in the management company records, specific equipment items cannot be easily located or verified through the inventory. Identification is also difficult if the property tag number is not affixed to the asset. Known losses and additions or donations may not be reported to the management company, precluding necessary adjustments to the furniture and equipment account and the related depreciation. Without a clear capitalization policy, there will not be consistency between similar items and between the facilities.

Recommendation

The board should work with the management company to develop a specific plan of action to correct this material weakness. The plan should include a thorough reconciliation between the physical inventory and the management company's accounting records for fixed assets. The random number used in the accounting records to identify equipment items should be replaced with the property tag number. Property tags should be placed, and replaced as necessary, on equipment items. Where the actual attachment of property tags is not practical, the property tag number should otherwise be inscribed on the equipment items.

The property officer should forward the information necessary to record all additions and deletions of equipment in the accounting records to the controller. Donated property items should require official acceptance by the property officer who would then be responsible for providing the necessary information to the management company for addition to the accounting records.

The property officer in conjunction with the controller should review and clarify the capitalization policy as necessary to establish consistent procedures for capitalization and valuation of property additions. Finally, the administrator should see that unused and unneeded equipment is properly disposed of to prevent unnecessary expenditures for storage space for these items.

Management's Comment

We concur. Although progress has been made and acknowledged in the audit report, more work needs to be done. We are evaluating whether the suggested reconciliation can be done in the manner described. There are many situations where it will be impossible to "match up" equipment or fixed asset items in the facility with the accounting records because such descriptions were never provided that would enable such identification. Some fixed assets are identified in groups in the accounting records.

3. Internal control for purchasing is not adequate

Finding

The Tennessee State Veterans' Homes Board facilities do not have an adequate segregation of duties relating to purchasing, the board's policies and procedures over purchasing are not being followed, and service contract approvals required by state law are not being obtained. The lack of a proper segregation of duties related to the receptionists' positions was included as part of a prior finding in the previous audit report. Management did not concur, stating that department managers also carry out those duties. However, although the department managers may handle those duties for their particular department, the receptionists are still authorized to perform those duties for the business offices. It appears that new staff at the management company have a greater understanding of the significance of lack of segregation of duties and that the comments to the last audit failed to address the basic problem.

Job duties are not adequately segregated as follows:

a. The same individuals order and receive supplies. At Murfreesboro, the department head orders the supplies and also receives and inspects those supplies. At Humboldt, the maintenance supervisor does the ordering for the maintenance department and also receives items that are delivered to the maintenance area.

b. Receptionists also may order and receive the administrative supplies and equipment. In addition, receptionists perform accounts payable and cash receipting functions.

If one individual is responsible for both ordering and receiving goods, the opportunity for fraud is increased. Individuals could order goods and divert them for personal use or could, through collusion with a vendor, order goods which are not delivered but for which payment is made. Also, if receptionists are permitted to perform both accounts payable and cash receipting duties an opportunity is provided whereby the receptionists could acquire cash by canceling orders for goods and receiving refunds directly from the vendors and diverting them to personal use.

Also, policies and procedures related to purchasing are not being followed. The board's purchasing policies and procedures require department heads to complete purchase requisitions and to submit them to the purchasing clerk. The clerk is then to give the requisitions to the Administrator for review and approval. After approval is obtained, the clerk is to initiate the purchase orders. The purchasing policies and procedures also indicate that a purchase requisition and purchase order will be completed for all purchases. Purchase orders between $500 and $1,000 require at least three informal (oral) bids, and purchase orders over $1,000 require three formal (written) bids. In addition, the policies indicate that periodically a comparison will be made of the prices in the market place for equivalent supplies to ensure that vendors selected are giving the best prices.

These purchasing policies and procedures are not being followed. Twenty-seven of 29 vouchers tested (93%) did not have a purchase requisition. Twenty-one of 29 vouchers tested (72%) did not have a purchase order. Five of five vouchers tested that required bids (100%) did not have bid documentation. Three of these vouchers were over $1,000, and two were between $500 and $1000. We also looked at the documentation for significant vendors. Twenty of 24 significant vendors (83%) did not have formal written bid documentation. Also, 24 of the 24 significant vendors tested (100%) did not have documentation of price comparisons. Failure to follow purchasing policies and procedures could result in fraud, waste, or inefficiencies.

In addition, service contracts are not being obtained and sent to the Commissioner of the Tennessee Department of Finance and Administration for approval. For 26 of 42 service vendors tested (62%), a service contract could not be provided. Section 58-7-103, *Tennessee Code Annotated* states, "Contracts for services must also be approved in advance pursuant to Section 12-4-109." Properly approved contracts for services are necessary to ensure all parties are aware of the duties and responsibilities of each party and to ensure that agreements are in the best interest of the state.

Recommendation

The administrator at each facility should ensure purchasing duties are adequately segregated. The individual ordering the goods should not also receive and inspect the goods. Further, this individual should not have accounts payable and cash receipting duties. In addition, the administrators should ensure that board purchasing policies and procedures are followed. Service contracts should be established by the management company and approved in accordance with state law.

Management's Comment

We concur that purchasing duties should be adequately segregated. However, the position of purchasing clerk described in the audit report does not exist. To create such a position where a person only received goods ordered by the department heads, or only ordered goods to be received by department heads or their designees, would require major changes in the organizational structure of each facility. Since these changes might require unbudgeted expenses the board and the management company will carefully consider this issue. We will review and revise as necessary our policies and practices so that purchase requisitions and purchase orders are used as appropriate. We will review policies requiring informal and written bids for certain purchases so that our practices are consistent with board policy. Service contracts will be established and approved to the extent possible in accordance with state law.

4. <u>Foundation affairs are not separate</u>

Finding

The foundation affairs are not independent from the board, its personnel, or facilities. Currently, foundation operations are performed primarily at the Murfreesboro facility by board personnel. Board employees handle the cash receipting and financial records for the foundation.

Attorney General Opinion No. U94 – 037, dated March 10, 1994, indicates that the foundation

> "must operate independently of the Board and its personnel and facilities. . . . State resources such as state personnel and state facilities should not be devoted to the operation of such a [foundation]. . . . The affairs of the Board must remain separate and distinct in all respects from the affairs of the [foundation]."

The opinion recognized that private citizens may establish and operate nonprofit corporations for fundraising; however, the board is not authorized by law to create or operate such a corporation. The foundation board has knowledge of this opinion but chooses to use state resources rather than expending funds derived from donations for the administrative expenses.

Recommendation

In accordance with the Attorney General Opinion, the board should ensure that the operations of the foundation are separate from the operations of the board, its personnel, and facilities.

Management's Comment

We do not concur. The expense of paying additional personnel from donated funds to carry out administrative duties can not be justified.

Auditor's Comment

As noted in the finding, the Attorney General has issued an opinion on this matter stating that state resources should not be used for the operation of the foundation. The board does not have the authority to disregard this opinion merely due to financial considerations.

5. Receipt of goods and services was not documented

Finding

As noted in the prior audit, internal control for payables is not adequate. The board concurred with the prior finding, stating, "Our efforts continue in this area both to improve the timely processing of invoices for payment, and to provide the proper verification of receipt." Although invoices are now processed in a timely manner, verification of receipt was not consistently documented.

Thirteen of 29 disbursements tested for the year ended June 30, 2000, (45%) did not have an employee's initials or signature and date as evidence of receipt. According to management, receipt will be documented by the department head or other appropriate personnel signing and dating the invoice. If the receipt of goods and services is not documented, the facility may not receive the proper quantity or the proper item, or it may pay for goods or services not received. Also, without record of the date of receipt, the establishment of year-end payables may be erroneous.

Recommendation

The administrator at each facility should ensure that verification of receipt is documented by personnel receiving the goods or services.

Management's Comment

We concur. The Administrators of each facility will ensure that personnel receiving goods or services properly document receipt of goods or services. Invoices will be stamped noting the person who received the goods or services and the date it was received.

6. Internal control for donations to the Tennessee Veterans Home Foundation, Inc., is not adequate

Finding

The facilities do not have adequate internal control for cash-receipting. Donations to the foundation can be made at either facility. Donations made at the Humboldt facility are forwarded to the Murfreesboro facility for receipting and depositing.

At the Humboldt facility, there is not a receipt book or a log to record incoming donations. At the Murfreesboro facility, the executive assistant opens the mail and prepares the receipt, reconciles the bank account, and maintains the accounting records. This is not an adequate segregation of duties. Further checks are not restrictively endorsed as soon as they are received, and the receipts are not reconciled to the actual deposit.

Without a receipt book or log, several employees are allowed access to receipts before accountability is established. When a receipt book is prepared, accountability is still not established unless a third party compares the amount recorded in the receipt book to the amount of the deposit. When checks are not endorsed immediately, the risk of misappropriation increases. The lack of appropriate segregation of duties further weakens internal control by providing the opportunity to conceal misappropriation.

Recommendation

The administrator at each facility should ensure that internal control over cash receipting is established. A cash receipts log should be maintained at the Humboldt facility. To ensure that all funds received were deposited, the Murfreesboro receipts and the Humboldt log should be compared to the deposit. The duties relating to opening the mail and preparing the receipt should be independent of the bank reconciliation duties and maintenance of the accounting records. All checks should be restrictively endorsed upon receipt.

Management's Comment

We concur. The Executive Assistant at Humbolt is maintaining a cash receipts log. This log is e-mailed to the Executive Assistant at Murfreesboro monthly. The Executive Assistant at Murfreesboro checks the cash receipts logs to the receipt book to assure all checks were deposited. The Executive Assistant at Humbolt will endorse any checks received there before forwarding to Murfreesboro.

1. The receptionist at the Murfreesboro facility will prepare a receipt and endorse checks for the Foundation.
2. The Business Office Manager will prepare the deposit and verify the amount to be deposited.
3. The Payroll Director will deposit the verified amount.
4. The Foundation Treasurer will receive and review the monthly bank statements before forwarding to the Executive Assistant at the Murfreesboro facility.
5. The Executive Assistant at Murfreesboro will use the bank statement to reconcile the Monthly Financial Report for the Foundation.
6. The Financial Report will then be mailed to the Foundation Trustees for review.

We do not concur with Paragraph 2, last sentence of the findings. "Further checks are not restrictively endorsed as soon as they are received, and the receipts are not reconciled to the actual deposit."

The checks are endorsed with the Foundation stamp as soon as they are received at the Murfreesboro facility. The receipts are used to verify proper amounts deposited when the List of Income Statement is prepared.

Auditor's Comment

Although the checks are endorsed as soon as they are received at the Murfreesboro facility, checks are often received at the Humboldt facility and may pass through several people's hands unendorsed before arriving at the Murfreesboro facility. Also, management was unable to provide the field auditors with documentation showing that receipts are reconciled with the amounts deposited.

7. State funds are being commingled with management company funds

Finding

The Tennessee State Veterans' Homes Board facilities are under the control and authority of the board. The day-to-day operations of the facilities are under the control of the management company. Presently the management company pays the bills of the veterans' homes by writing checks against a bank account controlled by the management company. This bank account is an account the management company also uses for transactions which are not related to the veterans' home operations. The management company is in Chapter 11 Bankruptcy proceedings.

The board is ultimately responsible for the financial obligations of the veterans' homes.

The contract between the board and the management company has conflicting language with regard to the way the board and the management company are to handle payment of obligations of the veterans' homes. In one part of the contract, the board is to "reimburse" the management company for its payment of bills on behalf of the veterans' homes. In another section of the contract, the management company is to pay the bills as it receives repayment from the board for the expenses it intends to incur. In other words, there is not a reimbursement for checks which have cleared the management company's bank account. Instead, the management company does not remit its checks on behalf of the veterans' homes until it has received the "reimbursement" from the board.

The current practice is consistent with the section of the contract that permits the management company to hold its checks until it receives the corresponding checks from the board. Although this practice is consistent with that section of the contract, this procedure is not a "reimbursement." In fact, this process effectively commingles the funds of the board with the funds of the management company during the period between the time the management company receives the checks from the board and the time the management company checks clear the management company's bank account.

This process needs to be revisited. Although the contract language permits this arrangement, the contract also refers to the process as one of "reimbursement". If the intent of the contract was for the management company to be reimbursed for its expenses on behalf of the facilities then the current process fails to reflect that intent. Clearly the way these transactions take place is not a reimbursement.

Furthermore, notwithstanding the original intent of the parties, the management company is in bankruptcy. While the current process clearly assists the management company with its cash flow, it also puts state funds at a greater risk than a true reimbursement process would.

Recommendation

The board should re-examine the contract it has with the management company and take steps to implement a process for the payment of veterans' home bills that more suitably protects the state's funds. The board could insist that all payments for the facilities be paid directly from a bank account solely controlled by the board. The checks should be signed by a board employee. Another approach would be for the board to truly reimburse the management company for checks which have cleared the bank account of the management company. The board should then amend the contract to reflect the new practice.

Management's Comment

We concur. Changes have been made to establish separate bank accounts solely controlled by the board for all payments for the facilities. The checks will bear the signature of a board employee. This change will take effect during the first week of September.

8. Petty cash policies are inadequate and are not being followed

Finding

The petty cash policy does not address what types of purchases can be made through petty cash funds. The policies and procedures that have been adopted are not being followed.

The petty cash policies and procedures do not provide guidance as to the types of purchases for which petty cash may be used, and there are no guidelines specifying what is an allowable petty cash expense. At Humboldt, petty cash was used to purchase Halloween decorations, a birthday cake, and pay vendor mileage. At Murfreesboro, petty cash was used for the same two nurses to dine out repeatedly with residents, a fishing trip for residents, pizza for housekeeping staff, and $200 of books for a nursing class. Although board personnel may consider all of these items to be allowable expenses, the use of the petty cash fund allows employees to avoid additional approvals. Without policies identifying allowable expenditures, the petty cash could be used for activities that are outside the mission of the board.

The petty cash policies and procedures that have been adopted were not followed. Twelve of 45 petty cash receipts tested (27%) exceeded the petty cash purchase limit of $30. At Humboldt, five of five petty cash vouchers tested (100%) did not contain a completed and signed petty cash reconciliation form, from which petty cash is to be replenished. One petty cash advance tested at each facility did not contain the Administrator's signature.

The policies and procedures for petty cash indicate that petty cash disbursements should not exceed $30. Purchases greater than this amount must go through accounts payable. The procedures require a petty cash reconciliation form approved by the Administrator documenting the reconciliation of petty cash and the check request to replenish petty cash. In addition, the procedures for cash advances are that the advance be approved by the Administrator and that the amount of the cash advance is written on the petty cash receipt. Then, once the change from the cash advance is brought back to the custodian, the custodian is to write down the amount of the purchase and the funds returned. These policies were implemented to establish internal control over petty cash. When the policies are not followed, the fund may be used for purposes for which it was not intended.

Recommendation

The board should modify the petty cash policy to include guidance for the types of appropriate petty cash purchases. The management company should ensure that existing petty cash policies and procedures are followed.

Management's Comment

We concur. A revised petty cash policy was approved on July 26, 2001. The management company will closely monitor practices in each facility to insure that proper receipting, proper signatures and compliance with established limits are followed.

9. <u>Resident trust fund petty cash is vulnerable to misappropriation</u>

Finding

Resident trust fund petty cash controls are not adequate. Duties are not adequately segregated, and approvals for withdrawal are not appropriate.

At both facilities during the audit period, the payroll clerk had access to the cash, posted receipts and petty cash disbursements, prepared the check to replenish petty cash, and prepared the bank reconciliation. Duties have now been partially segregated, but the individual posting the disbursements still has access to the cash.

Residents receiving petty cash are to sign a receipt documenting receipt of the money. Residents who are not able to sign their name place an 'X' on the signature line. The person issuing the funds signs as a witness. The signature of just one person for withdrawal of a resident's cash is not sufficient to reduce the risk of theft.

An adequate segregation of duties is a primary component of internal control. Segregation of duties is essential in fraud detection and aids in prevention of possible errors and misappropriation of funds. To have adequate control over cash, cash withdrawals must be approved by more than one individual when the resident is unable to document approval.

Recommendation

The Administrator at each facility should ensure resident trust fund petty cash duties are adequately segregated. The same individual should not both post disbursements and have access to cash. The individual acting as a witness to disbursements should not also be the individual issuing the funds. An additional approval should be required when the individual issues the funds to a resident who is unable to sign for the funds.

Management's Comment

We concur. The facility policies will be revised to insure that individuals posting disbursements do not have access to cash, and that individuals acting as a witness are not also issuing the funds.

10. Management fee expense was not adjusted timely

Finding

The Tennessee State Veterans' Homes Board management fees were not adjusted timely for prior-year audit adjustments to bad debt expense. The board overpaid the management company by $21,719.

As a result of the prior year audit, adjustments were made by the management company that increased the amount of bad debt expense recorded related to the year ended June 30, 1999. As a result of the audit and additional analysis by the management company, the bad debt expense increased by $310,088 and $124,297 for the Humboldt and Murfreesboro facilities, respectively. The management fee for that period was calculated by multiplying the board's revenues less bad debt expense by 5%, pursuant to the contract. Thus, an increase in bad debt expense of $434,385 reduces the management fees. The management fees were not adjusted to reflect these prior-year audit adjustments. Because the management fee was not recalculated, the management company was overpaid by $21,719.

Recommendation

The management company should ensure the management fee is properly reduced for audit adjustments affecting the calculation. When adjustments are made that affect net revenues, the board should ensure that the adjustments are properly reflected in the amount paid to the management company. The management company should apply the $21,719 that was overpaid to the current year management fees.

Management's Comment

We concur. The management fees in question will be credited to the next deferred fee invoice. When the invoice is processed by the TSVHB the transaction recommended by the State audit report will be concluded.

11. Cash receipts were vulnerable to misappropriation

Finding

As noted in the prior two audits, the Tennessee State Veterans' Homes did not have adequate cash receipting procedures. The facilities receive room and board payments and resident trust fund additions by mail and in person. Medicare and Medicaid payments are also received by mail. Veterans Affairs payments are received by direct deposit into the depository bank accounts.

The board concurred with the prior findings. Changes to duties were made after the audit period. However, cash receipting duties were not adequately segregated at either facility during the audit period. The receptionist opened the mail and prepared the cash receipt. The business office manager prepared the deposit, prepared the cash transmittal, and handled disputed items. It is from the cash transmittal form that the management company posts the room and board receipts into the accounting records. No one ensured that the dollar value of receipts equaled the dollar value of deposits, no one verified the sequence of the receipts, and no one compared the receipts to the information that was posted to the cash transmittal form. Also, for one month during the fiscal year, cash receipts were not prenumbered. Instead, receipt numbers were handwritten by the receptionist.

Additional segregation problems existed over resident trust fund account receipts at both the Murfreesboro and Humboldt facilities. The payroll clerk made the deposit, reconciled the bank statement, and posted the resident trust information to the resident's account. The receipts were neither reconciled to the actual deposit nor to the amount posted to the resident's account.

At both facilities, errors were noted concerning the issuance and preparation of cash receipts. The same set of receipt numbers were used more than once. Changes to receipts were not adequately documented or witnessed, receipts were not properly voided, and receipts were not issued in order.

An adequate segregation of duties is a primary component of internal control. Segregation of duties is essential in fraud detection and aids in prevention of possible errors and misappropriation of funds. The use of prenumbered receipts in conjunction with comparisons between receipts, deposits, and postings helps to ensure accountability for all receipts.

Recommendation

Compensating controls for the lack of segregation of duties except the handling of disputed items were implemented in September 2000. The management company should continue to monitor the cashreceipting process to ensure that duties remain adequately segregated and that disputed items are initially handled by someone independent of deposit preparation and posting. Prenumbered receipts should be used in order, and receipt numbers should not be duplicated. Changes to receipts should be witnessed, and supporting documentation should be maintained. Voided receipts should be marked void and the original receipt should be retained with the duplicate.

Management's Comment

We concur. The September 2000 policy will be closely monitored for compliance in both facilities.

STATE OF TENNESSEE
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Independent Auditor's Report

June 1, 2001

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying balance sheets of the Tennessee State Veterans' Homes Board, a component unit of the State of Tennessee, as of June 30, 2000, and June 30, 1999, and the related statements of revenues, expenses, and changes in equity and cash flows for the years then ended. These financial statements are the responsibility of the board. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with government auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee State Veterans' Homes Board as of June 30, 2000, and June 30, 1999, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Schedule of Pension Funding Progress, on page 45 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements, taken as a whole. The accompanying financial information, on pages 46 through 50, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements, taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 1, 2001, on our consideration of the board's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/mb

Exhibit A

TENNESSEE STATE VETERANS' HOMES BOARD
BALANCE SHEETS
JUNE 30, 2000, AND JUNE 30, 1999

	June 30, 2000	June 30, 1999
ASSETS		
Current assets:		
Cash (Note 2)	$ 513,826.10	$ 1,257,394.83
Investments (Note 2)	50,076.78	25,076.78
Resident accounts receivable:		
Private	1,919,899.08	2,376,213.94
U.S. Department of Veterans Affairs	429,045.55	372,824.00
Allowance for doubtful accounts	(1,372,668.97)	(1,062,027.17)
Amounts advanced to the management company	4,482.86	-
Medicare cost settlement receivable	317,576.32	274,267.56
Medicaid cost settlement receivable	6,270.00	6,270.00
Inventories	42,220.22	48,035.94
Prepaid items	9,108.03	17,664.51
Total current assets	1,919,835.97	3,315,720.39
Restricted assets (Note 4):		
Cash (Note 2)	2,544,641.56	1,665,696.36
Total restricted assets	2,544,641.56	1,665,696.36
Other assets:		
Deposit with management company	10,000.00	10,000.00
Unamortized bond issuance costs	117,748.43	124,065.35
Unamortized preopening expenses	19,518.94	52,974.94
Total other assets	147,267.37	187,040.29
Fixed assets:		
Land	194,244.00	194,244.00
Buildings and improvements	10,890,645.63	10,878,743.25
Accumulated depreciation - buildings and improvements	(1,740,742.59)	(1,452,095.00)
Furniture and equipment	1,652,226.77	1,614,880.93
Accumulated depreciation - furniture and equipment	(892,709.53)	(744,752.79)
Total fixed assets	10,103,664.28	10,491,020.39
Total assets	$ 14,715,409.18	$ 15,659,477.43

Exhibit A (Cont.)

TENNESSEE STATE VETERANS' HOMES BOARD
BALANCE SHEETS
JUNE 30, 2000, AND JUNE 30, 1999

	June 30, 2000	June 30, 1999
LIABILITIES AND EQUITY		
Liabilities:		
Current liabilities:		
Accounts payable and accruals	$ 812,657.40	$ 1,307,793.95
Due to primary government (Note 3)	657,763.82	950,278.63
Amounts advanced by management company	-	103,533.51
Amounts held in custody for others	101,944.62	79,204.47
Medicaid current financing	241,493.17	148,876.10
Advance from primary government (Note 6)	10,000.00	10,000.00
Total current liabilities	1,823,859.01	2,599,686.66
Current liabilities payable from restricted assets:		
Bonds payable (Note 5)	160,000.00	155,000.00
Total current liabilities payable from restricted assets	160,000.00	155,000.00
Noncurrent liabilities:		
Bonds payable, net of unamortized discount (Note 5)	4,727,344.28	4,884,814.32
Advance from primary government (Note 6)	160,000.00	170,000.00
Total noncurrent liabilities	4,887,344.28	5,054,814.32
Total liabilities	6,871,203.29	7,809,500.98
Equity:		
Contributed capital (Note 7)	9,208,718.84	9,208,718.84
Retained earnings:		
Reserved for foundation	79,994.29	64,188.82
Unreserved	(1,444,507.24)	(1,422,931.21)
Total retained earnings	(1,364,512.95)	(1,358,742.39)
Total equity	7,844,205.89	7,849,976.45
Total liabilities and equity	$ 14,715,409.18	$ 15,659,477.43

The notes to the financial statements are an integral part of this statement.

Exhibit B

TENNESSEE STATE VETERANS' HOMES BOARD
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN EQUITY
FOR THE YEARS ENDED JUNE 30, 2000, AND JUNE 30, 1999

	For the Year Ended June 30, 2000	For the Year Ended June 30, 1999
Operating revenue:		
Resident service revenue less contractual adjustments of $1,006,911.03 for 2000 and $1,176,243.79 for 1999	$ 10,290,229.90	$ 9,837,724.66
Total operating revenue	10,290,229.90	9,837,724.66
Operating expenses:		
Administrative and general	1,824,706.03	1,752,889.22
Nursing services	3,865,279.14	3,430,927.48
Central services	317,794.79	343,796.48
Ancillary departments	1,097,191.25	1,115,176.90
Dietary	866,203.75	845,256.33
Activities	146,358.93	132,090.90
Social services	112,562.15	108,736.17
Housekeeping services	372,452.13	358,769.77
Laundry and linens	186,296.85	183,110.64
Plant operations and maintenance	530,825.89	505,092.44
Depreciation	436,604.33	433,305.88
Amortization of preopening expenses	33,456.00	33,456.00
Bad debt expense	311,996.00	524,619.64
Other operating expenses	3,012.03	2,620.00
Total operating expenses	10,104,739.27	9,769,847.85
Operating income	185,490.63	67,876.81
Nonoperating revenues (expenses):		
Interest revenue	137,580.05	101,739.28
Miscellaneous revenue	43,139.20	20,654.60
Interest expense	(348,813.67)	(356,918.96)
Amortization of bond issuance costs	(6,316.92)	(6,316.92)
Cable television expense	(11,178.39)	(11,132.13)
Miscellaneous expense	(5,671.46)	(6,438.19)
Total nonoperating revenues (expenses)	(191,261.19)	(258,412.32)
Net loss	(5,770.56)	(190,535.51)
Equity, July 1	7,849,976.45	8,040,511.96
Equity, June 30	$ 7,844,205.89	$ 7,849,976.45

The notes to the financial statements are an integral part of this statement.

Exhibit C

TENNESSEE STATE VETERANS' HOMES BOARD
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2000, AND JUNE 30, 1999

	For the Year Ended June 30, 2000	For the Year Ended June 30, 1999
Cash flows from operating activities:		
Operating income	$ 185,490.63	$ 67,876.81
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	470,060.33	466,761.88
Miscellaneous nonoperating revenues	43,139.20	20,654.60
Miscellaneous nonoperating expenses	(16,849.85)	(18,169.32)
Changes in assets and liabilities:		
(Increase) decrease in resident accounts receivable - private	456,314.86	(783,563.49)
(Increase) decrease in resident accounts receivable - U.S. Department of Veterans Affairs	(56,221.55)	25,132.67
Decrease in resident accounts receivable - primary government	-	15,720.71
Increase in allowance for doubtful accounts	310,641.80	544,762.68
(Increase) in amounts advanced to management company	(4,482.86)	-
(Increase) decrease in Medicare cost settlement receivable	(43,308.76)	433,407.00
Decrease in Medicaid cost settlement receivable	-	19,939.00
Decrease in inventories	5,815.72	10,005.13
Decrease in prepaid items	8,556.48	3,406.26
Increase (decrease) in accounts payable and accruals	(491,082.28)	29,533.29
Increase (decrease) in due to primary government	(292,514.81)	425,939.01
Increase (decrease) in amounts advanced by management company	(103,533.51)	5,897.29
(Decrease) in Medicaid cost settlement payable	-	(344.00)
Increase (decrease) in amounts held in custody for others	22,740.15	(17,178.48)
Increase in Medicaid current financing	92,617.07	73,519.30
Total adjustments	401,891.99	1,255,423.53
Net cash provided by operating activities	587,382.62	1,323,300.34
Cash flows from noncapital financing activities:		
Principal paid on advance from state	(10,000.00)	(10,000.00)
Net cash used for noncapital financing activities	(10,000.00)	(10,000.00)
Cash flows from capital and capital-related financing activities:		
Purchase of fixed assets	(49,248.22)	(126,010.81)
Principal paid on bonds	(155,000.00)	(150,000.00)
Interest paid on bonds	(350,337.98)	(359,371.85)
Net cash used for capital and capital-related financing activities	(554,586.20)	(635,382.66)

TENNESSEE STATE VETERANS' HOMES BOARD
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2000, AND JUNE 30, 1999

	For the Year Ended June 30, 2000	For the Year Ended June 30, 1999
Cash flows from investing activities:		
Purchase of certificate of deposit	(25,000.00)	-
Interest received	137,580.05	101,739.28
Net cash provided by investing activities	112,580.05	101,739.28
Net increase in cash	135,376.47	779,656.96
Cash, July 1	2,923,091.19	2,143,434.23
Cash, June 30	$ 3,058,467.66	$ 2,923,091.19

The notes to the financial statements are an integral part of this statement.

Tennessee State Veterans' Homes Board
Notes to the Financial Statements
June 30, 2000, and June 30, 1999

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Tennessee State Veterans' Homes Board was established in 1988 under the provisions of Title 58, Chapter 7, *Tennessee Code Annotated*. This statute authorizes the creation of public homes for veterans throughout the state to provide support and care for honorably discharged veterans who served in the United States armed forces. At June 30, 2000, two facilities, located in Murfreesboro and Humboldt, were operating. The ten-member board has appointed an executive director and contracted with a management company to carry out its operations.

The Tennessee State Veterans' Homes Board is a component unit of the State of Tennessee (the primary government). Although it is a separate legal entity, the board is appointed by the Governor, and its budget is approved by the state. In addition, the issuance of bonds must be approved by the State Funding Board. The board is discretely presented in the *Tennessee Comprehensive Annual Financial Report.*

The Tennessee Veterans Home Foundation, Inc., was established by the Tennessee State Veterans' Homes Board to receive donations for the benefit of the facilities' residents. The foundation Board of Directors has 11 members, 6 of which are appointed by the Tennessee State Veterans' Homes Board. The board was developed solely to benefit the residents of Tennessee State Veterans' Homes. Due to this relationship, the foundation is included in the board's financial statements.

B. Basis of Presentation

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The Tennessee State Veterans' Homes Board follows applicable GASB pronouncements, as well as applicable private-sector pronouncements issued on or before November 30, 1989.

C. Measurement Focus and Basis of Accounting

The financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under the accrual basis, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

D. Investments

The investments are certificates of deposit which are stated at cost.

E. Inventories

Inventories of medical, dietary, and housekeeping supplies are determined by physical count and are valued at replacement cost. This valuation is not materially different from historical cost.

F. Restricted Assets

Certain assets of the Tennessee State Veterans' Homes Board are classified as restricted assets because their use is restricted by applicable bond covenants.

G. Bond Discounts and Issuance Costs

Bond discounts and issuance costs are deferred and amortized over the life of the bonds using the straight-line method. The results of this method are not materially different from those of the effective interest method. Bonds payable are reported net of unamortized bond discount.

H. Fixed Assets and Depreciation

Fixed assets are recorded at cost and are depreciated on a straight-line basis over the estimated useful lives of the assets. Donated fixed assets are stated at fair value at the date of donation. The board's policy is to capitalize interest expense incurred during the construction of assets.

NOTE 2. DEPOSITS

The board's bank accounts and investments are insured by the FDIC or are in financial institutions that participate in the bank collateral pool administered by the Treasurer of the

State of Tennessee. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure.

The board also has deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. The LGIP is part of the Pooled Investment Fund. The fund's investment policy and custodial credit risk are presented in the *Tennessee Comprehensive Annual Financial Report*.

NOTE 3. DUE TO PRIMARY GOVERNMENT

June 30, 2000		
Due To:		
Department of Finance and Administration–Medicaid current services less void adjustments	$	316,271.30
Department of Finance and Administration–Medicaid overpayments occurring before 1994		282,062.42
Department of Health–bed tax		26,000.00
Department of the Treasury–retirement contributions		27,189.01
Department of Labor and Workforce Development–unemployment taxes		6,241.09
Total due to primary government	$	657,763.82

June 30, 1999		
Due To:		
Department of Health–Medicaid current services less void adjustments	$	626,134.42
Department of Health–Medicaid overpayments occurring before 1994		282,062.42
Department of the Treasury–retirement contributions		8,430.37
Department of the Treasury–Claims Award Fund		27,600.00
Department of Employment Security–unemployment taxes		6,051.42
Total due to primary government	$	950,278.63

The amount Due to Primary Government, Department of Health—Medicaid current services less void adjustments, includes both the receivable for amounts collectible from Medicaid for current services, and a payable to Medicaid for void adjustments that may be related to previous services. At June 30, 2000, the receivable from Medicaid is $591,414.88, and the estimated payable to Medicaid for void adjustments is $907,686.18. At June 30, 1999, the receivable from Medicaid is $632,066.07, and the estimated payable to Medicaid for void adjustments is $1,258,200.49.

The amount Due to Primary Government, Department of Health—Medicaid overpayments occurring before 1994 consists of $282,062.42 payable for Medicaid overpayments made prior to the implementation of the void adjustment process.

NOTE 4. RESTRICTED ASSETS

The balances of the board's restricted asset accounts are as follows:

	June 30, 2000	June 30, 1999
Cash in depository account	$ 64,998.77	$ 231,852.98
Revenue bond revenue account	1,349,901.85	263,993.49
Revenue bond debt service account	197,109.39	383,467.73
Revenue bond debt service reserve account	513,228.62	513,228.62
Revenue bond repair and replace-ment account	419,402.93	273,153.54
	$2,544,641.56	$1,665,696.36

NOTE 5. BONDS PAYABLE

Bonds payable consisted of the following:

	June 30, 2000	June 30, 1999
Revenue bonds, Series 1989, 6.3% to 7.5%, due from 2000 to final maturity in 2014 (net of unamortized discount of $27,982.77 for 2000 and $30,042.81 for 1999)	$1,922,017.23	$1,999,957.19
Revenue bonds, Series 1994, 4.75% to 6.75% due from 2000 to final maturity in 2021 (net of unamor-tized discount of $9,672.95 for 2000 and $10,142.87 for 1999)	2,965,327.05	3,039,857.13
Total bonds payable	$4,887,344.28	$5,039,814.32

Debt-service requirements to maturity of the bonds payable at June 30, 2000, are as follows:

For the Year(s) Ended June 30	Principal	Interest	Total
2001	$ 160,000.00	$ 340,442.50	$ 500,442.50
2002	165,000.00	330,122.50	495,122.50
2003	170,000.00	319,187.50	489,187.50
2004	180,000.00	307,807.50	487,807.50
2005	210,000.00	295,612.50	505,612.50
2006-2021	4,040,000.00	2,298,787.50	6,338,787.50
	$4,925,000.00	$3,891,960.00	$8,816,960.00

NOTE 6. ADVANCE FROM PRIMARY GOVERNMENT

The board received a $200,000 advance from the primary government to be repaid from excess revenues from the operations of the Murfreesboro facility. No interest is accrued. Payments of $10,000 are made yearly.

NOTE 7. CONTRIBUTED CAPITAL

Contributed capital represents equity acquired through capital grants and capital contributions. The U.S. Department of Veteran's Affairs has provided grant assistance for constructing and equipping the Humboldt and Murfreesboro facilities.

All capital contributed for the Humboldt facility was received prior to July 1, 1998. The total grant contribution from the U.S. Department of Veteran's Affairs was $4,873,293.76. In addition, the board received $870,162.70 in appropriations and a $44,592.00 vehicle from the State of Tennessee, and the City of Humboldt donated land valued at $160,544.00. Total contributed capital for the Humboldt facility is $5,948,592.46.

All capital contributed for the Murfreesboro facility was received prior to July 1, 1994. The total grant contribution from the U.S. Department of Veteran's Affairs was $3,226,426.38. In addition, the U.S. Department of Veteran's Affairs donated land valued at $33,700.00 for the Murfreesboro facility. Total contributed capital for the Murfreesboro facility is $3,260,126.38.

NOTE 8. DEFINED BENEFIT PENSION PLAN

A. Plan Description

Employees of Tennessee State Veterans' Homes Board are members of the Political Subdivision Pension Plan (PSPP), an agent multiple-employer defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement benefits as well as death and disability benefits. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with 5 years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members at the age of 55 or at any age with 25 years of service. Disability benefits are available to active members with five years of service who became disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the system after July 1, 1979, become vested after 5 years of service and members joining prior to July 1, 1979, were vested after 4 years of service. Benefit provisions are established in state statute found in Title 8, Chapters 34-37, *Tennessee Code Annotated*. State statutes are amended by the Tennessee General Assembly. Political subdivisions such as Tennessee State Veterans' Homes Board participate in the TCRS as individual entities and are liable for all costs associated with the operation and administration of their plan. Benefit improvements are not applicable to a political subdivision unless approved by the chief governing body.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for the PSPP. That report may be obtained by writing to the Tennessee Treasury Department, Con-solidated Retirement System, 10th Floor, Andrew Jackson Building, Nashville, Tennessee 37243-0230, or can be accessed at www.treasury.state.tn.us.

B. Funding Policy

The Tennessee State Veterans' Homes Board has adopted a noncontributory retirement plan for its employees by assuming employee contributions up to 5.0 percent of annual covered payroll.

The Tennessee State Veterans' Homes Board is required to contribute at an actuarially determined rate; the rate for the fiscal year ending June 30, 2000, was 8.67% of annual covered payroll. The contribution requirement of plan members is set by state statute. The contribution requirement for the board is established and may be amended by the TCRS' Board of Trustees.

C. Annual Pension Cost

For the year ending June 30, 2000, Tennessee State Veterans' Homes Board's annual pension cost of $226,876 to TCRS was equal to the board's required and actual contributions. The required contribution was determined as part of the June 30, 1997, actuarial valuation using the frozen initial liability actuarial cost method.

Significant actuarial assumptions used in the valuation include (a) rate of return on investment of present and future assets of 7.5% a year compounded annually, (b) projected salary increases of 5.5% annual rate (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries), (c) projected 4.5% annual increase in the social security wage base, and (d) projected post retirement benefit increases of 3% annually. The actuarial value of assets was determined using techniques that smooth the effect of short-term volatility in the market value of total investments over a five-year period. Required contribution rates as determined by the July 1, 1999, actuarial valuation are effective July 1, 2000.

Three-Year Trend Information

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 2000	$226,876	100.00%	-
June 30, 1999	$196,711	100.00%	-
June 30, 1998	$176,998	100.00%	-

NOTE 9. RISK MANAGEMENT

The board is exposed to various risks of loss related to general liability; automobile liability; professional malpractice; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters.

A. The building and contents are insured by the State of Tennessee. The board has scheduled coverage of $10,494,200 for the buildings and $1,254,400 for the contents.

   The state purchases commercial insurance for real property losses above $5 million per year and surety bond coverage on the state's officials and employees. In the past three fiscal years, the state has not had any claims filed with the commercial insurer. A designation for casualty losses in the amount of $7.256 million has been established in the State of Tennessee general fund to provide for any property losses other than the commercial insurance coverage.

B. The board participates in the State of Tennessee's Claims Award Fund, an internal service fund in which the state has set aside assets for claims settlement. This fund services all claims for risk of loss to which the state is exposed, including general liability, automobile liability, professional malpractice, and workers' compensation. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the participating agencies based on a percentage of each agency's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of each fiscal year-end to determine the fund liability and premium allocation.

C. The board has elected to provide health coverage for its employees through a health plan for eligible local governments and quasi-governmental agencies in Tennessee. The Local Government Group Insurance Fund provides access to affordable health insurance by pooling risk among the groups. The plan provides for greater stability in controlling premium increases and, through a structured managed-care program, helps contain health care costs of participating members.

The plan is administered by the State of Tennessee, using a separately established fund. Premiums of participating units are deposited to this fund and used to pay claims for health care costs of participants, as well as the state's administrative costs of the plan. Employees have the option of obtaining insurance through either Blue Cross Blue Shield of Tennessee or Prudential Insurance. Claims are administered by these companies, which are currently under contract to provide these and other services to the state. Insurance premiums are adjusted at the end of the year based on the claims experience of the pool. Individual pool participants are not assessed additional premiums based on individual claims experience. Employees and providers have 13 months to file medical claims under Blue Cross Blue Shield of Tennessee and Prudential.

Tennessee State Veterans' Homes Board
Required Supplementary Information
Schedule of Pension Funding Progress

(Expressed in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
7/01/99	$1,134	$1,134	$0	100%	$2,022	0%
6/30/97	$645	$645	$0	100%	$2,191	0%

Information is shown only for the years available. Additional years will be shown as they become available.

<u>Actuarial Assumptions</u>

An actuarial valuation was performed as of July 1, 1999, to establish contribution rates as of July 1, 2000. The June 30, 1997, actuarial valuation established contribution rates for the years ended June 30, 2000, and June 30, 1999. Significant actuarial assumptions used in the valuation include (a) rate of return on investment of present and future assets of 7.5% a year compounded annually, (b) projected salary increases of 5.5% annual rate (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries), (c) projected 4.5% annual increase in the social security wage base, and (d) projected post retirement benefit increases of 3% annually.

TENNESSEE STATE VETERANS' HOMES BOARD
SUPPLEMENTARY BALANCE SHEETS
JUNE 30, 2000, AND JUNE 30, 1999

	June 30, 2000				June 30, 1999			
	Murfreesboro	Humboldt	Foundation	Totals	Murfreesboro	Humboldt	Foundation	Totals
ASSETS								
Current assets:								
Cash	$ 426,323.71	$ 57,584.88	$ 29,917.51	$ 513,826.10	$ 607,540.92	$ 611,670.23	$ 38,183.68	$ 1,257,394.83
Investments	-	-	50,076.78	50,076.78	-	-	25,076.78	25,076.78
Resident accounts receivable:								
Private	860,331.06	1,059,568.02	-	1,919,899.08	1,250,545.76	1,125,668.18	-	2,376,213.94
U.S. Department of Veterans Affairs	150,008.32	279,037.23	-	429,045.55	132,186.76	240,637.24	-	372,824.00
Allowance for doubtful accounts	(672,228.00)	(700,440.97)	-	(1,372,668.97)	(589,582.20)	(472,444.97)	-	(1,062,027.17)
Amounts advanced to management company	30,530.46	-	-	30,530.46	-	-	-	-
Medicare cost settlement receivable	271,711.23	45,865.09	-	317,576.32	263,829.56	10,438.00	-	274,267.56
Medicaid cost settlement receivable	6,270.00	-	-	6,270.00	6,270.00	-	-	6,270.00
Due from Murfreesboro facility	-	25,342.38	-	25,342.38	-	171,822.60	-	171,822.60
Inventories	16,126.55	26,093.67	-	42,220.22	22,961.19	25,074.75	-	48,035.94
Prepaid items	5,278.52	3,829.51	-	9,108.03	19,059.71	(2,323.56)	928.36	17,664.51
Total current assets	1,094,351.85	796,879.81	79,994.29	1,971,225.95	1,712,811.70	1,710,542.47	64,188.82	3,487,542.99
Restricted assets:								
Cash	1,173,442.75	1,371,198.81	-	2,544,641.56	985,129.44	680,566.92	-	1,665,696.36
Total restricted assets	1,173,442.75	1,371,198.81	-	2,544,641.56	985,129.44	680,566.92	-	1,665,696.36
Other assets:								
Deposit with management company	10,000.00	-	-	10,000.00	10,000.00	-	-	10,000.00
Unamortized bond issuance costs	23,823.68	93,924.75	-	117,748.43	25,577.48	98,487.87	-	124,065.35
Unamortized preopening expenses	-	19,518.94	-	19,518.94	-	52,974.94	-	52,974.94
Total other assets	33,823.68	113,443.69	-	147,267.37	35,577.48	151,462.81	-	187,040.29
Fixed assets:								
Land	33,700.00	160,544.00	-	194,244.00	33,700.00	160,544.00	-	194,244.00
Buildings and improvements	3,963,255.67	6,927,389.96	-	10,890,645.63	3,953,186.09	6,925,557.16	-	10,878,743.25
Accumulated depreciation - buildings and improvements	(954,695.42)	(786,047.17)	-	(1,740,742.59)	(846,275.77)	(605,819.23)	-	(1,452,095.00)
Furniture and equipment	814,325.10	837,901.67	-	1,652,226.77	790,280.22	824,600.71	-	1,614,880.93
Accumulated depreciation - furniture and equipment	(550,834.44)	(341,875.09)	-	(892,709.53)	(488,105.52)	(256,647.27)	-	(744,752.79)
Total fixed assets	3,305,750.91	6,797,913.37	-	10,103,664.28	3,442,785.02	7,048,235.37	-	10,491,020.39
Total assets	$ 5,607,369.19	$ 9,079,435.68	$ 79,994.29	$ 14,766,799.16	$ 6,176,303.64	$ 9,590,807.57	$ 64,188.82	$ 15,831,300.03

TENNESSEE STATE VETERANS' HOMES BOARD
SUPPLEMENTARY BALANCE SHEETS
JUNE 30, 2000, AND JUNE 30, 1999

	June 30, 2000				June 30, 1999			
	Murfreesboro	Humboldt	Foundation	Totals	Murfreesboro	Humboldt	Foundation	Totals
LIABILITIES AND EQUITY								
Liabilities:								
Current liabilities:								
Accounts payable and accruals	$ 408,326.08	$ 404,331.32	$ -	$ 812,657.40	$ 757,097.36	$ 550,696.59	$ -	$ 1,307,793.95
Due to primary government	237,340.26	420,423.56	-	657,763.82	370,685.51	579,593.12	-	950,278.63
Amounts advanced by management company	-	26,047.60	-	26,047.60	17,385.68	86,147.83	-	103,533.51
Amounts held in custody for others	48,657.89	53,286.73	-	101,944.62	52,990.26	26,214.21	-	79,204.47
Medicaid current financing	115,323.50	126,169.67	-	241,493.17	58,229.60	90,646.50	-	148,876.10
Due to Humboldt facility	25,342.38	-	-	25,342.38	171,822.60	-	-	171,822.60
Advance from primary government	10,000.00	-	-	10,000.00	10,000.00	-	-	10,000.00
Total current liabilities	844,990.11	1,030,258.88	-	1,875,248.99	1,438,211.01	1,333,298.25	-	2,771,509.26
Current liabilities payable from restricted assets:								
Bonds payable	85,000.00	75,000.00	-	160,000.00	80,000.00	75,000.00	-	155,000.00
Total current liabilites payable from restricted assets	85,000.00	75,000.00	-	160,000.00	80,000.00	75,000.00	-	155,000.00
Noncurrent liabilities:								
Bonds payable, net of unamortized discount	1,837,017.23	2,890,327.05	-	4,727,344.28	1,919,957.19	2,964,857.13	-	4,884,814.32
Advance from primary government	160,000.00	-	-	160,000.00	170,000.00	-	-	170,000.00
Total noncurrent liabilities	1,997,017.23	2,890,327.05	-	4,887,344.28	2,089,957.19	2,964,857.13	-	5,054,814.32
Total liabilities	2,927,007.34	3,995,585.93	-	6,922,593.27	3,608,168.20	4,373,155.38	-	7,981,323.58
Equity:								
Contributed capital	3,260,126.38	5,948,592.46	-	9,208,718.84	3,260,126.38	5,948,592.46	-	9,208,718.84
Retained earnings:								
Reserved for foundation	-	-	79,994.29	79,994.29	-	-	64,188.82	64,188.82
Unreserved	(579,764.53)	(864,742.71)	-	(1,444,507.24)	(691,990.94)	(730,940.27)	-	(1,422,931.21)
Total retained earnings	(579,764.53)	(864,742.71)	79,994.29	(1,364,512.95)	(691,990.94)	(730,940.27)	64,188.82	(1,358,742.39)
Total equity	2,680,361.85	5,083,849.75	79,994.29	7,844,205.89	2,568,135.44	5,217,652.19	64,188.82	7,849,976.45
Total liabilities and equity	$ 5,607,369.19	$ 9,079,435.68	$ 79,994.29	$ 14,766,799.16	$ 6,176,303.64	$ 9,590,807.57	$ 64,188.82	$ 15,831,300.03

TENNESSEE STATE VETERANS' HOMES BOARD
SUPPLEMENTARY STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN EQUITY
FOR THE YEARS ENDED JUNE 30, 2000, AND JUNE 30, 1999

	For the Year Ended June 30, 2000				For the Year Ended June 30, 1999			
	Murfreesboro	Humboldt	Foundation	Totals	Murfreesboro	Humboldt	Foundation	Totals
Operating revenue:								
Resident service revenue less contractual adjustments of $1,006,911.03 for 2000 and $1,176,243.79 for 1999	$ 5,368,543.64	$ 4,921,686.26	$ -	$ 10,290,229.90	$ 5,037,894.91	$ 4,799,829.75	$ -	$ 9,837,724.66
Total operating revenue	5,368,543.64	4,921,686.26	-	10,290,229.90	5,037,894.91	4,799,829.75	-	9,837,724.66
Operating expenses:								
Administrative and general	907,737.23	916,968.80	-	1,824,706.03	892,683.24	860,205.98	-	1,752,889.22
Nursing services	2,045,009.51	1,820,269.63	-	3,865,279.14	1,790,333.97	1,640,593.51	-	3,430,927.48
Central services	140,683.52	177,111.27	-	317,794.79	151,203.36	192,593.12	-	343,796.48
Ancillary departments	675,332.12	421,859.13	-	1,097,191.25	653,490.37	461,686.53	-	1,115,176.90
Dietary	437,648.03	428,555.72	-	866,203.75	455,038.88	390,217.45	-	845,256.33
Activities	73,757.77	72,601.16	-	146,358.93	66,698.64	65,392.26	-	132,090.90
Social services	60,001.87	52,560.28	-	112,562.15	57,892.45	50,843.72	-	108,736.17
Housekeeping services	195,756.62	176,695.51	-	372,452.13	190,856.24	167,913.53	-	358,769.77
Laundry and linens	98,354.52	87,942.33	-	186,296.85	91,529.31	91,581.33	-	183,110.64
Plant operations and maintenance	293,303.23	237,522.66	-	530,825.89	297,799.36	207,293.08	-	505,092.44
Depreciation	171,148.57	265,455.76	-	436,604.33	169,894.38	263,411.50	-	433,305.88
Amortization of preopening expenses	-	33,456.00	-	33,456.00	-	33,456.00	-	33,456.00
Bad debt expense	84,000.00	227,996.00	-	311,996.00	173,297.21	351,322.43	-	524,619.64
Other operating expenses	2,054.12	957.91	-	3,012.03	2,620.00	-	-	2,620.00
Total operating expenses	5,184,787.11	4,919,952.16	-	10,104,739.27	4,993,337.41	4,776,510.44	-	9,769,847.85
Operating income	183,756.53	1,734.10	-	185,490.63	44,557.50	23,319.31	-	67,876.81
Nonoperating revenues (expenses):								
Interest revenue	74,391.05	62,631.88	557.12	137,580.05	61,461.12	38,679.42	1,598.74	101,739.28
Miscellaneous revenue	20.00	-	43,119.20	43,139.20	400.00	276.60	19,978.00	20,654.60
Interest expense	(150,428.37)	(198,385.30)	-	(348,813.67)	(155,103.80)	(201,815.16)	-	(356,918.96)
Amortization of bond issuance costs	(1,753.80)	(4,563.12)	-	(6,316.92)	(1,753.80)	(4,563.12)	-	(6,316.92)
Cable television expense	-	-	(11,178.39)	(11,178.39)	-	-	(11,132.13)	(11,132.13)
Building improvements donation	6,241.00	-	-	6,241.00	-	-	-	-
Building improvements expense	-	-	(6,241.00)	(6,241.00)	-	-	-	-
Equipment donation	-	4,780.00	-	4,780.00	599.00	-	-	599.00
Equipment expense	-	-	(4,780.00)	(4,780.00)	-	-	(599.00)	(599.00)
Miscellaneous expense	-	-	(5,671.46)	(5,671.46)	(120.00)	-	(6,318.19)	(6,438.19)
Total nonoperating revenues (expenses)	(71,530.12)	(135,536.54)	15,805.47	(191,261.19)	(94,517.48)	(167,422.26)	3,527.42	(258,412.32)
Net income (loss)	112,226.41	(133,802.44)	15,805.47	(5,770.56)	(49,959.98)	(144,102.95)	3,527.42	(190,535.51)
Equity, July 1	2,568,135.44	5,217,652.19	64,188.82	7,849,976.45	2,618,095.42	5,361,755.14	60,661.40	8,040,511.96
Equity, June 30	$ 2,680,361.85	$ 5,083,849.75	$ 79,994.29	$ 7,844,205.89	$ 2,568,135.44	$ 5,217,652.19	$ 64,188.82	$ 7,849,976.45

TENNESSEE STATE VETERANS' HOMES BOARD
SUPPLEMENTARY STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2000, AND JUNE 30, 1999

	For the Year Ended June 30, 2000				For the Year Ended June 30, 1999			
	Murfreesboro	Humboldt	Foundation	Totals	Murfreesboro	Humboldt	Foundation	Totals
Cash flows from operating activities:								
Operating income	$ 183,756.53	$ 1,734.10	$ -	$ 185,490.63	$ 44,557.50	$ 23,319.31	$ -	$ 67,876.81
Adjustments to reconcile operating income to net cash provided by operating activities:								
Depreciation and amortization	171,148.57	298,911.76	-	470,060.33	169,894.38	296,867.50	-	466,761.88
Miscellaneous nonoperating revenues	20.00	-	43,119.20	43,139.20	400.00	276.60	19,978.00	20,654.60
Miscellaneous nonoperating expenses	-	-	(16,849.85)	(16,849.85)	(120.00)	-	(18,049.32)	(18,169.32)
Changes in assets and liabilities:								
(Increase) decrease in resident accounts receivable - private	390,214.70	66,100.16	-	456,314.86	(541,156.30)	(242,407.19)	-	(783,563.49)
(Increase) decrease in resident accounts receivable - U.S. Department of Veterans Affairs	(17,821.56)	(38,399.99)	-	(56,221.55)	(9,506.77)	34,639.44	-	25,132.67
Decrease in resident accounts receivable - primary government	-	-	-	-	15,720.71	-	-	15,720.71
Increase in allowance for doubtful accounts	82,645.80	227,996.00	-	310,641.80	193,440.25	351,322.43	-	544,762.68
(Increase) in amounts advanced to management company	(30,530.46)	-	-	(30,530.46)	-	-	-	-
(Increase) decrease in Medicare cost settlement receivable	(7,881.67)	(35,427.09)	-	(43,308.76)	361,348.00	72,059.00	-	433,407.00
Decrease in Medicaid cost settlement receivable	-	-	-	-	19,939.00	-	-	19,939.00
Decrease in due from Murfreesboro	-	146,480.22	-	146,480.22	-	107,937.06	-	107,937.06
(Increase) decrease in inventories	6,834.64	(1,018.92)	-	5,815.72	3,398.94	6,606.19	-	10,005.13
(Increase) decrease in prepaid items	13,781.19	(6,153.07)	928.36	8,556.48	(1,860.67)	6,195.29	(928.36)	3,406.26
Increase (decrease) in accounts payable and accruals	(346,404.61)	(144,677.67)	-	(491,082.28)	154,273.08	(124,739.79)	-	29,533.29
Increase (decrease) in due to primary government	(133,345.25)	(159,169.56)	-	(292,514.81)	85,865.80	340,073.21	-	425,939.01
Increase (decrease) in amounts advanced by management company	(17,385.68)	(60,100.23)	-	(77,485.91)	(28,805.47)	34,702.76	-	5,897.29
(Decrease) in Medicaid cost settlement payable	-	-	-	-	-	(344.00)	-	(344.00)
Increase (decrease) in amounts held in custody for others	(4,332.37)	27,072.52	-	22,740.15	(429.75)	(16,748.73)	-	(17,178.48)
Increase in Medicaid current financing	57,093.90	35,523.17	-	92,617.07	27,420.81	46,098.49	-	73,519.30
(Decrease) in due to Humboldt	(146,480.22)	-	-	(146,480.22)	(107,937.06)	-	-	(107,937.06)
Total adjustments	17,556.98	357,137.30	27,197.71	401,891.99	341,884.95	912,538.26	1,000.32	1,255,423.53
Net cash provided by operating activities	201,313.51	358,871.40	27,197.71	587,382.62	386,442.45	935,857.57	1,000.32	1,323,300.34
Cash flows from noncapital financing activities								
Principal paid on advance from state	(10,000.00)	-	-	(10,000.00)	(10,000.00)	-	-	(10,000.00)
Net cash used for noncapital financing activities	(10,000.00)	-	-	(10,000.00)	(10,000.00)	-	-	(10,000.00)
Cash flows from capital and capital-related financing activities:								
Purchase of fixed assets	(27,873.46)	(10,353.76)	(11,021.00)	(49,248.22)	(61,402.54)	(64,608.27)	-	(126,010.81)
Principal paid on bonds	(80,000.00)	(75,000.00)	-	(155,000.00)	(75,000.00)	(75,000.00)	-	(150,000.00)
Interest paid on bonds	(150,735.00)	(199,602.98)	-	(350,337.98)	(155,985.00)	(203,386.85)	-	(359,371.85)
Net cash used for capital and capital-related financing activities	(258,608.46)	(284,956.74)	(11,021.00)	(554,586.20)	(292,387.54)	(342,995.12)	-	(635,382.66)

TENNESSEE STATE VETERANS' HOMES BOARD
SUPPLEMENTARY STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2000, AND JUNE 30, 1999

	For the Year Ended June 30, 2000				For the Year Ended June 30, 1999			
	Murfreesboro	Humboldt	Foundation	Totals	Murfreesboro	Humboldt	Foundation	Totals
Cash flows from investing activities:								
Purchase of certificate of deposit	-	-	(25,000.00)	(25,000.00)	-	-	-	-
Interest received	74,391.05	62,631.88	557.12	137,580.05	61,461.12	38,679.42	1,598.74	101,739.28
Net cash provided by (used for) investing activities	74,391.05	62,631.88	(24,442.88)	112,580.05	61,461.12	38,679.42	1,598.74	101,739.28
Net increase (decrease) in cash	7,096.10	136,546.54	(8,266.17)	135,376.47	145,516.03	631,541.87	2,599.06	779,656.96
Cash, July 1	1,592,670.36	1,292,237.15	38,183.68	2,923,091.19	1,447,154.33	660,695.28	35,584.62	2,143,434.23
Cash, June 30	$ 1,599,766.46	$ 1,428,783.69	$ 29,917.51	$ 3,058,467.66	$ 1,592,670.36	$ 1,292,237.15	$ 38,183.68	$ 2,923,091.19