Tennessee State Veterans' Homes Board

For the Year Ended
June 30, 2003

Arthur A. Hayes, Jr., CPA, JD, CFE
Director

Edward Burr, CPA
Assistant Director

Katherine J. Anderson, CPA
Audit Manager

Donna L. Jewell, CPA, CFE
In-Charge Auditor

Ike Boone, CFE
Brian Brechon
Mary McCalip, CFE
Barbara Ragan, CFE
Staff Auditors

Gerry C. Boaz, CPA
Technical Analyst

Amy Brack
Editor

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 401-7897

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

June 14, 2005

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Board of Directors
Tennessee State Veterans' Homes Board
P.O. Box 10299
Murfreesboro, TN 37129

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee State Veterans' Homes Board for the year ended June 30, 2003. You will note from the independent auditor's report that a qualified opinion was issued on the fairness of the presentation of the financial statements due to unsupported and misclassified receivable balances.

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/cj
04/069

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, 2003

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.

CONSEQUENCES OF THE NUMEROUS, LONGSTANDING INTERNAL CONTROL AND COMPLIANCE FINDINGS NOTED IN THE AUDIT

The opinion on the financial statements of the Tennessee State Veterans' Homes Board for the year ended June 30, 2003, is qualified due to questions about accounts receivable. In the previous audit for the year ended June 30, 2002, we disclaimed an opinion on the financial statements. An audit report containing numerous control findings or less than an unqualified opinion reflects negatively on the audited entity. These problems are intensified when the findings are chronic. Also, the weaker the internal controls, the greater the risk of fraud.

The ongoing control problems span the past five years and the various Veterans' Homes Board's administrations that have been in place over that period. For the years 1998 through 2003 the number of findings has been 3, 5, 11, 9, 14, and 15. The number of findings repeated from previous years in each year's report has been 2, 3, 4, 6, 9, and 9.

Auditors have to exercise professional judgment and professional skepticism in their efforts to address these heightened concerns about possible fraud. In general, the auditor has to do enough work to obtain reasonable assurance in the auditor's judgment, that the risk of material fraud is reduced to an acceptable level. And, within the limited resources we have available, when there is a heightened risk of fraud or material misstatement due to fraud or errors, we extend our test work to as many transactions as possible. Of course, this approach does involve the expenditure of scarce state resources which would not have to be expended if the staff and management of the entity in question had met their initial and primary responsibilities to the taxpayers.

Until the issues addressed in this report are remedied, the risk of financial misstatements and fraud cannot be reduced to an acceptable level and the limited assurances that the auditors may be able to provide with regard to fraud and misstatements, through the expenditure of extraordinary audit resources in researching transactions, will only be effective for the period covered by the auditors' work.

INTERNAL CONTROL FINDINGS

For the Seventh Consecutive Year, Accounts Receivable Practices Are Not Adequate**

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 still not promptly refunded Medicaid overpayments. There are also several unexplained negative receivable balances not associated with the Medicaid overpayments. In addition, board personnel at the Humboldt facility circumvented policies by creating fictitious remittance advices to clear credits and debits in the system (page 16).

Accounting Records Do Not Portray a True Picture of Receivables*

The Tennessee State Veterans' Homes Board does not maintain adequate accounting records regarding receivables. The balances shown on the financial statements as well as the individual receivable balances for a number of past and present receivables do not portray an accurate picture of the amounts owed to the board (page 22).

Collection Efforts for Accounts Receivable Are Not Adequate*

Written procedures to collect receivables are not followed and action taken to collect the receivables is not documented (page 25).

For the Seventh Consecutive Year, Internal Control for Capital Assets Is Not Adequate**

Significant deficiencies continue to exist in internal control for capital assets. These deficiencies include an inability to correlate the results of physical inventories with accounting records, inaccurate equipment listings, and incomplete policies and procedures (page 27).

The Board Has No Policies and Procedures in Place Regarding the Authorization or Use of Credit Cards and Lines of Credit

Although there are several credit cards and/or lines of credit in the name of the board, the board does not have adequate controls in place over the use of such credit. Unapproved, unsupported, and questionable purchases were noted (page 35).

Internal Control for Purchasing Is Not Adequate**

The board's policies and procedures over purchasing are not being followed, and service contract approvals required by state law are not being obtained. In addition, contract payments were not always properly invoiced or reviewed (page 38).

Duties at the Tennessee State Veterans' Homes Board Facilities Are Not Adequately Segregated
Duties involving key board functions are not adequately segregated. Receipting duties at the Murfreesboro facility and cash disbursement duties at the Humboldt facility are not adequately segregated (page 42).

Internal Controls for Information Systems Are Not Adequate*
Few policies and procedures, either written or unwritten, relating to the information system are maintained. Also, controls regarding access to the system are weak (page 44).

Accountability for Restricted Foundation Accounts and Foundation Funds Needs Improvement
Although the foundation uses restricted accounts for donated funds, the accounts sometimes have a negative balance, and the overall financial picture related to the restrictions is not analyzed by the foundation (page 51).

For the Fifth Consecutive Year, the Facilities Could Not Substantiate That They Had Received All Goods and Services Paid For**
The verification of receipt of goods or services was still not consistently documented (page 56).

Petty Cash Policies Are Still Inadequate and Are Still Not Being Followed**
The petty cash policy is not sufficient. The policies and procedures that have been adopted are not being followed (page 56).

COMPLIANCE FINDINGS

For the Seventh Consecutive Year, Accounts Receivable Practices Are Not Adequate**
The board has not promptly refunded Medicaid overpayments (page 16).

Medicaid Residents Were Charged More than Private Paying Residents
The Tennessee State Veterans' Homes Board failed to follow the *Rules of the Tennessee Department of Finance and Administration Bureau of TennCare* and charged Medicaid residents more for room and board than it charged private paying residents (page 33).

Travel Claims Again Were Not in Compliance with Comprehensive Travel Regulations, Resulting in Excessive Reimbursement of over $3,400**
Board members and employees of the facilities have not completed travel claims in accordance with Comprehensive Travel Regulations (page 48).

Bank Accounts Are Not in Compliance With Section 9-4-302, *Tennessee Code Annotated*, and Department of Finance and Administration Policy 07
The board failed to comply with the state law as well as the policy established by the state regarding departmental bank accounts (page 53).

The Board Has Failed to Implement a Title VI Plan
The board has not complied with state law regarding Title VI of the Civil Rights Act of 1964. The board does not have a written implementation plan and has not submitted annual compliance reports (page 55).

One of the reportable conditions described above included material noncompliance:

- For the seventh consecutive year, accounts receivable practices are not adequate

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

- For the seventh consecutive year, accounts receivable practices are not adequate
- Accounting records do not portray a true picture of receivables
- Collection efforts for accounts receivable are not adequate
- For the seventh consecutive year, internal control for capital 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.

* 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 qualified due to unsupported and misclassified receivable balances.

Audit Report
Tennessee State Veterans' Homes Board
For the Year Ended June 30, 2003

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Tennessee State Veterans' Homes Board
For the Year Ended June 30, 2003

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. Although the state contributed certain capital to the board during the construction of its facilities, the board does not receive operating funds from the state. Prior to September 11, 2003, the board was funded with revenue bonds. Subsequently, the revenue bonds were replaced by general obligation bonds of the State of Tennessee. The board is responsible for the debt service on their portion of the general obligation bonds. The board's primary revenue source is residents' fees. 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

The Executive Director is responsible for the oversight of all the facilities. The board contracted with National HealthCare Corporation (NHC) as their management company as of December 1, 2001. The management company employed an administrator to oversee daily operations of each facility. The administrator then hired 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 were hired by the administrator from the management company, they were employees of the board. As of January 1, 2003, NHC began serving in the role of consultant to the board. At this time, the administrators became employees of the board.

In April 2004, the board hired a financial director. The board is in the process of implementing a new information system. After this information system is in place and functioning properly, the board will not extend its contract with NHC. Management anticipates that this information system will be in place in October of 2004.

An organization chart for the Tennessee State Veterans' Homes Board is on the following page.

AUDIT SCOPE

The audit was limited to the period July 1, 2002, through June 30, 2003, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The Tennessee State Veterans' Homes Board has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report.*

TENNESSEE STATE VETERANS' HOMES BOARD

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.

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 May 5, 2004. A follow-up of all prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the board has corrected previous audit findings concerning monitoring the trustee and internal control over cash, providing adequate documentation for the audit process, improper employer/employee relationships and potential conflicts of interest, and noncompliance with legally binding documents.

REPEATED AUDIT FINDINGS

The prior audit report also contained findings concerning accounts receivable practices, accounting records, controls over capital assets, controls over information systems, collection efforts, compliance with Comprehensive Travel Regulations, purchasing, petty cash, and receipt of goods and services. These findings have not been resolved and are repeated in this report.

PAST FINDING NOT ACTED UPON BY MANAGEMENT

Prior audits of the Tennessee State Veterans' Homes Board have contained a finding concerning the foundation board's improper use of Veterans' Homes Board employees and resources for its operations. Although this finding has been reported for several years, management has not taken action to resolve the matters discussed in the finding. This finding will not be repeated in subsequent audit reports.

<u>The foundation board continues to improperly use Veterans' Homes Board employees and resources for its operations</u>

As noted in the prior three audits, the foundation affairs are not independent from the board, its personnel, or facilities. Currently, financial records are maintained and foundation operations are performed primarily at the Murfreesboro facility by Veterans' Homes Board personnel. Board employees at both the Murfreesboro and Humboldt facility handle the cash receipting function for the foundation. Although a foundation board member did perform some of the bookkeeping functions for the foundation, the majority of the tasks were performed by Veterans' Homes Board employees.

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 had knowledge of this opinion for several years but chooses to use Veterans' Homes Board resources for the administrative expenses of the foundation rather than expending funds derived from donations. The foundation board includes 11 members, 6 of whom are appointed by the Veterans' Homes Board. In the prior three audits, the Veterans' Homes Board and the foundation board did not concur with this finding. In the prior audit report, management stated that it could not justify the expense of additional personnel for administrative duties and that the amount of time spent by board personnel in support of the foundation is insignificant. However, the board does not have the authority to disregard this opinion merely due to financial considerations.

OBSERVATIONS AND COMMENTS

CONSEQUENCES OF THE NUMEROUS, LONGSTANDING INTERNAL CONTROL AND COMPLIANCE FINDINGS NOTED IN THE AUDIT

The opinion on the financial statements of the Tennessee State Veterans' Homes Board for the year ended June 30, 2003, is qualified due to questions about accounts receivable. We believe that accounts receivable are material to the financial statements and may not be fairly stated. This is because management has not researched and corrected errors in accounts receivable and because management was not able to support certain receivables.

In the previous audit for the year ended June 30, 2002, we disclaimed an opinion on the financial statements. This means we were unable to determine that the financial statements of the Veterans' Homes Board were fairly presented in conformity with generally accepted accounting principles.

An audit report containing numerous control findings or less than an unqualified opinion reflects negatively on the audited entity. In the case of the Veterans' Homes Board, in addition to the numerous internal control findings, the conditions specifically leading to the qualified opinion are reflected in findings one and two in this audit report.

These problems are intensified when the findings are chronic.

The ongoing control problems span the past five years and the various Veterans' Homes Board's administrations that have been in place over that period. For the years 1998 through 2003 the number of findings has been 3, 5, 11, 9, 14, and 15. The number of findings repeated from previous years in each year's report has been 2, 3, 4, 6, 9, and 9.

When auditors find that internal controls are not operating as designed or as appropriate in a particular area, the auditors have to perform additional work to make sure that they understand the situation more fully. When it is confirmed that particular controls are not designed properly or are not functioning properly, then the auditor has to consider what the implications for the engagement are. In other words, if the controls broke down in a particular area, what could be the consequences?

In October 2002, the American Institute of Certified Public Accountants (AICPA) promulgated a new auditing standard relative to fraud detection and prevention. This is not the institute's first effort to improve the public's confidence in the financial operations of organizations in the United States. However, it contains some critical new measures. In particular, the new standard requires the auditor to specifically assess the risk of material misstatements due to fraud. That assessment is similar to previous assessments that auditors have had to make with regard to the effectiveness of the internal controls in place in the audited entity. But clearly the Institute and the public are more interested than ever in the possibility of fraud resulting from internal control weaknesses.

Simply stated, the weaker the internal controls, the greater the risk of fraud.

Auditors have to exercise professional judgment and professional skepticism in their efforts to address these heightened concerns about possible fraud. In general, the auditor has to do enough work to obtain reasonable assurance in the auditor's judgment, that the risk of material fraud is reduced to an acceptable level.

The less the auditors can rely on the internal controls, the more additional work the auditor must perform to reach the level of assurance required by the standards.

It is the practice of the Department of Audit of the Comptroller of the Treasury to assist those entities we audit in their efforts to avoid unnecessary findings and less than unqualified opinions, consistent with the auditing standards we follow, in particular with regard to independence. What this means, for example, is that we will engage in additional work to attempt to get as much information as possible to determine if there are compensating controls in place when the basic internal controls are ineffective. And, within the limited resources we have available, when there is a heightened risk of fraud or material misstatement due to fraud or errors, we extend our test work to as many transactions as possible. Of course, this approach does involve the expenditure of scarce state resources which would not have to be expended if the staff and management of the entity in question had met their initial and primary responsibilities to the taxpayers.

In the matter of the Veterans' Homes Board, in recent years we have had to expand our audit hours approximately 100% to perform additional audit procedures to determine if the many weaknesses noted in the internal controls had been exploited or had allowed errors to occur unnoticed. The expansion was also required because the lack of internal control has created a lack of recordkeeping which caused us to have to perform additional substantive procedures to verify the reasonableness of account balances.

The good news is that our efforts did not reveal any significant instances of fraud or abuse, to the extent of the additional work we performed.

On the other hand, it must be remembered that the value of that additional work is limited to the information developed by us at the time of our additional work. Because the weaknesses in the controls still have not been corrected by staff and management, then the weaknesses continue to be susceptible to errors, fraud, or abuse until they are corrected.

In other words, the additional audit efforts give little if any assurances beyond the information that was developed at the time of the fieldwork. The risk of material fraud for periods subsequent to the conclusion of our field work is again high. And, therefore, the risk of quantitatively immaterial fraud is even greater. Of course, in the public sector, the level of materiality is significantly lower than in the private sector. Any fraud in a public institution can have serious negative consequences in the eyes of the public. And this is particularly true when the underlying conditions giving rise to a greater risk of fraud had been long-standing.

In addition to the new auditing standard, in the wake of the highly publicized fraud and abuses in major corporations, other measures, such as the Sarbanes-Oxley Act, have been enacted to attempt to increase the diligence of auditors and management with regard to fraud. Although the auditing standards do apply to government audits, the Sarbanes-Oxley Act only applies to publicly traded companies. Still, both actions are consistent in their approach to fraud and provide excellent guidance to all who are engaged in financial operations.

Over the years, the State Veterans' Homes Board has taken various actions to attempt to improve the accountability of the Board's facilities. Unfortunately, in spite of these efforts many issues remain.

The State Veterans' Homes Board has a separate audit committee. It is hoped that the full board, with the audit committee, will take additional steps to ensure that the problems noted in this and prior audits are appropriately addressed.

The audit committee and the leadership of the board demonstrated a positive approach to dealing with the issues we have noted during the engagement reflected by this report. The initial responses from the homes' management did not appear to be responsive to our findings. After conversations directly with the board chairman, the auditors received more appropriate responses to the findings.

The auditors are available to work with the audit committee and any members of the board to assist them in their efforts to improve the accountability of the homes and to reduce the number and nature of the audit findings, as well as remove the qualification to the homes' opinion. These efforts must be consistent with the principles of auditor independence and must be the responsibility of the board and management of the homes and not the auditors. When the controls are weak, the ability of management and the board to maintain accountability for operations and for assets on a day-to-day basis are severely impaired. After all, the controls are intended to assist staff and management in the execution of their responsibilities with regard to the homes. Effective controls are critical to a timely and efficient audit, but the primary reason for effective controls is to ensure the entity is being operated efficiently, effectively and with the appropriate level of safeguards for the assets and the reporting of operations by the entity on a day-to-day basis.

Until the issues addressed in this report are remedied, the risk of financial misstatements and fraud cannot be reduced to an acceptable level and the limited assurances that the auditors may be able to provide with regard to fraud and misstatements, through the expenditure of extraordinary audit resources in researching transactions, will only be effective for the period covered by the auditors' work.

AUDIT COMMITTEE RECOMMENDATIONS

As a result of the fraud-related business failures of companies such as Enron and WorldCom in recent years, Congress and the accounting profession have taken aggressive measures to try to detect and prevent future failures related to fraud. These measures have included the signing of the *Sarbanes-Oxley Act of 2002* by the President of the United States and the issuance of *Statement on Auditing Standards Number 99* (SAS 99) by the American Institute of Certified Public Accountants. This new fraud auditing standard has not only changed the way auditors perform audits but has also provided guidance to management and boards of directors on creating antifraud programs and controls. This guidance has included the need for an independent audit committee.

As a result of these developments, we are recommending that agencies with boards establish audit committees. Or, where agencies, such as the Tennessee State Veterans' Homes Board, already have audit committees, that those agencies reexamine the activities of the existing audit committees. The specific activities of any audit committee will depend on, among other things, the mission, nature, structure, and size of each agency. In creating or revising its charter, each board should examine its agency's particular circumstances. Anti-fraud literature notes that there are two categories of fraud: fraudulent financial reporting and misappropriation of assets. The audit committee should consider the risks of fraud in its agency in general as well as the history of its particular agency with regard to prior audit findings, previously disclosed weaknesses in internal control, and compliance issues. The audit committee should consider both the risk of fraudulent financial reporting and the risk of fraud due to misappropriation or abuse of agency assets.

Boards should exercise professional judgment in establishing the duties, responsibilities, and authority of their audit committee. The factors noted below are not intended to be an exhaustive listing of those matters to be considered. The committee should not limit its scope to reacting to a preconceived set of issues and actions but rather should be proactive in its oversight of the agency as it concentrates on the internal control and audit-related activities of the entity. In fact, this individualized approach is one of the main benefits derived from an active audit committee.

At a minimum, audit committees should:

1. Develop a written charter that addresses the audit committee's purpose and mission, which should be, at a minimum, to assist the board in its oversight of the agency.

2. Formally reiterate, on a regular basis, to the board, agency management, and staff their responsibilities for preventing, detecting, and reporting fraud, waste, and abuse.

3. Serve as a facilitator of any audits or investigations of the agency, including advising auditors and investigators of any information they may receive or otherwise note regarding risks of fraud or weaknesses in the agency's internal controls; reviewing with the auditors any findings or other matters noted by the auditors during audit

engagements; working with the agency management and staff to ensure implementation of audit recommendations; and assisting in the resolution of any problems the auditors may have with cooperation from agency management or staff.

4. Develop a formal process for assessing the risk of fraud at the agency, including documentation of the results of the assessments and assuring that internal controls are in place to adequately mitigate those risks.

5. Develop and communicate to staff of the agency their responsibilities to report allegations of fraud, waste, or abuse at the agency to the committee and the Comptroller's Office as well as a process for immediately reporting such information.

6. Immediately inform the Comptroller of the Treasury's Office when fraud is detected.

7. Develop and communicate to the board, agency management, and staff a written code of conduct reminding those individuals of the public nature of the agency and the need for all to maintain the highest level of integrity with regard to the financial operations and any related financial reporting responsibilities of the agency; to avoid preparing or issuing fraudulent or misleading financial reports or other information; to protect agency assets from fraud, waste, and abuse; to comply with all relevant laws, rules, policies, and procedures; and to avoid engaging in activities which would otherwise bring dishonor to the agency.

The charter of the audit committee should include, at a minimum, the following provisions:

1. The audit committee should be a standing committee of the board.

2. The audit committee should be composed of at least three members. The chair of the audit committee should preferably have some accounting or financial management background. Each member of the audit committee should have an adequate background and education to allow a reasonable understanding of the information presented in the financial reports of the agency and the comments of auditors with regard to internal control and compliance findings and other issues.

3. The members of the audit committee must be independent from any appearances of other interests that are in conflict with their duties as members of the audit committee.

4. An express recognition that the board, the audit committee, and the management and staff of the agency are responsible for taking all reasonable steps to prevent, detect, and report fraud, waste, and abuse.

5. The audit committee should meet regularly throughout the year. The audit committee can meet by telephone, if that is permissible for other committees. However, the audit committee is strongly urged to meet at least once a year in person. Members of

the audit committee may be members of other standing committees of the board, but the audit committee meetings should be separate from the meetings of other committees of the board.

6. The audit committee should record minutes of its meetings.

The Division of State Audit will be available to discuss with the board any questions it might have about its particular audit committee. There are also other established audit committees at other state agencies that the board may wish to contact for advice and further information.

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, 2003, 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 auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Material weaknesses and other reportable conditions, along with recommendations and management's responses, are detailed in the findings and recommendations.

Compliance

The results of our audit tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*. These instances 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 a qualified opinion on the Tennessee State Veterans' Homes Board's financial statements due to unsupported and misclassified receivable balances.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

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 25, 2004

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, 2003, and have issued our report thereon dated June 25, 2004. Our report was qualified due to unsupported and misclassified receivable balances. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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

This instance of noncompliance is described in finding 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.

- Medicaid residents were charged more than private paying residents

- Travel claims again were not in compliance with Comprehensive Travel Regulations, resulting in excessive reimbursement of over $3,400

- Bank accounts are not in compliance with Section 9-4-302, *Tennessee Code Annotated*, and Department of Finance and Administration Policy 07

- The board has failed to implement a Title VI plan

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 the 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:

- For the seventh consecutive year, accounts receivable practices are not adequate

- Accounting records do not portray a true picture of receivables

- Collection efforts for accounts receivable are not adequate

- For the seventh consecutive year, internal control for capital assets is not adequate
- The board has no policies and procedures in place regarding the authorization or use of credit cards and lines of credit
- Internal control for purchasing is not adequate
- Duties at the Tennessee State Veterans' Homes Board facilities are not adequately segregated
- Internal controls for information systems are not adequate
- Accountability for restricted foundation accounts and foundation funds needs improvement
- For the fifth consecutive year, the facilities could not substantiate that they had received all goods and services paid for
- Petty cash policies are still inadequate and are still not being followed

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.

- For the seventh consecutive year, accounts receivable practices are not adequate
- Accounting records do not portray a true picture of receivables
- Collection efforts for accounts receivable are not adequate
- For the seventh consecutive year, internal control for capital assets is not adequate

We also noted other matters involving the internal control over financial reporting, which 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

AAH/cj

FINDINGS AND RECOMMENDATIONS

1. <u>For the seventh consecutive year, accounts receivable practices are not adequate</u>

Finding

As reported in the prior six 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 still not promptly refunded Medicaid overpayments. There are also several unexplained negative receivable balances not associated with the Medicaid overpayments. In addition, board personnel at the Humboldt facility circumvented policies by creating fictitious remittance advices to clear credits and debits in the system.

The board concurred with the prior finding regarding the numerous credits that remained on the books and stated that additional staff would be hired immediately to research old accounts. [Responses to findings are prepared by management but are provided to the board for review and final approval. Hence, when we refer to prior responses to findings, we are referring to the position of the board members.] Similarly, the board has concurred and promised corrective action in response to the finding in each audit report since the credit balances were first reported in the audit report for the year ended June 30, 2000. While both homes hired temporary staff to help correct the accounts, the two individuals were soon reassigned to other tasks, and no significant changes were noted in credit balances for the year ended June 30, 2003, or subsequently.

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 a veteran's costs before any other assistance 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 was $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 is 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 $689,556 at June 30, 2003.)

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.

In 1995, 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. However, the void adjustments are not processed timely. Many void adjustments from the previous years were not yet processed. 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 representing amounts due back to Medicaid. The facilities still have significant credit balances related to prior periods. Of the estimated $689,556 in outstanding void adjustments, only $226,300 appears to relate to the most recent six-month period. The other $463,256 has remained unpaid for long periods of time. These large credit amounts cause the individual accounts receivable balances to appear to be much less than the amounts that the homes must actually attempt to collect.

Numerous other credit balances exist

Unresolved credit balances also exist for reasons other than void adjustments. Corrective action required for these amounts could include recognizing revenue for certain individuals with large patient liability amounts, corrections related to improper coding, or refunds to the residents. Some of the same credit balances still exist in the accounts receivable records from at least three years ago, when this problem was first identified in the finding. These accounts still haven't been researched and corrected. Credit balances from before January 2002 were identified in the accounts receivable records by auditors, and $213,077 is the auditor estimate of credit balances that are not related to void adjustments. The cause of these other credits is unknown. Additional credits exist after January 2002. The credits will remain in the accounting records until they are researched by board staff and appropriately resolved.

Improper accounting practices

Testwork at the Humboldt facility revealed that board personnel inappropriately resolved some credits by offsetting the amounts in the computer system through the use of nonexistent Medicaid remittance advices (R/As). These fictitious R/As were used to inappropriately clear up old credit and debit receivable balances across multiple residents. For instance, a $500.00 credit balance for resident 1 would be offset by uncollected receivables of $200.00 for resident 2 and $300.00 for resident 3 and represented in the accounting records as being the result of a Medicaid requested adjustment. Seven such R/As were created in the year ended June 30, 2003, that had a total of $72,835 in debits and $72,835 in credits. An e-mail was sent by the regional accountant to the administrator in Humboldt on June 18, 2003, informing her that adjustments made in this manner were "an improper accounting practice" and that a "serious accounting issue" resulted from it. Even though this improper practice was identified and reported, action was not taken by the administrator to correct the improper adjustments. There was no documentation of any disciplinary action taken by the administrator to the employee or by the executive director to the Humboldt management related to this issue.

These types of adjustments create several practical and policy issues. First, the removal of Medicaid credits in this manner is not acceptable as the majority of the amounts that were removed may have represented intended void adjustments. Secondly, the removal of debit and credit balances in this manner circumvents the established write-off procedures in removing a receivable that the homes have a right to collect or a credit that the homes must refund without performing the necessary research, including required approvals from state officials. Thirdly, this tactic not only misrepresents the financial operations of the homes, but actually makes it even more difficult to research and correct the affected accounts.

Conclusion

Without promptly refunding Medicaid overpayments recorded as payments on behalf of the residents and without making other appropriate 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 and due from primary government balances become more distorted, and financial decision making or monitoring may be affected. Credit balances are included in these accounts, causing the receivable balances on the board's monthly financial statements to appear to be lower than the amount the board actually must attempt to collect.

Improper accounting entries also distort the receivable balance by not recognizing amounts that may still be owed. Rather than trying to address the problem, and the underlying issue—either inept staff or staff acting in bad faith—Humboldt management focused on attempts to correct current accounts and did not set the proper ethical tone through disciplinary action or even correct the entries that were made to previous accounts, even though they knew they were improper.

Recommendation

The Executive Director should make a serious attempt to resolve these issues. 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 is necessary to manually process certain accounts receivable transactions. The board should carefully evaluate the accounts receivable practices. Any necessary policies and procedures should immediately be developed, documented, and implemented. The policies should include a periodic review of all credit balances as well as a review of all resident accounts to ensure receivables are properly stated. Corrections through fictitious R/As should be prohibited. The Executive Director should carefully supervise operations to ensure compliance with the policies and procedures. The board should review the actions of the Executive Director and the Humboldt Administrator in condoning the accounting tricks of the Humboldt staff and the implications for this serious breach of trust. It is critical that management set a positive tone for staff, reflecting proper respect for honesty and integrity.

If additional manual processing of certain transactions is required, the board should ensure that sufficient staff is available and adequately trained to perform these functions. Staff and management are aware that the adjusting of credit and debit balances in any way other than established, approved measures is unacceptable. The fictitious R/A entries should be reversed and researched. The board should determine the circumstances that created the inappropriate accounting practices and take disciplinary action as necessary to prevent the practice from recurrence, and the board should immediately dedicate the resources necessary to get the old credit balances resolved.

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

Management's Comment

Medicaid overpayments are not refunded promptly

We concur that not all Medicaid overpayments are refunded promptly.

It is management's intent to refund overpayments to the Medicaid program within 60 days and, as the auditors have pointed out, we have been able to accomplish that in many cases. We have continued to make progress in clearing the overpayments.

As stated by the auditor, two additional employees have been hired at each facility to research patient accounts receivable. With the additional staff, both facilities focused on resolving Medicaid credit balances. Void adjustments submitted to the Medicaid Department but not processed through the system totaled $429,484.16 for Murfreesboro and $416,733.96 for Humboldt at June 30, 2004.

Void adjustments processed by Medicaid since June 2004 for the two homes amount to over $1,120,000.

State Veterans Homes receive a monthly subsidy from the U.S. Department of Veterans Affairs based on the number of veterans in residence during the month. This payment is treated differently by different States. Many viewed this as a grant to the State Veteran Home not as an ". . . offset to veteran's costs before Medicaid resources are applied."

H.R. 3936 was signed by the President on November 30, 2004, and became Public Law 108-422.

The most important part of the legislation to State Veterans Homes is:

SEC. 202. TREATMENT OF DEPARTMENT OF VETERANS AFFAIRS PER DIEM PAYMENTS TO STATE HOMES FOR VETERANS.

Section 1741 is amended by adding at the end the following new subsection:

> "(e) Payments to States pursuant to this section shall not be considered a liability of a third party, or otherwise be used to offset or reduce any other payment made to assist veterans."

This law means that State Veterans Homes will retain all funding from the Department of Veterans Affairs and that no part shall be used to offset receivables from the Medicaid program effective January 1, 2005. Future processing of void adjustments will be unnecessary.

Since the law clarifies the intent of the VA subsidy, additional discussion with the Department of Medicaid will be necessary to determine how any unprocessed void adjustments shall be handled.

The aggressive processing of void adjustments has had a huge negative impact on our cash flow. Therefore, until the Medicaid Department is able to recoup the void adjustments already submitted and until it is determined how Public Law 108-422 impacts unprocessed take-backs, void adjustments for the months of October, November, and December 2004 will be deferred to allow for a more controlled impact to cash flow.

Numerous other credit balances exist

We concur that credit balances are a significant portion of patient accounts receivable.

As we research patient accounts over the next months, these credit balances will be handled appropriately.

Improper accounting practices

We concur that the posting of fictitious remittance advices is highly improper and inappropriate.

Discussion with staff reveals a lack of communication concerning the e-mail from the former management company and with internal management. No one at the executive staff level was notified of the situation at the time it happened.

Management did not and does not condone "the accounting tricks of the Humboldt staff and the implication for this serious breach of trust." We expect high standards of ourselves and our employees and view this as a serious violation of principles and contrary to the values of TSVH.

Staff is well aware now that this action is not to be repeated. Procedures for the posting of cash require that the batch entry be tied back to the bank deposit slip and to the deposit recorded by the bank. The ability to post adjustments to accounts has been limited to specific staff members in the business offices.

The inappropriate transfers that occurred in 2003 were found by another staff member in early 2004 who began the process to correct the accounts prior to the arrival of the auditors. The corrections were completed and void adjustments sent through where appropriate.

2. Accounting records do not portray a true picture of receivables

Finding

As stated in the prior audit report, the Tennessee State Veterans' Homes Board does not maintain adequate accounting records regarding receivables. The balances shown on the financial statements as well as the individual receivable balances for a number of past and present residents do not portray an accurate picture of amounts owed to the board. The accounts still have not been researched and resolved.

In response to the prior-year finding, management agreed that old accounts should be researched and collected or written off. The board estimated that it would take the immediate hiring of three additional people to conduct the necessary research. One person was hired to assist in collections at the Humboldt home in October of 2003. In addition, one person was hired to conduct research on old accounts at the Murfreesboro home in March of 2004. The board stated that they intended to have all accounts researched and cleaned up before conversion to the new accounting system. Preparations were under way to implement the new system by October 1, 2004. However, as of May 6, 2004, substantial problems still existed with the accounts. The board also stated that accounts receivable policies were implemented in July of 2003 to start a periodic review of all accounts and credit balances. When a copy of the new policy was requested, what was provided was a policy that had been approved in January of 2002 when National HealthCare Corporation took over management company duties. That policy was still not followed during the year ended June 30, 2003.

The Tennessee State Veterans' Homes Board offers a place of residence and medical care for veterans or spouses of veterans in the State of Tennessee. The board is compensated for these services by several different sources. Medicare, Medicaid, Veterans Affairs, private insurance companies, and the residents themselves are all major payor sources for the board. As noted in finding 1 of this report, the board has had problems for several years concerning a large amount of credit receivables on the books. (A credit balance in receivables reflects a debt owed by the facility.) In addition, the board has a lot of old receivable balances that have not been collected or written off and are included in the allowance for doubtful accounts. The conversion to a new management company in January 2002 compounded these problems.

When the conversion was made from the old management company ledgers to the new management company ledgers, any receivable amount that existed as of December 31, 2001, was placed into a separate receivable account titled "Accounts Receivable Prior." This account was established without taking the necessary time to research the details of the amounts being placed into it. Before receivables can be turned over to the collection agency, each amount must be researched to determine if the receivable is valid and to adjust out any erroneous credits. Due to the time requirements related to the research, old accounts are not being turned over to the collection agency and remain on the books. In addition, certain other receivables and payables that were recorded in the old management company's ledger, such as cost report receivables, were added to the new management company's ledger without research. Humboldt has unsupported receivables of at least $408,571 and an unsupported payable of $27,813. Murfreesboro has an unsupported receivable of $44,906 and an unsupported payable of $19,699. These accounts have been unresolved even though, over time, it has become clear that the receivables and payables are no longer valid.

Receivable balances for the different payor sources (private, Medicaid, Medicare, VA, hospice, private insurance) at June 30, 2003, may not be representative of actual amounts owed to the board. In addition to the "Accounts Receivable Prior" account having unresolved credits, it was noted that occasionally the system incorrectly records charges for residents. The receivable is sometimes set up in the wrong payor source. When the payment related to the receivable arrives, the payment is then recorded to the correct payor source. This results in an overstated receivable for one payor source and an understated receivable or a credit balance for the other payor source. It also causes a receivable for a particular payor source to still exist when the payment was already received. Manual adjustments are then needed to correct this, but they are not always made. This situation was also aggravated by the use of fictitious Medicaid remittance advices by the Humboldt facility, as described in finding 1, to conceal older receivable balances, and the use of unsupported manual adjustments that cleared out certain credits to balance residents' accounts in Murfreesboro. Board employees at Murfreesboro were unable to explain the unsupported adjustments. Due to these situations, the staff is not able to assess whether a certain payment has been received.

As some payors have very specific guidelines for billing, failure to bill and/or follow up with these payors could result in a loss of income for the facilities. For instance, the Accounts Receivable Prior account at Humboldt included Medicaid and Medicare receivables at June 30, 2003, purported to be related to periods prior to January 2002 in the amount of $221,619. The same account in Murfreesboro included Medicaid and Medicare receivables in the amount of $59,473. It is not likely that the facilities will be able to collect these funds due to the time limits imposed by these payors.

As in the prior year, certain instances were noted in which the staff was not even able to provide documentation that the facilities had billed the payor source or followed up on denials. During testwork for one month, one out of the 31 Medicaid residents in Humboldt (3%) and 3 out of the 33 Medicaid residents in Murfreesboro (9%) had charges that were initially denied for resolvable reasons but were never resubmitted for payment. The amount not billed exceeded $8,500 just for this one month reviewed. As previously stated, the time requirements for submitting claims make it appear unlikely that the homes will be able to recoup unbilled amounts.

Also, when individuals call the board to see what they owe, the staff is not able to provide an accurate amount in a reasonable time period. The staff would have to take the time to research each individual account through several old management company aging reports, some of which are no longer available, as well as the different reports produced by the current system to ensure that charges and payments were entered correctly. During the prior audit, board staff stated that each individual receivable takes at least four hours to research. This takes valuable time, but when the research is not performed, the result may be communication of incorrect information or the loss of an opportunity to collect outstanding funds.

Recommendation

The Executive Director should reassign staff specifically to this task to take the necessary time to research each resident's account that has any type of balance in the aging reports and make sure the amounts are correct. If available staff cannot take the time to do this needed research, the Executive Director should again bring in additional help to rectify this problem. Appropriately researched accounts should be collected or submitted to the collection agency. Existing balances that are determined to be inaccurate should be corrected. The corrections should go through an appropriate review process before adjustments to the accounting records occur, including approval by the Financial Director, and thorough documentation should be retained to support the adjustments made. The new accounting system should be designed to flag inappropriate entries and unresolved billings. The system should have information available and easily accessible by staff to answer simple billing questions so personnel can efficiently perform their duties. The Financial Director should carefully review the billings each month to ensure each payor source is appropriately billed. Accounts receivable policies concerning the periodic review of accounts for any errors should be followed by the homes. The resolution of these accounts should become a priority in order to restore accurate accounting records and to increase the chances of collection on past-due receivables.

Management's Comment

We concur that the amounts shown on the balance sheet do not accurately reflect amounts of patient accounts receivable.

The board has agreed that old accounts should be researched and collected or written off. The procedures for research and write off are time consuming and staff intensive.

The accounting system used by the previous management firm was extremely cumbersome and staff did not have access to all functions, thereby limiting the ability to make corrections to patient accounts. Limited staff precluded the ability to concentrate on research and resolution of outstanding accounts.

With the addition of two people in each business office, it is the goal of management to focus on, correct, and bring to resolution accounts receivable balances. This project requires time and will continue to be a focus of the business offices.

The new software addresses several concerns of the auditor with a “Reverse and Rebill” feature. This feature provides an automated way of making corrections to the resident account and then reversing the original invoice and rebilling using the updated information. Access to this feature is limited to specific individuals of the business office.

As the accounts receivable balances are researched, corrections to balances in the different payor sources will be made and adjustments to receivables and revenues recorded as appropriate.

Part of the month end closing process includes a manual reconciliation to the revenues posted in the new software. This reconciliation shall be tied to the payor source and reviewed for reasonableness on a monthly basis.

Each business office has been given a copy of the current accounts receivables policies. These policies will be reviewed in detail with the business office personnel to ensure that each office is aware of policies that govern the homes.

We concur that receivables which no longer meet timely filing guidelines remain on the books and that claims denials have not always been followed up and resubmitted for payment. The Board has made efforts in this area by hiring qualified individuals with billing experience. Those claims that are still within timely filing guidelines shall be researched and resubmitted where at all possible.

We recognize the loss of faith involved when current residents are billed incorrectly or retain balances from prior periods which are incorrect. Each facility has reviewed the files of our current residents to resolve any incorrect postings and to obtain current insurance information and has made adjustments that are necessary to correct the accounts. On-going reviews are necessary to maintain accurate statements and accounts receivables balances.

3. <u>Collection efforts for accounts receivable are not adequate</u>

Finding

As noted in the prior audit, collection efforts for accounts receivable at the facilities are not adequate. The board does have written procedures in place to collect receivables, but the procedures are not followed and actions are not documented. If receivables will never be collected, these accounts should be written off. However, write-offs cannot be approved until adequate collection efforts have been performed. At June 30, 2003, resident accounts receivable from private payor sources was $1,461,580. Of this amount, $1,323,529 was over 180 days past due.

The Murfreesboro facility’s procedures include completing forms when telephone calls are made, sending letters to responsible parties, and turning in names to the Administrator for additional telephone calls. The Humboldt facility’s procedures include completing forms when telephone calls are made and turning in names to the Administrator for additional telephone calls. The board has also contracted with a collection agency to further attempt to collect on accounts receivable before write-off. In addition, both facilities use the State Attorney General to assist in certain collections.

In order to test the board's collection efforts, we selected a sample of individuals with receivable balances in the "Prior" account at June 30, 2003. This account represents any accounts receivable at December 31, 2001, the day prior to the conversion to the information system used by National HealthCare Corporation. At June 30, 2003, these accounts totaled $1,182,946 and are, at a minimum, 18 months old. Documentation on any collection efforts on the selected accounts was requested including any efforts made until testwork dates of February 2004 for the Humboldt facility and April 2004 for the Murfreesboro facility.

For the Murfreesboro facility, the efforts to collect from 13 of the 185 residents with prior private-pay receivables were reviewed. The total of these 13 balances at June 30, 2003, was $14,619. As of May 5, 2004, the balance remained $14,619. Results from this testwork revealed that adequate documentation of collection efforts did not exist in 12 of the 13 residents' balances (92%). For the Humboldt facility, the efforts to collect from 13 additional residents of 165 were reviewed. The total of these 13 balances at June 30, 2003, was $31,972. As of May 10, 2004, the balance of these accounts had not changed. Results from this testwork revealed that adequate documentation of collection efforts did not exist in any of these 13 residents' balances.

In general, accounts are not submitted to the collection agency. Overall, as of April 28, 2004, Murfreesboro had only submitted 11 of the 185 accounts to the contracted collection agency and 2 accounts to the Attorney General. All of these were submitted prior to the fiscal year under audit. For Humboldt, as of March 2, 2004, none of the 165 past-due accounts had been turned over to the contracted collection agency, and only 10 accounts have been submitted to the Attorney General's Office in recent years.

In response to the prior-audit finding, management conceded that collection procedures were not adequate at the facilities until November 2003 for the Murfreesboro facility and December 2003 for the Humboldt facility. Management stated that these time frames were when the problems with accounts receivable were first noted and the business office began to follow collection procedures at that time. However, based on the time frame subjected to our test, it does not appear that the facilities have begun to follow collection procedures. Also, management has been made aware from the auditors' management letters that issues surrounding collection procedures existed as far back as the audit for the year ended June 30, 2000, for the Humboldt facility and as far back as the audit for the year ended June 30, 2001, for the Murfreesboro facility.

If personnel do not document what attempts are being made to collect accounts receivable, unpursued accounts could go unnoticed. Without proper collection efforts, money owed to the board goes uncollected. As receivables will remain on the general ledger until adequate collection efforts have been made and documented, accounts receivable and the related allowance for doubtful accounts may be overstated.

Recommendation

The board should ensure that collection policies and procedures are adequate and that they are being communicated to the Financial Director and followed by business office personnel. The Financial Director should ensure that collection attempts are made in a timely manner and that the attempts are documented fully. After the required attempts by board personnel have failed, the Financial Director should immediately submit the accounts to the collection agency and the Attorney General, as necessary. After collection agency efforts are exhausted, the Financial Director should take the necessary steps to write off the uncollectible accounts.

Management's Comment

We concur that collection efforts for the fiscal year ended June 30, 2003, were not adequate.

Reconciliations of the resident accounts is necessary prior to collections efforts. This crucial step will protract the process, but is needed to ensure that correct and accurate balances are reflected on the accounts.

Each facility is now focused on payment from current residents, those amounts due that are near the timeliness deadlines, as well as older receivables.

A review of collections policies shall be made with board staff for effectiveness and then reviewed with current Business Office staff as part of the accounts receivables policies mentioned earlier in finding 2. Documentation of collection attempts will be reviewed as an important and basic step in the collections process.

It is the goal of management to bring accounts for write-off to the board in fiscal year June 2005 and, with board approval, to the Department of Finance and Administration for its approval.

4. <u>For the seventh consecutive year, internal control for capital assets is not adequate</u>

Finding

Significant deficiencies continue to exist in internal control for capital assets. These deficiencies include an inability to correlate the results of physical inventories with accounting records; inaccurate equipment listings; the absence of property tags on the equipment items; donated items that are not recorded on equipment listings or accounting records; the failure to remove or investigate lost, stolen, cannibalized, or obsolete equipment; the absence of board-approved policies and procedures for determining the useful life of an item; the failure to properly surplus equipment items; a lack of proper approvals for adjustments to the accounting records; 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 storage space to store this equipment.

Similar deficiencies have been reported in prior findings in the last six audit reports. Management has concurred with the previous findings and recommendations and pledged that corrective action would be taken. Some progress was made in past years. Staff began performing annual inventories, designated a property officer, and clarified the dollar value and useful life to be used for capitalizing equipment. However, no significant progress has been detected in the past two audits and problems still remain. Management stated that a reconciliation would be performed and that the property tag numbers would be included on the capital asset listing maintained by National HealthCare Corporation (NHC). Although a reconciliation was attempted, the results were not accurate and were not integrated with the capital asset records. In addition, property tag numbers are still not included on the capital asset records. Management also stated that each home's property officer would notify NHC, in writing, when capital assets are lost, destroyed, or salvaged through the state and that donated property would be recorded in the same manner. While some capital assets were deleted from the property records, the surplus documentation did not contain enough information to establish which capital assets were deleted. Management also stated that the capitalization policy would be clarified for capitalization procedures and valuation of property additions, but the policy still does not address these issues. In addition, the facilities are following two different policies in regard to the capitalization threshold. Finally, management stated that unused and unneeded equipment would be disposed of every 90 days. However, there was no evidence that this was being done. As these changes have not been made, little has been done to eliminate the deficiencies in internal control for capital assets.

Capital asset records continue to be inadequate. Previously, the only shared attribute between the inventory records and the capital asset records was a vague description, and because of the differences in the two records, the physical inventory records that had the tag number as the main identifying feature did not correlate with the accounting records for capital assets. Changes in the physical inventory were not carried forward to the capital asset records, and the capital asset records became increasingly inaccurate. The board has now attempted to reconcile the two listings by adding the randomly assigned asset number from the capital asset records to the physical inventory records. However, the results of the reconciliation have not been adjusted in the capital asset records or the general ledger. The physical inventory records do not have cost information so the amount of capital assets on hand is still unknown. In addition, numerous errors occurred in the reconciliation process that may significantly affect the amount of capital assets recorded.

Testwork was performed on capital assets by selecting items from the capital assets listing and attempting to find the asset number on the physical inventory records. If the asset number was not found, disposal documentation was requested. If the asset number was found on the physical inventory records, the descriptions, and the invoices when necessary, were reviewed to determine if the reconciler had matched the items appropriately. We then attempted to locate the assets at the facilities. When we compared the capital asset listing to the physical inventory records, there were several discrepancies. At the Murfreesboro facility, 10 of 35 additions to the capital asset listing did not agree with the information on the physical inventory records. In Humboldt, the same was true for one of 48 additions. The problems noted included several significant differences:

- An entry of “beds” on the capital asset listing, which from review of the invoice includes three beds with mattresses, was matched up with 35 mattresses on the physical inventory records.

- An entry including 27 over-the-bed tables purchased in April 2003 was assigned the same asset number as 120 over-the-bed tables on the physical inventory listing.

- An entry for 120 tables was not matched up with the physical inventory listing at all.

- An entry for 24 head and foot boards purchased in April 2003 has the same asset number as one head and foot board on the physical inventory listing.

- An entry on the capital asset listing for a conference table, fireproof safe, and 17 chairs was matched only with the conference table on the physical inventory records.

- In addition, two separate occurrences were noted where the invoice said six items were received but the physical inventory listing only had one item listed. Without the correct quantity on the physical inventory, the information on the number of items correlated with the cost could be lost, and the improper cost may stay on the ledger even when over half the items are gone.

Another cause for concern was the fact that the asset number for certain additions purchased during the year was not matched up with the physical inventory records at all. It appears that these newer assets that were purchased were assigned an asset number related to purchases that had been made in previous years. Because the cost to obtain assets normally increases over time and because the older items would already have significant accumulated depreciation amounts, this situation will likely skew the final reconciliation amounts even further.

When items did not match between the two listings, the reconciliation by facility staff usually noted the items as being surplused, whether or not they had documentation to support that assumption. The Murfreesboro physical inventory listing in particular had some questionable items. Certain items noted as being surplused, including 27 chairs and 2 window treatments, had actually been purchased during the audit period according to the capital asset listing and the invoices. Several of the chairs and window treatments were subsequently observed by the auditor and were obviously not surplused.

Because the physical inventory records lacked cost information and were not reliable, and because the information on the financial statements comes from the capital asset listing, the capital asset listing was used to determine if equipment items could be located. Since the capital asset records do not include property tag numbers, 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. From testwork on randomly selected items from the capital asset listing, it was noted that at the Humboldt facility, 9 of 176 equipment items tested (5%) could not be located. At the Murfreesboro facility, 6 of 69 equipment items tested (9%) could not be located. During the Murfreesboro "additions" testwork, significant differences were noted. As mentioned previously, the new additions were often correlated with old asset numbers. Facility staff could not explain this condition. This probably occurred because very few items have been deleted from the capital asset listing in the last few years. As equipment has been surplused or disposed of, the related cost information has stayed on the capital assets listing as if the equipment were still present and operational. The differences noted included:

- The total number of beds according to the capital asset listing was 144, but only 117 were located.
- The total number of over-the-bed tables according to the capital asset listing was 147, but only 117 were located.
- The total number of nightstands according to the capital asset listing was 147, but only 130 were observed.
- Fourteen chests were listed on the capital asset listing, but only 8 chests could be found.
- The fireproof safe and chairs mentioned previously were not located.

Also, 12 instances were noted where property tags were not attached to the additions, making specific identification even more difficult. In addition, 5 of 51 equipment items tested (10%) had no invoice to support the purchase of the equipment, also making specific identification difficult.

Because the reconciliation prepared by management was not effective, it is vital that the description of equipment items is correct to enable matching inventory results to the accounting records. However, it was noted that the description of items on the capital assets listing is also not always accurate. One instance at the Murfreesboro facility involved an item recorded on the capital asset listing as "Recliners." However, according to the prior-year audit work papers, this item was a freezer. An item with the description of "Chairs" on the Humboldt capital asset listing was actually a drain cleaning machine according to the invoice. Although these instances were reported to management in the prior-year audit, they were not corrected.

There are no procedures in place for ensuring that donated assets are properly added to the capital asset listing. Capital assets have been donated by the foundation to the facilities but not added to the accounting records of the homes.

Both facilities do perform an annual count of assets. However, at the Murfreesboro facility, there are no procedures in place to report and investigate any differences between the current-year inventory listing and the prior-year inventory listing. At Humboldt, the administrator is informed by the property officer of any items that cannot be located during inventory. The administrator inquires of departmental staff to try to determine what happened to the item. However, there is no documentation of the investigation of lost equipment.

In addition, it was noted that some equipment has been removed from the facilities through surplus procedures. However, the listing of equipment removed from the Murfreesboro facility was not detailed enough to determine whether or not the items were removed from the capital assets listing. The listings appear to contain equipment that is no longer at the facilities due to loss, theft, cannibalization, or other disposition. Additionally, equipment that was no longer being used was being stored outside the facility building without protection from theft or the elements. These items were not secured in such a way as to prevent loss due to weather conditions, fire, theft, or misplacement. Several items at the Humboldt facility that were awaiting surplus were reported stolen. Also, the Murfreesboro facility has been renting storage space for items that are awaiting surplus or disposal. The facility paid $450 to the storage facility during the fiscal year under audit. Subsequently, the facility paid an additional $1,375 for storage during the period July 1, 2003, through April 29, 2004.

When items were surplused, proper surplus procedures were not followed. Property was removed from the Murfreesboro facility without the administrator’s written authorization. The board’s policy states, “No item can be disposed of in any manner without the Administrator’s written authorization.” The surplus property report was not even signed by the property officer. No approvals were documented.

The written procedures for capital assets are not adequate. The procedures do not address which assets to capitalize and at what amount, the process to incorporate additions and deletions into the accounting records, the classification of capital assets, or the method for valuing capital assets. In order to establish consistency and comparability between years, the policies need to be comprehensive. As a result of inadequate written procedures, the threshold for defining capital assets is different at each facility. The Murfreesboro facility was capitalizing items worth more than $100, while the Humboldt facility would only capitalize items with a value exceeding $500.

Furthermore, the board has no policies for determining the useful life of an asset. According to NHC personnel, the method for determining the useful life of an asset is to review the 1996 edition of the AHA (American Hospital Association) *Useful Lives Guide*. If no comparable item is found, NHC staff must rely on their own judgment. The board was unable to provide a copy of that particular guide, but based on a review of the 1998 edition of the AHA *Useful Lives Guide*, at the Murfreesboro facility 2 of 47 items tested (4%) did not have a reasonable useful life.

Without properly reconciling the annual physical inventories to the capital asset records, the misstatement of capital assets because of loss or theft could go unnoticed, and the accounting records become increasingly distorted. Identification is difficult if the property tag number is not affixed to the asset. When known losses and additions or donations are not reported to management, necessary adjustments to the furniture and equipment account and related depreciation are not recorded. Amounts recorded may not represent the actual amount of capital assets held, and insurance coverage based on the erroneous amounts may be inadequate. Without clear capitalization and useful life policies, there will not be consistency between similar items and between the facilities. Failure to follow established surplus procedures could result in inaccuracies in the accounting records or could result in the premature removal of useful property from the facility. The assets were purchased for the care of Tennessee's veterans. Assets that are stolen due to the lack of proper safeguards could require replacement and unnecessarily increase the rates paid by the veterans.

Recommendation

The Financial Director should immediately attempt to resolve this material weakness. The board should work with the Financial Director to develop a specific plan of action with a specific time frame for completion and oversee the progress made. The plan should include a review of the reconciliations performed between the physical inventory and the accounting records for capital assets. Corrections should be made as necessary, and in the case of the Murfreesboro facility, the reconciliation should be redone. To allow for annual inventories that will be used to support the financial statement amounts, the number used in the accounting records to identify equipment items should be the property tag number. Property tags should be placed 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 to the business office the information necessary to record all additions and deletions of equipment in the accounting records. Acceptance of donated property items including donations from the foundation should require official notification to the property officer, who would then be responsible for providing the necessary information to the central office for addition to the accounting records.

Items that are no longer useful should be surplused, and when awaiting the surplus process, should be stored in a location safe from natural elements. Also the administrators should see that unused and unneeded equipment is properly disposed of to prevent unnecessary expenditures for storage space for these items. The Financial Director should ensure compliance with surplusing procedures.

The board should review and clarify the capitalization policy as necessary to establish consistent procedures for capitalization and valuation of property additions. Also, the board should establish procedures and apply them consistently concerning the useful life of an asset.

Management's Comment

We concur that, while each facility maintains an asset listing which includes property tags, this information was not tracked by the management company's accounting records.

A review of the physical count and the asset listing shall be made and a reconciliation of the two records made in fiscal year 2004-2005. The asset property tag number shall be used in the accounting records to identify specific assets.

A procedure shall be set in place so that additions and deletions of assets can be tracked in the accounting records. Donated items shall be addressed in the additions of capital assets procedure. Surplus property shall be addressed in the deletions of assets procedure.

The board's capitalization policy shall be clarified and consistency reinforced between the facilities. The accounting records for fiscal year 2004-2005 shall match the physical count.

5. Medicaid residents were charged more than private paying residents

Finding

The Tennessee State Veterans' Homes Board failed to follow the *Rules of the Tennessee Department of Finance and Administration Bureau of Tenncare* as it pertains to the relationship between the private pay rate as established by the homes and the Medicaid reimbursement per diem as established by the Division of TennCare of the Comptroller's Office. This failure to adhere to policy has resulted in overpayments by the state as well as a loss of revenue by the homes.

Medicaid is a program that pays for medical assistance for certain individuals and families with low incomes and resources. This program became law in 1965 and is jointly funded by the federal and state governments to assist states in providing long-term medical care assistance to people who meet certain eligibility criteria. Medicaid is the largest source of funding for medical and health-related services for people with limited income.

Per the *Rules of the Tennessee Department of Finance and Administration Bureau of Tenncare,* Chapter 1200-13-1.05, (4)(g), "Regardless of the reimbursement rate established for a Skilled Nursing Facility, no Skilled Nursing Facility may charge Medicaid patients an amount greater than the amount per day that is charged to private paying patients for equivalent accommodations and services." However, it was noted that the private pay rate for level 2 residents was lower than the established Medicaid reimbursement rate at both Veterans' Homes.

The Medicaid rate that was set for fiscal year 2003 was $162.12 per day, for both facilities. At the Humboldt facility, the level 2 private pay rate for fiscal year 2003 was $156.00 per day. This difference of $6.12 per day resulted in questionable payments from Medicaid in the amount of $19,333. At the Murfreesboro facility, the level 2 private pay rate for fiscal year

2003 was $158.00 per day. This difference of $4.12 per day resulted in questionable payments from Medicaid in the amount of $15,289. The Medicaid rate does include ancillary charges, such as additional charges for certain therapies or pharmaceuticals, whereas the facilities charge for ancillaries separately from the private pay rate. This would resolve some of the questioned amounts. Also, when the private pay rate and the ancillary charges related to the residents were calculated in total and compared to the Medicaid amounts received, the amount was greater than what was received. However, this occurred because significant ancillary charges related to one or two residents offset the smaller ancillary charges of the majority of the residents. Overall, over one-half of the Medicaid residents had rates received from Medicaid that exceeded the rate they would have paid had they been private paying residents.

In addition to the costs that the homes may be responsible for repaying, the Tennessee State Veterans' Homes Board also lost revenue to which it would have been entitled had the level 2 private pay rates been established properly. As Medicaid was established to pay reasonable costs associated with long-term care for individuals with limited income, it would appear that the rates established for non-Medicaid residents should be, at a minimum, equal to, if not greater than, the rates established for Medicaid residents.

Recommendation

The Tennessee State Veterans' Homes Board should ensure that all rules and regulations established by the state and federal governments are followed. The board should immediately adjust its private pay rates accordingly in order to avoid any further questionable reimbursements which the board may ultimately be required to repay.

Management's Comment

We concur that the Medicaid reimbursement rate was greater than the room rate for part of fiscal year 2003.

As pointed out by the auditors, the Medicaid reimbursement is all-inclusive while private pay residents must also pay for all ancillary and central supply charges.

This situation can arise annually when the facilities receive notification from the Medicaid Department of a retroactive rate increase. For fiscal year 2005, the Medicaid Department issued a letter dated August 10, 2004 of its reimbursement rate changes for both ICF and SNF residents with an effective date of July 1, 2004. Management must obtain both board approval and give a 30-day notice before increasing the room rates. Therefore, there is a period of time when the Medicaid reimbursement rates can be higher than the room rates charged to private paying individuals.

For fiscal year 2002-2003, both facilities failed to increase the room rates to match the Medicaid reimbursement.

A procedure shall be proposed to the board that would allow for automatic board approval of room rate increases in circumstances where the established room rate no longer exceeds the reimbursement rate from Medicaid. The 30 day notice to residents is still a necessary step prior to the implementation of a room rate increase.

6. <u>The board has no policies and procedures in place regarding the authorization or use of credit cards and lines of credit</u>

Finding

The board does not have adequate controls in place over the use of credit cards and lines of credit. The board has not adopted any policies to address who is authorized to request credit lines with vendors. The facilities do not have policies and procedures outlining safeguard measures for the physical possession of credit cards, nor do the facilities maintain a list of individuals with authorization to make credit purchases on behalf of the facilities. There are no controls in place regarding advance approval for purchases on a credit card or a line of credit, and when subsequent approvals are obtained, the approval is not always timely. There are also no controls in place to ensure timely or correct payments for credit purchases, and appropriate support is not always required.

During the period under audit, the Humboldt facility had credit cards or lines of credit with five vendors. Of these accounts, three gave the facility a specific limit to the credit extended and two were open accounts with no limits. The limited credit extended to the facility totaled $15,000. The Murfreesboro facility has had credit cards or lines of credit with at least 11 vendors. Of these accounts, five gave the facility a specific limit to the credit extended and six were open accounts with no limits. The limited credit currently extended to the facility totals $19,500. The accounts mentioned above may not be the only ones available to the Murfreesboro facility. During preliminary discussions with board personnel, the business office manager was not aware that credit had been extended to the facility by all of these vendors. The business office manager became aware of the number of cards, credit limits, and authorized users (according to the vendor) only when the vendors were contacted by the business office manager after auditor inquiry.

The unwritten process for credit purchases at the Humboldt facility during the period under audit started with the employee obtaining verbal approval from the administrator to use the facility’s credit. The employee would then get the card from the filing cabinet in which they are stored with the receptionist. This employee would then write his or her name, the card being used, and the date on a sheet of paper kept in the cabinet for this purpose. Upon the employee’s return, the card would be returned to the cabinet, and the return date would be added to the log. A purchase order would then be completed for the purchase and stapled to the receipt. These items would be given to the accounts payable clerk for payment. Upon the next check run, the vendor would be paid based on the receipt. During the first part of the audit period, any statements received from the vendor were placed in the vendor file. No formal reconciliation was performed to ensure all charges were supported by receipts and purchase orders approved by the appropriate personnel. During the latter part of the audit period, a reconciliation process was implemented at the Humboldt facility. The process used by the Murfreesboro facility during the audit period was similar except that certain individuals in the facility retained possession of the credit cards and would use a card or give a card to another employee whenever needed without the advance approval or log process. After the purchase was made, the receipt would be given to the receptionist, and a purchase order would be prepared for payment with the next check run. Statements received at the Murfreesboro facility were not maintained or reconciled to receipts to determine if allowable purchases had been made.

The procedures described above create several internal control issues. Physical access to the cards was not controlled appropriately. At Humboldt, the receptionist did not have a list of individuals authorized to use the cards, and anyone with access to the filing cabinet could obtain the cards for use. Also, one of the retailers had been given a list of individuals who were authorized to purchase on a line of credit, and that listing included the name of a terminated employee. At Murfreesboro, many employees retained credit cards for use whenever the employee thought appropriate. The employees did not always appear to be authorized to have the cards or authorized to purchase on behalf of the facility. Not only was the business office manager not aware of all credit lines, she was also not aware of physical custody of the cards. Two of the issued credit cards could not be located even after inquiry of all the department heads. Also, credit cards are believed to still be in the possession of at least two individuals who are no longer employees of the board. In addition, one receipt from Hobby Lobby in the amount of $13 was observed containing the signature of an individual unknown to the auditors. After inquiry of board personnel and a review of current and past employees, this individual who made purchases on the board's behalf still could not be identified.

Procedures in place for approval of credit card transactions are not adequate. At Humboldt, the verbal approval to purchase the items is not documented. At Murfreesboro, approval is not even required before purchase. Items could be purchased that would not have been approved. Also, even though most purchase orders that document approval for payment are eventually completed, purchase orders are not always completed and not always timely. No purchase orders were completed for one vendor at either facility. Two of the Murfreesboro purchase orders that were completed did not contain an authorized signature. During the Humboldt testwork, 80 instances were noted in which the purchase orders were not completed until the day after the purchase or later. The time frames noted ranged from one day after the purchase to 89 days after the purchase. Two additional purchase orders were observed without dates. During the testwork in Murfreesboro, 22 instances were noted in which the purchase orders were not completed until the day after the purchase or later. The time frames noted ranged from one day after the purchase to seven days after the purchase. Two additional purchase orders were observed without dates.

Purchases made on credit cards did not always go through the same approval process as other purchases. The purchase of $1,300 of gift cards for employees was approved only by the administrator of the facility, and $2,115 of gift cards did not have a purchase order at all. Board policy states that purchases greater than $1,000 must be approved by the Executive Director in addition to the administrator. Also, one unapproved receipt was observed that included $62 of items like newborn diapers and infant socks that did not appear to relate to the objectives of the board. The business office manager stated that the items may have been for a baby shower. These types of purchases may not have been approved had they gone through the normal accounts payable process.

In addition to untimely or improper approval for purchases, certain purchases were not supported adequately. Three unsupported payments in Humboldt were for payment of the fuel card balance. The fuel card company sends weekly fleet reports listing individual fuel purchases, locations of those purchases, amounts of fuel purchased, and the vehicle for which the fuel was purchased. The employees also get receipts that are sometimes turned in for documentation. However, the documentation retained as support for payment was a monthly report that did not show any of this detail. Fuel card amounts were also not supported in Murfreesboro. Most of the weekly reports were not retained. In addition, the receipts for the individual purchases were not retained. There were an additional six instances in Humboldt where the support for payment was a copy of the statement. Three charges were for WalMart totaling $134, and three charges were for Sam's Club totaling $329. No receipt had been given to the receptionist for payment, and no purchase order had been completed until the statement had been received.

Reconciliations were not performed during part of the year in Humboldt, and no reconciliations were performed in Murfreesboro to ensure all charges on the vendor statements were authorized and paid or were in the process of being paid. In fact, during the audit period, no Murfreesboro statements were even retained. Because the vendors are paid based on submitted receipts, additional charges could be present on the statements that were unauthorized. These charges may go unnoticed, unpaid, and uninvestigated. Conversely, charges might be paid without proper support in order to clear up debts owed to the creditors. A reconciliation between the receipts and the statement prior to payment would allow the facilities to recognize and resolve unauthorized charges and would help to avoid interest charges. Based on a review of the statements that were retained, the Humboldt facility incurred late fees on four occasions and interest fees on 22 occasions. Discussions with a Murfreesboro vendor revealed that one vendor had closed the facility's account in September 2003 due to delinquency.

With management's lack of awareness or concern for the amount of credit extended to the facility and with the lack of policies regarding authorized credit card users and advance approvals, the board may be responsible for charges that are not related to board activities. When purchase orders are not completed timely and when reconciliations to statements are not performed, interest and penalty charges may accrue on the charges. The credit cards, without policies to prevent it, can be used to avoid following existing disbursement policies. The lack of policies related to the credit cards is an invitation for fraud that could occur and go undetected.

Recommendation

The board should immediately address policies and procedures regarding the authorization and use of credit cards and lines of credit. The Financial Director should immediately determine the extent of all credit extended to the facilities, collect the existing cards, and cancel all lines of credit. An assessment of the need for credit cards should be performed and if the use of credit is necessary, policies should be developed before the credit is reestablished. Lines of credit should be limited to the minimum amount determined in a risk assessment. The Financial Director should take steps to assure herself that she knows who has possession of the credit cards at all times and that the cards are assigned to a limited number of employees. Management should also ensure that employees who are terminating employment return all items, including credit cards, to the board upon termination. Any unlocated cards should be immediately canceled. Credit card purchases should be scrutinized frequently by the authorized purchaser's supervisor. Written policies should be developed by the board to make clear what type of purchases are allowable by credit card and what type of approvals will be required. The time frame for approvals should also be established to ensure that approvals for purchases occur and are documented before the purchase occurs. Written policies should make it clear that the credit cards should not be used to circumvent regular approvals and bidding requirements. The Financial Director should require reconciliations of billing statements to the receipts approved by the supervisors, and any charges without approved receipts should be investigated immediately. Furthermore, the board should assess the risk of fraud related to the credit cards and immediately investigate the credit card purchases to determine if fraud has occurred.

Management's Comment

We concur that the board has no policy or procedure on the use of credit cards or lines of credit.

Credit cards shall be maintained in a locked cabinet or drawer with limited access. Individuals must receive prior authorization and approval of purchases and sign a log when taking a card for use. The receipt and purchase order shall be given to the accounts payable clerk who shall match the receipt with the statement from the credit card company. Discrepancies shall be investigated and resolved prior to payment.

Purchases by credit card shall require the same approval process and shall not be used in a manner that circumvents the purchasing policy established by the board.

Management shall address this issue and develop appropriate policies to address the recommendations of the auditors in fiscal year 2005.

7. <u>Internal control for purchasing is not adequate</u>

Finding

As noted in the prior three audits, the Tennessee State Veterans' Homes Board's policies and procedures over purchasing are not being followed, and service contract approvals required by state law are not being obtained. In addition, contract payments were not always properly invoiced or reviewed.

In response to the prior-year audit, as in response to the two previous audits, management concurred with the finding and stated that the policies and procedures over purchasing were being reviewed and would be revised if necessary to ensure proper segregation of duties. Management did finally follow through and ensure adequate segregation of duties regarding the individuals who order and receive supplies. However, the revised purchasing policy as it relates to purchase orders is still not being followed. Management also concurred that service contract approvals had not been properly obtained and stated that the contract review process had begun and contract development was being studied in order to streamline the process. However, the contract review process was not completed. Therefore, during the audit period, the conditions still existed.

The written policies and procedures in place during most of the fiscal year under audit (subsequent to August 1, 2002) require department supervisors to complete purchase orders to initiate, justify, and request purchases and to submit them to the accounts payable clerk. The clerk is then to give the purchase orders to the administrator for review and approval. After approval is obtained, the purchase order is returned to the department supervisor for the initiation of the desired purchase. The procedures require a purchase order to be completed for all purchases except those purchases from vendors with whom a standing contract exists. Purchases over $1,000 also require the approval of the purchase order by the Executive Director. Purchase orders less than $500 may be initiated without bids. The policies state that it is "desirable" to have informal (oral) bids for purchase orders between $500 and $1,000; however, the policy allows the administrator to authorize such purchases "from any sources as may be reasonable." Unless purchased under a statewide contract, purchase orders over $1,000 require three formal (written) bids. Personnel involved in the purchasing function are also required to compare prices obtained to current market prices to ensure the board is not paying more than is necessary for goods and services. This comparison is to be performed no less than quarterly.

These purchasing policies and procedures are not being followed. Certain disbursements were reviewed, and testwork revealed the following errors:

- Five of 14 disbursements tested at the Humboldt facility (36%) and 5 of 18 disbursements tested at the Murfreesboro facility (28%) were not supported by a purchase order.
- Of the 9 disbursements tested at the Humboldt facility that were supported by purchase orders, 3 (33%) were dated after the services were rendered, indicating that the purchase order was not approved prior to purchase. Of the 13 disbursements tested at the Murfreesboro facility supported by a purchase order, 3 (23%) were dated after the services were rendered.
- One of the 9 disbursements tested at the Humboldt facility (11%) was supported by a purchase order completed by someone other than the department supervisor.

- One of the 9 disbursements tested at the Humboldt facility supported by a purchase order (11%) was not properly approved. Two of the 13 disbursements tested at the Murfreesboro facility supported by a purchase order (15%) were not properly approved.

In addition to the problems noted during testwork, problems were also noted during discussions with various facility personnel. Staff at the Murfreesboro facility indicated that currently most purchase orders are prepared on the date the invoice and/or goods are received from the vendor. Another staff member will sign and date the purchase order as received without actually seeing the goods or knowing the services were received. Staff at the Murfreesboro facility also indicated that prices obtained are not being compared to current market prices on a quarterly basis to ensure the board is not paying more than is necessary for goods and services. Failure to follow purchasing and cash disbursement policies and procedures could result in fraud, abuse, or waste.

Service contracts are still not being prepared and sent to the Commissioner of the Tennessee Department of Finance and Administration for approval. For three of five service vendors tested in Murfreesboro (60%) and three of five service vendors tested in Humboldt (60%), a valid service contract could not be provided. Two of the vendors in Humboldt and one in Murfreesboro had had contracts with the board in the past; however, these contracts had expired. In addition, one of the contracts at the Humboldt facility had been approved by the administrator of the facility only. It was not approved by the Commissioner of the Tennessee Department of Finance and Administration. 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 enforceable and in the best interest of the state.

When a payment to each of the three vendors with Humboldt contracts was reviewed, one of the three payments to Humboldt service vendors (33%) exceeded the maximums per individual service stated in the contract. The board does not have internal control in place to prevent exceeding approved contract amounts. When one payment to each of the five vendors at each facility was reviewed, three payments from the Humboldt facility (60%) and two payments from the Murfreesboro facility (40%) did not have adequate supporting documentation in the request for payment. For example, timesheets were not included for certain invoices from temporary staffing agencies and some charges did not include the names of the individuals or the dates services were provided. Facility personnel did not completely review or follow up discrepancies such as those noted below:

- Based on our review, $300 was questioned and determined by the vendor to have been related to another facility.
- At least $54 was determined to have been paid erroneously to another vendor even though the Director of Nursing had clearly marked on the invoice not to pay for the services, and when time cards were attached to the related invoices, the time cards did not always match the number of hours on the invoice.

As previously mentioned, management did adopt a new purchasing policy as of August 1, 2002. This new policy eliminates the need for a purchase order if a standing contract exists. However, the related cash disbursement policy still requires a purchase order for all disbursements. This contradictory language may create confusion regarding documentation requirements.

Recommendation

The Financial Director should ensure that purchasing procedures are adequate and are being followed. Properly completed purchase orders should be approved in advance of all applicable purchases. Items should be received and inspected by an individual other than the purchaser, and this inspection should be documented. The Financial Director should ensure that price comparisons are performed as required by the board policy. Service contracts should be established and approved in accordance with state law. Contracts should be reviewed prior to disbursing funds to ensure vendors' compliance with contract requirements and documentation requirements. In addition, the discrepancies noted should be investigated, and reviews should be performed to determine if similar overcharges have occurred. The board should make policy changes as necessary to ensure that purchasing and cash disbursement policies are not contradictory. The board should formalize a process for standing contracts including development of a policy for establishing limits to the contracts, necessary approvals, and monitoring the amounts outstanding on the contracts. A listing of standing contracts should be available to business office personnel.

Management's Comment

We concur that controls on purchases have been inadequate.

Management shall continue to address this issue and develop appropriate practices to match policy in fiscal year 2005. Staff responsible for accounts payable shall be instructed to reconcile the purchase order with receipts and invoices and the statement and pay only those invoices with documentation.

A review of the purchasing policy shall be made and reviewed with facility administrators. Education of department heads and vendors will be undertaken in fiscal 2005, as well. The change in practice will take time to implement as department heads are trained to follow the purchasing policies.

The contract review process is extremely burdensome and difficult to work with. Even though no state monies are involved, all contracts are to be submitted to the Office of Contract Review under Finance and Administration for its approval. It generally takes a minimum of 90 days and can take over one year before receiving approval of one contract. In the meantime, the facilities must continue to provide services and pay vendors. Emphasis has been placed on submitting contracts for approval through the Office of Contract Review.

Since July 2004, there have been three contracts submitted for extension and three contracts submitted for approval to the Office of Contract Review. Of these submissions, four have been approved to date.

8. <u>Duties at the Tennessee State Veterans' Homes Board facilities are not adequately segregated</u>

Finding

The Tennessee State Veterans' Homes Board does not have adequate segregation of duties in several areas of operation. Receipting duties at the Murfreesboro facility and cash disbursement duties at the Humboldt facility are not adequately segregated. Without adequate segregation of duties, funds of the board may be misused or misappropriated.

Receipting duties for accounts receivable

At the Murfreesboro facility, the billing specialist opens all mail. While she does not prepare receipts for the funds received in the mail, she does have access to all funds received at the facility prior to the receipt preparation process. The billing specialist's other duties include billing Medicaid for Level 2 residents, billing insurance companies, and billing Medicare. She is also responsible for posting receipts to the receivable records and has the ability to post adjustments to the receivable records. This combination of duties is not an adequate segregation of duties. Residents or their responsible parties could be billed excessively, funds could be misappropriated upon receipt, and the accounting records could be manipulated to hide this activity. Numerous manual adjustments have been made to the accounting records (see finding 2) which increase the risk of fraud. These adjustments would make any improper manipulation difficult to detect.

Receipting duties for the resident trust fund

As stated above, the billing specialist at the Murfreesboro facility opens all mail. She also performs some duties related to the resident trust fund. These duties include posting deposits and disbursements to the individual resident trust fund balances, reconciling the individual resident trust fund balances, and reconciling the bank statements. This is not an adequate segregation of duties and would allow misappropriations to occur within the trust fund. Funds could be received but not posted, or funds could be posted but not deposited.

Cash disbursement duties

At the Humboldt facility, the receptionist records accounts payable. When it is time to print checks, she prints a listing of payables for the administrator. The administrator then determines which payables should be paid when the check run is made. The payroll clerk then writes the checks based on the listing of payables approved by the administrator. After the checks have been written, the administrator reviews the checks, along with supporting documentation, before signing the checks. The signed checks are then given to the receptionist for mailing.

The process as previously described is designed to adequately segregate duties surrounding cash disbursements. However, if in practice, one step in the process is omitted or performed in an improper order, adequate segregation does not exist.

While at the Humboldt facility, an auditor observed the payroll clerk filling out checks that had already been signed by the administrator. When asked about this deviation from the process that had been described to the auditor earlier, the payroll clerk indicated that this deviation facilitated the payment of checks on a day when the administrator was busy. As a result, controls surrounding the disbursement of cash did not in fact exist.

With inadequate controls over the disbursing of cash, board funds could be misallocated or misused. Removing the administrator’s proper place in the approval process could allow the receptionist or payroll clerk to record improper payables or write checks that would not be scrutinized. Blank checks should never be signed.

Conclusion

All duties relating to the receipting or disbursing of cash, whether it is cash belonging to the board, the foundation, or the residents, must actually be adequately segregated. Failure to do so may result in fraud, waste, or abuse of those resources.

Recommendation

The board must immediately revise its procedures to ensure that the duties surrounding cash are adequately segregated. It should revise the existing written policies to ensure that all conflicting duties related to the cash transactions are appropriately assigned to separate individuals. The business office manager should periodically review the responsibilities to ensure that the correct individuals are performing their assigned tasks. The board should make it clear that departures are not acceptable. The Executive Director should ensure that blank checks are never signed and disciplinary action should be taken as necessary to deter this type of activity. Management should review cash receipts transactions and determine if any improper transactions have occurred. Any discrepancies should be thoroughly investigated.

Management’s Comment

We concur with the finding.

Part of the job duties for accounts receivable and the resident trust fund functions once handled by the billing specialist in Murfreesboro have been reallocated to other staff members.

Management is aware of the internal controls at risk and will continue to address separation of duties and implement checks and balances where feasible.

We concur that blank checks should never be signed by the administrator. This situation has been discussed with the administrator and staff and instruction given that the practice is not to be repeated.

We concur that duties associated with the receipt or disbursement of cash should be segregated. This issue is addressed in fiscal year June 2005 with the addition of personnel at each facility and with thoughtful reassignment of duties.

9. Internal controls for information systems are not adequate

Finding

On January 1, 2002, National HealthCare Corporation (NHC) began serving as the management company for the Tennessee State Veterans' Homes Board. NHC continued to serve in this capacity until January 1, 2003. At that point, and through the remainder of the period under audit, NHC served as a consultant to the board. As the management company, NHC was responsible for establishing and maintaining the information system used in the facilities. Although the relationship between NHC and the board changed on January 1, 2003, the responsibilities surrounding the information system did not change. The board continued to use the information system established by NHC. During the prior audit, significant deficiencies were noted in the internal control related to this information system. Based on discussions with management, changes have not been made to address these deficiencies. Therefore, the errors noted in the prior audit are repeated in italics below. New weaknesses noted during testwork are included later in the finding.

The information system used in the facilities during the audit period is based on a UNIX operating system and was developed by NHC. It includes applications for accounts receivable, accounts payable, resident care, equipment, payroll, and the general ledger. These applications contain confidential resident information that should only be viewed by those personnel whose job responsibilities require them to access this information.

In general, very few policies and procedures, either written or unwritten, relating to the information system are maintained.

- *There is no written policy in place regarding passwords for the system. In addition, there are no procedures to change passwords on a periodic basis. Thus, passwords are not changed.*
- *A formal disaster-recovery plan has not been developed and approved. Also, no alternate processing site has been established.*

- *There is no formal steering or planning committee established to oversee major Information Systems (IS) functions.*
- *There is no written policy regarding program changes. No documentation is maintained that indicates management approval and assignment of program change requests to individual programmers. No documentation is maintained to indicate the results of tests performed when programs are changed, nor does management review changed programs before they are moved into production. In addition, no documentation is maintained for changes made to the system software.*
- *There are no procedures to monitor use of the system. According to information systems personnel at NHC, the system itself can generate an e-mail message to the programmer when errors occur or when unauthorized usage is detected. However, personnel could not provide examples of circumstances that would warrant an e-mail being generated. Also, no listing of errors is maintained. Therefore, it would not be possible to monitor correction of these errors and determine the cumulative effect of these errors.*
- *No organization chart for the IS department is maintained.*
- *Written job descriptions for the IS positions could not be provided.*
- *No documentation is maintained that indicates how fire procedures are communicated to new personnel.*
- *No user manuals or operating instructions are available for the general ledger application.*
- *Controls over table file settings are inadequate. Table files control reference information for system processing, such as terminal codes and procedure codes. There is no policy regarding review of table file changes by NHC management or periodic review of table file settings by management. Changes to critical table information could occur and go undetected.*

In addition to a lack of written policies or procedures related to the information system, several instances of improper access to the system were noted that were applicable to the period audited.

- *Seventeen of 40 employees tested (43%) did not have a written request from management granting them access.*
- *Two of 23 employees tested (9%) had an incomplete request. The request did not indicate the type of access to be given.*
- *Two of 23 employees tested (9%) did not have a properly approved request. According to NHC information system personnel, their procedures require a written request approved by the facility's administrator. This approval is typically in the form of an e-mail from the facility's administrator.*

- *One of 23 employees tested (4%) had a higher type of access than the access requested. The request stated that this employee should have LPN access (code 182). A review of the Terminal Access by Center listing (a listing of all board personnel with access to the system as well as the level of access granted) indicated that this employee has Charge Nurse access (code 184).*

- *Twelve of 40 people tested (30%) were individuals who were no longer employees of the facility. These individuals' employment had been terminated between 4 days and 15 months prior to the date of the report listing individuals with access to the system.*

- *Screens observed on the Murfreesboro administrator's computer were not included on the NHC Program Access by Terminal Code Listing of screens. The Program Access by Terminal Code Listing is a system-generated report that indicates the screens available to a particular level of access. For instance, if an individual has level 101 access per the Terminal Access by Center listing, the individual should have access to all screens listed on the administrator (level 101) section of the Program Access by Terminal Code Listing.*

- *One screen included in the NHC Program Access by Terminal Code Listing (Administrator - Code 101) could not be accessed by the administrator, causing doubt as to the accuracy of the access capabilities listing.*

- *According to the Program Access Terminal Code Listing, all codes tested should allow users to access certain screens identified as PH type screens. These screens could not be observed on the administrator's or activities department head's computers at Murfreesboro. Both individuals should have had access to these screens. However, a security message appeared stating that these individuals did not have this type of access.*

- *Twenty-one of 135 employees with access to the system (16%) have access to a payroll screen where changes can be made to the time worked if employees work overtime or lose their clock-in badge. This percentage seems extremely high, and it appears unnecessary for 21 individuals (10 at Murfreesboro and 11 at Humboldt) to be able to make manual changes to employees' time and ultimately be able to affect payroll. After discussion with personnel at both facilities, it appears that only one employee at each facility uses this screen. Access to sensitive information like employees' payroll information should be limited to those individuals whose jobs require that level of access.*

- *One of 40 employees tested (3%) has access under two codes. As employees move from one position to another, their access should be updated to reflect new responsibilities. Likewise, access should be restricted to those new duties.*

- *A lack of segregation of duties is also indicated by the access levels granted to employees. An employee at Murfreesboro who approves accounts payable has access to a screen where payables can be initiated. The payroll officer at Humboldt during the audit period had the ability to post cash transactions. This employee was also responsible for preparing the bank reconciliation. The assistant bookkeeper at*

Humboldt is able to post cash transactions. This individual is also responsible for preparing the deposit.

Effective internal control would include written policies and procedures as well as maintenance of adequate documentation. Inadequate controls over access could result in sensitive information being obtained by inappropriate parties. With the heightened federal standards regarding sensitive information, especially those of the Health Information Portability and Accountability Act (HIPAA), including substantial fines for violations, it is increasingly important to guard this information from inappropriate parties.

Although this finding was reported to the board during the prior audit and comments from the board were requested, the board was unresponsive in its comments as related to the current operating system. The board stated that it was purchasing a new information system and would take the recommendations of the auditors under consideration in developing the control environment for the new system. Therefore, the conditions of the finding remained unchanged during the audit period. In addition, employees at the Humboldt facility were observed during the current audit logging into the information system as other employees. In one instance, one employee even logged in as an individual who had not been employed by the board for four months. An employee at the Murfreesboro facility stated that it is not uncommon to log in to a terminal in order to allow another employee to use the terminal with the access granted to the first employee. Subsequent to June 30, 2003, the board did purchase a new information system. The board also selected a steering committee in January 2004 and approved computer use policies and procedures on April 29, 2004.

Recommendation

Whether the information system is maintained by the board or by a management company, adequate documentation should be maintained for the tasks performed by the IS department. The board is responsible for ensuring adequate control is maintained with respect to its data. Written policies and procedures should be further developed to adequately address system issues. The security and controls over the system should become a priority for the board. To ensure adequate segregation of duties, the Financial Director should limit access to those individuals whose jobs require access to different areas of the system. The administrators should also ensure that each employee has a unique log-in name and password and is only using his or her assigned codes. When employment is terminated, the Financial Director should ensure that access to the system is removed immediately. Documentation requesting access should be maintained by business office personnel. Also, a disaster recovery plan as well as an alternate processing site should be established for use in the event of an emergency. The Financial Director should thoroughly review HIPAA requirements and ensure that the board complies.

Management's Comment

We concur with the finding of the information system of the former management company.

In fiscal year 2005 management brought the information system function in-house with the purchase of new hardware and software and the employment of an information systems manager. Policies and procedures have been developed by the Information Technology Steering Committee and approved by the board.

10. <u>Travel claims again were not in compliance with Comprehensive Travel Regulations, resulting in excessive reimbursement of over $3,400</u>

Finding

As noted in the two prior audits, travel claims were not in compliance with Comprehensive Travel Regulations. Regarding travel by board members, Section 58-7-105, *Tennessee Code Annotated*, states,

> All reimbursement for travel expenses shall be in accordance with the policies and guidelines approved by the board, but shall not exceed the maximum reimbursement for travel expenses allowed by the provisions of the comprehensive travel regulations as promulgated by the department of finance and administration and approved by the attorney general.

The management of the veterans' homes has chosen to adopt the same regulations for all travel by employees of the homes.

Management concurred with the prior-year finding and stated that training was provided for Humboldt staff in March of 2003 and for Murfreesboro staff in December of 2003 and that the administrators would ensure compliance. They had also conducted in-service training in 2002 in response to the first finding on this issue. Despite the training or any additional efforts by the administrators, the problems still existed. Management also stated that the policy on approval of travel vouchers would be reviewed for a more practical policy of who approves travel claims. Although a draft policy was observed during the audit, the policy had not been approved.

There were 385 travel claims submitted by the staff or board members of the Tennessee State Veterans' Homes Board for the year totaling $42,455. Sixty claims, 30 in Humboldt and 30 in Murfreesboro, were selected for review. Most of the travel claims reviewed were incorrect in some aspect. In Murfreesboro, 21 of 30 travel claims (70%) and in Humboldt, 29 of 30 travel claims (97%) were not completed in accordance with state policies or board policies. Travel claims were not always approved or dated. Other problems noted with the travel claims included untimely submission and incorrect or unallowable mileage, hotel, and per diem reimbursements.

The appropriate signatures and approvals for travel claims were not always obtained. Numerous travel claims were not approved by the designated individuals. Per the veterans' home travel policy, "The fiscal agent or his designee will complete and submit all travel reimbursement to the chairman of the board for signature. The fiscal agent or his designee will then forward the travel reimbursement forms to the management company for reimbursement." In Murfreesboro, 14 of 30 claims tested (47%) and in Humboldt, 28 of 30 claims tested (93%) were not properly approved for payment. Many individuals other than the chairman of the board approved the claims or signed for the chairman. In Humboldt, one instance was also noted in which a claim for the Executive Director was signed on his behalf by the Assistant to the Executive Director.

According to Section 10 of the regulations, employees should submit travel claims for reimbursement of travel expenses no later than 30 days after completion of travel. In Murfreesboro, 2 out of 30 claims tested (7%) were submitted untimely, and both elapsed over two fiscal years. The time between the covered period and submission of claims ranged from just over two months to four months later. In addition, in Murfreesboro, 3 of 30 travel claims tested (10%) were not dated. In Humboldt, 9 of 30 (30%) were not dated by the claimant.

According to the travel regulations, reimbursement for miles when using personally owned vehicles should equal the mileage from the Official State map with reasonable vicinity miles. Reimbursing employees for normal commuting miles is prohibited, and when traveling, reimbursable mileage will be the lesser of the mileage from the employee's residence to his or her destination or from his or her official station to the destination. In Humboldt, 7 of 28 claims tested (25%) included unallowable mileage. The amount of mileage claimed appeared unreasonable on 2 of the claims, commuting mileage was claimed on 3 of the claims, and mileage for travel was claimed from the employees' residence when it should have been claimed from their official station on 2 claims. Another mileage amount appeared unreasonable for one of 30 Murfreesboro travel claims tested (3%).

In addition to the reimbursement rates for mileage, the travel regulations set guidelines for hotel reimbursements as well as incidental expenses (meals, telephone charges, etc.) on a per diem basis. These rates vary based on the county or city of destination. In Murfreesboro, one of the 18 travel claims with hotel expenses tested (6%) and in Humboldt, one of 9 travel claims with hotel expenses tested (11%) were not reimbursed for the correct amount. The room rates exceeded the established per diem amounts. The per diem rates used for incidentals were also incorrect in several instances. In Murfreesboro, 4 of 20 claims tested (20%) had per diem amounts that were not allowable. In Humboldt, 2 of 11 claims tested (18%) included unallowable per diem amounts.

Furthermore, during testwork in Humboldt, six instances were noted where the board reimbursed travel for claimants who were not board employees. According to the contract between the management company (NHC) and the board, NHC is responsible for the reimbursement of travel expenses for NHC employees. One of the six claims was for the administrator of the Humboldt home, who was considered an employee of NHC until January of

2003. The other five claims were for an NHC employee who had traveled to the Humboldt home to assist in some business office work. The total overpayment for these claims is $3,123.

As a result of not adhering to the travel regulations as well as the terms of the contract with the management company, numerous travel claims were overpaid. Excluding potential overpayments related to individuals overclaiming mileage, the board appears to have made overpayments in the amount of $3,420.

Recommendation

The staff and board members of the veterans' homes should be knowledgeable about the state travel policies that have been adopted. If the training provided previously was ineffective, more training, focused at the approving supervisors, should be provided. The Financial Director should ensure all travel claims are completed in accordance with these policies by instructing the individuals responsible for accounts payable not to pay any travel claims that are not properly approved. The individuals responsible for accounts payable should be held responsible for ensuring that any travel claims approved for payment comply with the travel regulations. The Executive Director should seek repayment from NHC for travel paid for NHC employees. Overcharges should be investigated to determine why they were paid and who approved them. Frequent incorrect submissions or incorrect approvals should be addressed in employee performance evaluations.

Management's Comment

We concur that not all travel claims were approved by the chairman of the board.

The travel policy, although written with these terms, did not mean that, in practice, the chairman of the board would be responsible for approval of a claim submitted by the activities director or the maintenance worker for travel involved with their assigned duties. The policy has been re-written so that the administrator of each facility has approval authorization for those employees with business related travel expenses.

Employees shall be directed to provide additional written documentation when vicinity mileage exceeds what is usually claimed. Accounts payable clerks shall be instructed in reviewing travel claims for completeness prior to processing payments.

The travel expenses paid to NHC employees will be investigated and repayment will be requested where appropriate.

11. Accountability for restricted foundation accounts and foundation funds needs improvement

Finding

Tennessee Veterans Home Foundation accepts money from donors for the benefit of the residents of the veterans' homes. The donors sometimes donate money for particular purposes, such as improvements to the patio or an ice cream fund, and sometimes the donors donate the funds with no particular restrictions. According to Article IV, Section 5-Bequests, Gifts, etc., of the By-Laws of the Tennessee Veterans Home Foundation, Inc., "All restricted bequests and gifts will be credited to an appropriate account so that the restriction can be honored. All unrestricted bequests and gifts received will be credited to the unrestricted endowment fund." Although restricted accounts are used by the board, the accounts sometimes have a negative balance, and the overall financial picture related to the restrictions is not analyzed by the foundation. In addition, certain foundation transactions were not approved.

The foundation has a checking account, a money market account, and certificates of deposit. The restricted accounts are currently accounted for in the checking account. According to the Assistant to the Executive Director, as money is donated, the funds are debited to the appropriate restricted account. As the money is used for its intended purpose, the account is credited for the amount used. However, the foundation is allowing several of these restricted accounts to carry a negative balance. In other words, the foundation has spent more on certain activities than the total of the funds donated for that particular activity. This situation is not problematic as long as there are unrestricted funds available to cover the expenditures; however, if unrestricted funds are not available, the foundation may end up spending funds for this purpose that were actually restricted for another purpose by the donor.

The foundation board does not evaluate the restricted accounts appropriately to ensure that this situation is not occurring. As mentioned, all of the restricted accounts and some unrestricted money are accounted for in the checking account. However, due to the negative accounts, the total amount of the money that is still restricted exceeds the checking account balance. The foundation board is even allowing some of the unrestricted accounts accounted for in the checking account to carry a negative balance. In Murfreesboro at June 30, 2003, funds that still have restrictions total $8,708. In Humboldt, the total is $1,833, for a board total of $10,541. This means that the foundation board is required to spend $10,541 in the future for the purposes stated. However, the checking account balance is only $6,675. The $3,866 deficit was created because of $1,976 of negative balances in other restricted accounts and a total $1,890 of negative balances in the miscellaneous and general accounts used to account for unrestricted funds.

Because the foundation still has unrestricted funds in the money market account and the certificates of deposit, the foundation does still have the funds available to meet the intentions of the donors as of June 30, 2003. However, if the foundation continues to allow the accounts to become more and more negative without analyzing the overall cash situation, the funds could be used for purposes for which they were not intended. Currently, the accounts are simply added together, and as long as the total equals the checking account balance and the checking account balance is positive, any problems with negative balances are not revealed.

Issues regarding the use of the foundation's funds were also noted. According to the minutes from the foundation board meeting held February 27, 2003, "The Murfreesboro facility requested the purchase of uniforms for the Activity Department. The amount shall not exceed $500 . . ." However, three different purchase orders were issued and paid totaling $714.57. Approval from the board was not obtained for the additional funds spent.

The minutes from the foundation board meeting held February 27, 2003, also approved a request for $300 to be spent on a gift cart. The check was made payable to the Activities Director at the Humboldt facility on March 5, 2003. Of the $300.00 available, $255.50 was spent on gifts to be included in the gift cart. A final accounting of the funds spent was not made until June 16, 2003, when the remaining balance of $44.50 was supposedly placed in the facility's petty cash fund, more than three months after the check was initially written. As controls surrounding petty cash are inadequate (see finding 15), it was not possible for board employees to assert whether the funds were actually deposited into the facility's petty cash. As no mention of a decision to donate the unspent excess of $44.50 is made in the minutes to the foundation's board meetings, this transaction does not appear to have been approved by the board of the foundation. Board employees' having possession of foundation funds for an extended period of time also demonstrates a lack of control over cash advances for purchases. When cash advances are not controlled, foundation funds could be misappropriated by the employees involved.

Recommendation

The foundation board should not allow the restricted accounts to become negative. If the foundation board chooses to spend more on a restricted activity than the amount that was received by donors, the accountant should first ensure that additional funds are available in the unrestricted accounts and then should record the excess in the unrestricted accounts. The unrestricted accounts should never be allowed to become negative as this is indicative of the fact that there are no unrestricted funds available for use. If the foundation board considers the funds in the money market account and CDs as unrestricted funds that are available for use, then these accounts should be included in the account analysis instead of simply using the checking account total for the restricted and unrestricted funds.

Additional approvals should be required and obtained when the amounts spent exceed the amounts approved by the foundation board. Any cash advanced for foundation purposes should be accounted for in a timely manner, and any funds not used should be returned to the foundation board's account.

Management's Comment

We concur that the reports provided to the foundation board during fiscal year ending June 30, 2003 did not include all funds for restricted and unrestricted use.

We do not concur that negative balances were not revealed on the report. Each restricted use of funds was shown separately with individual balances. Reporting to the foundation board has been modified, however, to show a more complete picture of total activity and accountability. This allows the foundation board to monitor expenses and gives notice of any variations from the allocations. Unused monies are returned to the unrestricted fund and aids in preventing monies to be overspent.

Auditor's Comment

Negative balances are indeed shown on the subsidiary ledger; however, as stated in the finding, problems with those balances are not revealed. Analyses of the total restrictions outstanding compared to the cash balances were not performed and such problems were not acknowledged. There is a risk that the foundation board may overspend unrestricted funds without realizing it. Such situations do occur and the foundation board should be more careful in addressing this risk.

12. Bank accounts are not in compliance with Section 9-4-302, *Tennessee Code Annotated*, and Department of Finance and Administration Policy 07

Finding

The Tennessee State Veterans' Board failed to comply with Section 9-4-302, *Tennessee Code Annotated*, and the Department of Finance and Administration's Policy 07. The board is allowed to establish bank accounts under Section 58-7-108, *Tennessee Code Annotated*. However, it may do so only pursuant to Section 9-4-302, which states,

> Whenever the satisfactory conduct of the state's business clearly demands it, and not otherwise, the commissioner of finance and administration, with the approval of the governor and the state treasurer, may authorize establishment of an account in the name of a state department or agency in a state depository.

Under the authority granted by Title 9, Chapter 4, *Tennessee Code Annotated*, the Department of Finance and Administration, in conjunction with the Department of Treasury, developed Policy 07. Policy 07 states that departmental bank accounts "are established in accordance with T.C.A. 9-4-302 when authorized by the Commissioner of Finance and Administration, upon the approval of the Governor and Treasurer" and lists four categories of departmental bank accounts: imprest accounts, operating accounts, trust and agency accounts, and benefit accounts. When a state entity wishes to establish a departmental bank account, the request should be made in writing to the Commissioner of Finance and Administration and must include certain information. This information includes the purpose or justification for the account, the type of account, and the name and address of the financial institution where the account is to be held. Furthermore, Section 07-02-203 of Department of Finance and Administration Policy 07 states that after a departmental bank account is approved, any changes to the information previously mentioned " . . . shall be immediately communicated to the Division of Accounts, which will in turn communicate such information to the Comptroller of the Treasury."

Both the Humboldt facility and the Murfreesboro facility maintain several bank accounts, as well as at least one petty cash account at each facility. Bank accounts and petty cash accounts at each facility were tested for compliance with Section 9-4-302, *Tennessee Code Annotated*, and Department of Finance and Administration Policy 07.

During the year ended June 30, 2003, the Humboldt facility maintained 17 bank accounts and 2 petty cash accounts. Of those accounts, 11 of the bank accounts (65%) and one of the petty cash accounts (50%) do not appear to be authorized according to Section 9-4-302, *Tennessee Code Annotated*. In addition, changes to 5 bank accounts (29%) were not reported to the Department of Finance and Administration as required by Policy 07. In total, 17 of 19 accounts (89%) were not in compliance with Section 9-4-302, *Tennessee Code Annotated*, and/or Department of Finance and Administration Policy 07.

During the year ended June 30, 2003, the Murfreesboro facility maintained 10 bank accounts and 2 petty cash accounts. Of those accounts, 7 of the bank accounts (70%) and one of the petty cash accounts (50%) do not appear to be authorized according to Section 9-4-302, *Tennessee Code Annotated*. In addition, changes to one of the bank accounts (10%) were not reported to the Department of Finance and Administration as required by Policy 07. In total, 9 of 12 accounts (75%) were not in compliance with Section 9-4-302, *Tennessee Code Annotated*, and/or Department of Finance and Administration Policy 07.

Recommendation

The Financial Director should ensure that all departmental bank accounts and petty cash accounts held by each facility are in compliance with Section 9-4-302, *Tennessee Code Annotated*. Approval must be obtained as soon as possible for those accounts that have not already been authorized by the Commissioner of Finance and Administration. In addition, if the board determines that additional accounts are needed in the future, the Financial Director must ensure that the purpose behind the new account is approved. The Financial Director should also ensure that any changes to those accounts are communicated in writing to the Department of Finance and Administration immediately.

Management's Comment

We concur that bank accounts maintained at the facilities were not submitted to the Department of Finance and Administration for its approval. This area has been addressed in fiscal year 2005. Any changes in bank accounts shall be communicated in writing to the Department of Finance and Administration.

13. <u>The board has failed to implement a Title VI plan</u>

Finding

Title VI of the Civil Rights Act of 1964 requires all state agencies receiving federal money to implement plans to ensure that no person is discriminated against based on race, color, or national origin. Section 4-21-901, *Tennessee Code Annotated*, requires that each applicable agency develop a Title VI implementation plan. Each agency is also required to submit annual compliance reports and any updates to the implementation plan to the department of audit by June 30 of each year. The board is subject to Title VI as well as Section 4-21-901, *Tennessee Code Annotated*. For the period under audit, the board has not complied with the state law.

While the board does have a policy published in its annual report submitted to the Governor stating that it has "agreed to comply with the provisions of the Civil Rights Act of 1964 . . . and all requirements imposed," it does not have a written implementation plan to ensure compliance with that policy. Until July 22, 2004, the board did not specify an individual to be responsible for Title VI compliance. In addition, an annual compliance report has never been submitted to the department of audit as of June 30, 2004.

Recommendation

The board should ensure that an implementation plan is developed immediately. The board should also ensure that a responsible person is recognized as Title VI Coordinator. The board should ensure that any complaints related to Title VI are forwarded to appropriate personnel and handled timely. The board should ensure that the annual compliance report is submitted on or before June 30 to the department of audit.

Management's Comment

We concur that there was no written Title VI policy for fiscal year 2003. This has been addressed in fiscal year 2005. The written plan was sent to the Tennessee Title VI Compliance Commission on October 4, 2004. We, as yet, have not been notified that the plan has been approved. The board appointed the Executive Director as the Title VI Coordinator. The Title VI Coordinator is responsible for the annual compliance report that is to be submitted to the department of audit by June 30th of each year.

14. <u>For the fifth consecutive year, the facilities could not substantiate that they had received all goods and services paid for</u>

Finding

As noted in the prior four audits, internal control for payables is not adequate. The board has concurred with the finding and recommendation each year and promised corrective action. In response to the most recent finding, the board stated that compliance had been ensured as of November 1, 2003. However, during the year audited, verification of receipt was still not consistently documented.

Seven of 32 disbursements tested for the year ended June 30, 2003, (22%) did not have an employee's initials or signature and date as evidence of receipt. If the receipt of goods and services is not documented and payments are made without proper documentation, 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 Financial Director should ensure that the appropriate personnel receive the goods or services and that they comply with the policy requiring verification and documentation of receipt.

Management's Comment

We concur with the finding of this component of the purchasing cycle. Employee education shall be conducted in fiscal year 2005. This was addressed in management's response to Audit Finding 7.

15. <u>Petty cash policies are still inadequate and are still not being followed</u>

Finding

As noted in the prior three audits, the petty cash policy is not sufficient. And the policies and procedures that have been adopted are not being followed. In response to the prior audit finding, the board stated that petty cash policies had been revised to include what types of purchases are appropriate. In addition, management stated that the board would review the recommendations provided by the auditors for inclusion in the existing policy. However, many of the problems that existed with the former policy were not remedied with the revised policy. In addition, the revised policy actually removed the few controls that were included in the former policy. The policies, the former as well as the revised, do not require adequate internal control over petty cash.

In response to the finding from the audit of the fiscal year ending June 30, 2001, the board revised the petty cash policy. This policy was adopted as of August 2, 2001, and was in effect until February 27, 2003. This policy did 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 Murfreesboro from July 1, 2002, and during the time in which this policy was in effect, petty cash was used to purchase meals at local restaurants of at least $1,380, to replace funds allegedly stolen from residents by employees or other residents ($30), for gifts to employees and to reward employees with cash prizes ($342), to purchase cigarettes for residents ($14), to purchase gas for the facility's van even though the facility maintains an account with Fuelman ($485), and other questionable expenses ($230). At Humboldt, petty cash was used to replace funds allegedly stolen from residents by employees or other residents ($74), to purchase numerous lunches for staff members ($695), to purchase gifts or cash prizes for employees ($580), and to cover trips to the laundromat without receipts ($402). 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 expenses, the petty cash could be used for activities that are outside the mission and authority of the board.

In response to the prior-year finding, a revised petty cash policy was approved on February 27, 2003. This revised policy did list several items that the board would consider appropriate items for reimbursement from petty cash. However, the last item of the list is "Any other unforeseen expenditures as deemed appropriate by Administration." The policy fails to define those individuals who are included in the administration or to incorporate any additional controls for those expenditures. The specific items listed as appropriate included activity trips, activity supplies, groceries, emergency maintenance, and dues and fees. However, numerous instances of food for employees, gifts, and even a baby shower for an employee were noted after this policy was approved.

In addition, neither policy in effect during the audit period addresses the process for altering a petty cash receipt, the method of recording the expense account for the purchase, or the need for signatures of the custodian and the receiver of the petty cash. Without the requirement of the receiver initialing an alteration of information such as the amount on the petty cash receipt, the amounts could be altered by the person disbursing cash, increasing the risk of theft. Recording errors have been made because of the lack of guidance for coding the expenses related to petty cash disbursements. Also, if signatures are not obtained from both the employee receiving reimbursement from the petty cash fund and the custodian disbursing such funds, a disbursement could be made without knowledge of the custodian as there is no prior approval required for petty cash disbursements. One instance was noted at the Murfreesboro facility in which there was no signature on the receiver line. There was no indication of who actually received the cash.

The petty cash policies and procedures that have been adopted were not followed. Both policies in effect during the audit period indicate that petty cash disbursements should not exceed $50. Purchases greater than these amounts must go through accounts payable. However, 16 petty cash vouchers at the Murfreesboro facility did not comply with these policies and exceeded the limit by as much as $159. The policies do indicate that, with the administrator's signature, emergency purchases may exceed the limit. However, these purchases included food for employees, fishing trips for residents, flower arrangements, and prizes for employees. These purchases do not appear to be emergency purchases. In addition, one instance of possible invoice-splitting, a method to avoid the additional approvals necessary had the employee initiated the payment through the accounts payable process, was noted at the Murfreesboro facility. Two payments were made for one fishing trip. A disbursement was made but had no receipts supporting the disbursement. A few days later, a second disbursement was made with the description "2nd installment - fishing and picnic lunch" and had receipts supporting the total of the two disbursements.

In addition, both policies state that each disbursement must have a sales receipt to support withdrawals from petty cash. Eight petty cash receipts tested at the Murfreesboro facility totaling $219 and 22 petty cash receipts tested at the Humboldt facility totaling $726 did not have sales receipts to support the withdrawals.

The policy in effect for the majority of the audit period stated that cash advances for supplies must have the administrator's signed approval and the employee must sign a receipt for money advanced. Upon the employee's return, the sales receipt is to be attached to the petty cash receipt with the exact amount of change returned noted on the petty cash receipt. Thirty-six petty cash advances totaling $1,106 did not have the appropriate information accompanying the petty cash receipts. The policy adopted in February 2003 no longer requires the administrator's approval.

The policy in effect during the majority of the audit period stated that a petty cash reconciliation form is to be used to document the replenishment of petty cash and this form is to be reviewed and documented by the administrator. At Humboldt, no reconciliation form was utilized for petty cash replenishments. There was also no evidence of any type of reconciliation being performed. At Murfreesboro, several reconciliations did not have evidence of the administrator's review. Six reconciliations were signed by the business office manager with the notation that she signed them per the administrator. The seventh reconciliation contained no approval at all.

In addition to the reconciliations not being performed for the replenishment of petty cash, the petty cash replenishment amounts were not correct. At the Humboldt facility, two reimbursements were for different amounts than the sum of the applicable receipts. These two instances appeared to simply be small recording errors, but the errors would have been discovered had a reconciliation been performed. One instance was also noted in which the Tennessee State Veterans' Home Foundation approved a particular purchase and wrote a check to the activities director at the Humboldt facility. When the purchase did not require the entire amount that had been approved by the foundation board, the balance was supposedly deposited into the facility's petty cash. However, with no reconciliation, it could not be determined whether this actually happened.

The petty cash policy in effect until February 27, 2003, also stated, "On a weekly basis the A/P clerk will request a check to replenish petty cash." Both facilities performed reimbursements at various times. The Murfreesboro facility appeared to perform reimbursements on a monthly basis. The basis on which the Humboldt facility reimbursed petty cash could not be determined. The time between reimbursements ranged from 11 days to 47 days.

The policy that was implemented in February 2003 removed any time frame requirements and most reconciliation policies. It merely states that the fund should be replenished "as needed." There is now no requirement for a daily reconciliation of petty cash on hand included in the policy. The revised policy also does not indicate who has the responsibility for the reconciliations that do occur. The policy only states that "[s]omeone independent of the Payroll Office is responsible for reconciling the cash on hand." No particular form or method is mentioned for reconciling petty cash. Also, no review of the reconciliation is required.

Policies are necessary to establish internal control over petty cash. The policies that were implemented are important to establish that control, and more policies are needed. Petty cash disbursements for the year totaled over $9,000. When the policies are not followed, the fund may be used for purposes for which it was not intended. Without proper reconciliations and replenishments, errors and fraud within the fund could occur and go unnoticed.

Recommendation

The board should modify the petty cash policy to address receipt alterations, coding of expense accounts, and signature requirements for disbursements. What is considered an appropriate purchase should be clarified, and cash advance policies should be reexamined. Reconciliation policies should be revised to assign responsibility for the reconciliations and to require periodic reconciliations and approvals. The administrators should ensure that existing petty cash policies and procedures are followed. The Financial Director should take action to ensure that reasonable controls are in place related to the petty cash fund. Employees should not use the petty cash fund to avoid obtaining approvals that would otherwise be required for potentially questionable expenses. Disbursements should not exceed the purchase limit of $50 except in emergencies. Sales receipts should be submitted for all applicable purchases, and cash advance forms should be used as intended. Reconciliations should be performed and reviewed before replenishment. Overages and shortages should be documented and large differences investigated.

Management's Comment

We concur. Petty cash accounts at both facilities have been closed in fiscal year 2005.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

Independent Auditor's Report

June 25, 2004

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

Dear Mr. Morgan:

We have audited the accompanying statements of net assets of the Tennessee State Veterans' Homes Board, a component unit of the State of Tennessee, as of June 30, 2003, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the board's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

Except as discussed in the following paragraph, we conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 that our audit provides a reasonable basis for our opinion. Tennessee statute entrusts certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving the plan of operation for the Tennessee State Veterans' Homes Board, participating in the negotiation and procurement of certain services for the board, and managing the bonds of the State of Tennessee.

Management has not researched and corrected errors in accounts receivable resulting from manual and information system errors, and management was unable to support certain receivables. The amount by which these errors would affect the amount of receivables and net assets recorded, as well as the classification of receivables by payor is not reasonably determinable.

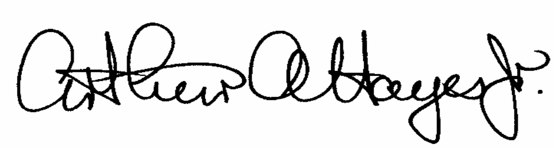
In our opinion, except for the effects of the unsupported and misclassified receivable balances as discussed in the previous paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee State Veterans' Homes Board as of June 30, 2003, and the changes in its financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Tennessee State Veterans' Homes Board has not presented the management's discussion and analysis section that accounting principles generally accepted in the United States of America have determined is necessary to supplement, although not required to be part of, the basic financial statements. The schedule of Pension Funding Progress on page 80 is not a required part of the basic financial statements but is supplementary information also required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements, taken as a whole. The accompanying financial information on pages 81 through 86 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 audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 25, 2004, 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., CPA
Director

AH/cj

Exhibit A

Tennessee State Veterans' Homes Board
Statement of Net Assets
June 30, 2003

Assets:		
Current assets:		
Cash (Note 2)	$	2,536,905.14
Investments (Note 2)		28,591.79
Resident accounts receivable, net of allowance for doubtful accounts of $1,701,233 (Note 3)		417,891.92
Medicare cost settlement receivable		280,044.89
Inventories		63,101.00
Prepaid items		8,968.87
Restricted cash (Notes 2, 5)		335,693.45
Total current assets		3,671,197.06
Noncurrent assets:		
Restricted cash (Notes 2, 5)		1,150,700.14
Unamortized bond issuance costs		98,797.67
Capital assets (Note 6):		
Land and improvements		252,102.00
Infrastructure		676,338.00
Accumulated depreciation-infrastructure		(251,211.95)
Buildings and improvements		10,344,636.97
Accumulated depreciation - buildings and improvements		(2,377,226.52)
Furniture and equipment		1,882,346.60
Accumulated depreciation - furniture and equipment		(1,163,885.47)
Construction in progress		45,733.22
Total noncurrent assets		10,658,330.66
Total assets		14,329,527.72

Tennessee State Veterans' Homes Board
Statement of Net Assets
June 30, 2003

Liabilities:		
Current liabilities:		
Accounts payable and accruals (Note 7)		806,281.94
Due to primary government (Note 4)		426,173.72
Checks payable		16,610.77
Amounts held in custody for others		109,571.87
Medicaid current financing		293,671.82
Bonds payable (Note 8)		180,000.00
Loan from the State of Tennessee		20,000.00
Total current liabilities		1,852,310.12
Noncurrent liabilities:		
Bonds payable, net of unamortized discount (Note 8)		4,219,934.16
Loan from the State of Tennessee (Note 8)		130,000.00
Total noncurrent liabilities		4,349,934.16
Total liabilities		6,202,244.28
Net Assets:		
Invested in capital assets, net of related debt		4,858,898.69
Restricted for:		
Debt service		613,501.44
Repairs and replacements		635,775.72
Foundation activities		10,541.07
Unrestricted		2,008,566.52
Total net assets	$	8,127,283.44

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

Exhibit B

Tennessee State Veterans' Homes Board
Statement of Revenues, Expenses, and Changes in Net Assets
For the Year Ended June 30, 2003

Operating revenue:	
Resident service revenue less contractual adjustments of $53,213.24 and bad debts of $238,580.33	$ 12,027,683.28
Total operating revenue	12,027,683.28
Operating expenses:	
Administrative and general	1,992,356.58
Nursing services	5,147,262.03
Central services	296,501.81
Ancillary departments	965,670.22
Dietary	1,009,384.14
Activities	175,659.83
Social services	155,071.56
Housekeeping services	487,198.76
Laundry and linens	179,274.09
Plant operations and maintenance	658,222.56
Depreciation	421,859.46
Total operating expenses	11,488,461.04
Operating income	539,222.24

Tennessee State Veterans' Homes Board
Statement of Revenues, Expenses, and Changes in Net Assets
For the Year Ended June 30, 2003

Nonoperating revenues (expenses):	
Interest revenue	61,151.00
Miscellaneous revenue	39,152.81
Interest expense	(318,208.86)
Amortization of discounts and issuance costs	(8,846.88)
Loss on disposal of equipment	(10,170.74)
Miscellaneous expense	(32,432.60)
Total nonoperating revenues (expenses)	(269,355.27)
Increase in net assets	269,866.97
Net Assets, July 1	7,857,416.47
Net Assets, June 30	$ 8,127,283.44

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

Exhibit C

Tennessee State Veterans' Homes Board
Statement of Cash Flows
For the Year Ended June 30, 2003

Cash flows from operating activities:		
Receipts from residents and third party payors	$	12,749,376.90
Other miscellaneous receipts		5,734.96
Payments to service providers and vendors		(4,608,677.30)
Payments to employees		(6,887,624.86)
Other miscellaneous payments		(20,361.55)
Net cash provided by operating activities		1,238,448.15
Cash flows from noncapital financing activities:		
Principal paid on loan from the State of Tennessee		(10,000.00)
Negative cash balance implicitly financed		4,052.50
Foundation donations		33,417.85
Expenses paid by the foundation		(32,632.75)
Net cash used for noncapital financing activities		(5,162.40)
Cash flows from capital and capital-related financing activities:		
Purchase of capital assets		(265,805.29)
Principal paid on bonds		(170,000.00)
Interest paid on bonds		(319,187.50)
Net cash used for capital and capital-related financing activities		(754,992.79)
Cash flows from investing activities:		
Interest received		60,345.28
Net cash provided by investing activities		60,345.28
Net increase in cash		538,638.24
Cash, July 1		3,484,660.49
Cash, June 30	$	4,023,298.73

Tennessee State Veterans' Homes Board
Statement of Cash Flows
For the Year Ended June 30, 2003

Reconciliation of operating income to net cash provided by operating activities:

Operating income	$	539,222.24
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation		421,859.46
Miscellaneous receipts		5,734.96
Decrease in net resident accounts receivable		100,067.52
Decrease in due from primary government		87,163.63
Increase in Medicare cost settlement receivable		(5,336.13)
Increase in inventories		(12,924.50)
Decrease in prepaid items		72,148.90
Decrease in noncapital accounts payable and accruals		(159,109.82)
Increase in due to primary government		85,911.26
Decrease in amounts held in custody for others		(20,361.55)
Increase in Medicaid current financing		124,072.18
Total adjustments		699,225.91
Net cash provided by operating activities:	$	1,238,448.15

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

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, 2003, two facilities, located in Murfreesboro and Humboldt, were operating. The ten-member board has appointed an executive director 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's 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.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

The Tennessee State Veterans' Homes Board distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services in connection with principal ongoing operations. The board's principal operation is to provide support and care for honorably discharged veterans who served in the United States armed services. Any revenues and expenses not meeting this definition would be reported as nonoperating revenues and expenses.

The effects of internal activity between the individual facilities and between the facilities and the foundation have been eliminated. When the board has both restricted and unrestricted resources available to finance a particular activity, it is the board's policy to use restricted resources before unrestricted resources.

D. Cash

Cash is defined as cash on hand and demand deposits. In addition to petty cash, facility bank accounts, and foundation bank accounts, cash includes funds held with a trustee. The unrestricted portion of the trustee funds included funds available for use for board operations through the budget process.

E. Investments

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

F. Inventories

Medical, dietary, and housekeeping supplies are recorded as expenses when purchased. Inventories are determined by physical count and are valued at replacement cost. This valuation is not materially different from historical cost.

G. 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. Other assets are the property of the homes' residents and are likewise classified as restricted assets.

H. Capital Assets and Depreciation

Capital assets are defined as assets with a useful life of at least 2 years and with a value of at least $100. Capital assets are recorded at cost and are depreciated on a straight-line basis over the estimated useful lives of the assets. Donated capital 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. All capital assets other than land are depreciated using the straight-line method using these asset lives:

Infrastructure	8 to 40 years
Buildings and building improvements	5 to 40 years
Furniture and equipment	3 to 20 years

I. Checks Payable

This amount represents the sum of checks written in excess of the board's checking account balance.

J. 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.

NOTE 2. DEPOSITS AND INVESTMENTS

At June 30, 2003, the carrying amount of the board's deposits was $355,306.13, and the bank balance was $551,916.70. The entire bank balance and investment balance at June 30, 2003 were considered insured by FDIC or were 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.

For 3 days of the year, bank balances were neither insured nor collateralized. The amounts that were not insured or collateralized ranged from $30,000 to $69,414.

The board also had $3,665,942.06 deposited in the Local Government Investment Pool (LGIP) administered by the State Treasurer and $2,050.54 of petty cash on hand. 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*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 3. ACCOUNTS RECEIVABLE

Receivables at June 30, 2003, consist of the following:

Receivables from patients and their insurance	$1,565,582.42
Receivable from Medicare	336,695.49
Receivable from U.S. Department of Veterans Affairs	216,847.01
Allowance for doubtful accounts	(1,701,233.00)
Net amount reported as resident accounts receivable	$ 417,891.92

The net receivable amount of $417,891.92 represents accounts receivable that are expected to be collected within one year.

NOTE 4. DUE TO PRIMARY GOVERNMENT

Due To:

Department of Finance and Administration–Medicaid current services less void adjustments	$ 49,994.38
Department of Finance and Administration–Medicaid overpayments occurring before 1994	282,062.42

Department of Finance and Administration – insurance premiums	18,056.06
Department of Health – bed tax	44,500.00
Department of the Treasury–retirement contributions	23,730.93
Department of Labor and Workforce Development– unemployment taxes	7,508.23
Department of Human Services – child support payments	321.70
Total due to primary government	$ 426,173.72

The amount Due from Primary Government, Department of Finance and Administration–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, 2003, the receivable from Medicaid is $639,561.28, and the estimated payable to Medicaid for void adjustments is $689,555.66.

The amount Due to Primary Government, Department of Finance and Administration–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 5. RESTRICTED ASSETS

The balances of the board's restricted asset accounts at June 30, 2003, are as follows:

Resident trust fund accounts	$109,571.87
Revenue bond debt service accounts	226,121.58
Revenue bond debt service reserve accounts	514,924.42
Revenue bond repair and replacement accounts	635,775.72
Total restricted assets	$1,486,393.59

NOTE 6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2003 was as follows:

	Beginning	Additions	Retirements	Ending
Capital assets, not being depreciated:				
Land and improvements	$252,102.00	$ -	$ -	$252,102.00
Construction in progress	-	45,733.22	-	45,733.22
Total capital assets, not being depreciated	252,102.00	45,733.22	-	297,835.22
Capital assets, being depreciated:				
Infrastructure	676,338.00	-	-	676,338.00
Buildings and improvements	10,330,008.66	15,278.31	(650.00)	10,344,636.97
Furniture and equipment	1,754,942.28	198,849.06	(71,444.74)	1,882,346.60
Total depreciable capital assets	12,761,288.94	214,127.37	(72,094.74)	12,903,321.57
Less accumulated depreciation:				
Infrastructure	(224,984.27)	(26,227.68)	-	(251,211.95)
Buildings and improvements	(2,105,298.78)	(272,171.49)	243.75	(2,377,226.52)
Furniture and equipment	(1,101,914.58)	(123,460.29)	61,489.40	(1,163,885.47)
Total accumulated depreciation	(3,432,197.63)	(421,859.46)	61,733.15	(3,792,323.94)
Total depreciable capital assets, net	9,329,091.31	(207,732.09)	(10,361.59)	9,110,997.63
Net capital assets	$9,581,193.31	($161,998.87)	($10,361.59)	$9,408,832.85

NOTE 7. ACCOUNTS PAYABLE AND ACCRUALS

Payables at June 30, 2003, consist of the following:

Payables to suppliers	$ 308,133.74
Accruals for salaries and benefits	370,603.64
Accrued interest	127,544.56
Amount reported as accounts payable and accruals	$ 806,281.94

NOTE 8. LONG TERM LIABILITIES

Long term debt activity for the year ended June 30, 2003 was as follows:

	Beginning	Additions	Reductions	Ending
Bonds payable:				
Series 1989	$1,656,137.31	-	($102,939.96)	$1,553,197.35
Series 1994	2,741,266.89	-	(74,530.08)	2,666,736.81
Total	4,397,404.20	-	(177,470.04)	4,219,934.16
Loan from the State of Tennessee	140,000.00	-	(10,000.00)	130,000.00
Total long term liabilities	$4,537,404.20	-	($187,470.04)	$4,349,934.16

The board received a $200,000 loan from the State of Tennessee to be repaid from excess revenues from the operations of the Murfreesboro facility. No interest is accrued. Payments of $10,000 are made yearly. The $10,000 due for the year ended June 30, 2003, was not paid until July 2003.

Total bonds payable consisted of the following:

	June 30, 2003
Revenue bonds, Series 1989, 7.4% to 7.5% due from 2003 to final maturity in 2014 (net of unamortized discount of $21,802.65 for 2003)	$1,658,197.35
Revenue bonds, Series 1994, 5.8% to 6.75% due from 2003 to final maturity in 2021 (net of unamortized discount of $8,263.19 for 2003)	2,741,736.81
Total bonds payable	$4,399,934.16

Debt-service requirements to maturity of the bonds payable at June 30, 2003, are as follows:

For the Year(s) Ended June 30	Principal	Interest	Total
2004	$ 180,000.00	$ 307,807.50	$ 487,807.50
2005	210,000.00	295,612.50	505,612.50
2006	220,000.00	281,472.50	501,472.50
2007	230,000.00	266,492.50	496,492.50
2008	240,000.00	250,222.50	490,222.50
2009 – 2113	1,535,000.00	961,500.00	2,496,500.00
2114 – 2118	1,115,000.00	490,162.50	1,605,162.50
2119 – 2021	700,000.00	48,937.50	748,937.50
	$4,430,000.00	$2,902,207.50	$7,332,207.50

NOTE 9. 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 five years of service, and members joining prior to July 1, 1979, were vested after four 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 the 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, Consolidated 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.

The Tennessee State Veterans' Homes Board is required to contribute at an actuarially determined rate; the rate for the fiscal year ended June 30, 2003, was 8.09% 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 ended June 30, 2003, Tennessee State Veterans' Homes Board's annual pension cost of $307,385 to TCRS was equal to the board's required and actual contributions. The required contribution was determined as part of the July 1, 2001, 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 annual salary increases of 4.75% (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries), (c) projected 3.5% 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.

Three-Year Trend Information

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 2003	$307,385	100.00%	-
June 30, 2002	$291,991	100.00%	-
June 30, 2001	$253,967	100.00%	-

NOTE 10. 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 $10,809,100 for the buildings and $1,575,600 for the contents.

   The state purchases commercial insurance for real property, flood, earthquake, and builder's risk losses and surety bond coverage on the state's officials and employees. The insurance policy deductibles vary from $1 million to $5 million by type of risk coverage. A designation of $3.271 million for incurred losses has been established in the State of Tennessee general fund.

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 BlueCross BlueShield of Tennessee or Aetna 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 BlueCross BlueShield of Tennessee and Aetna.

NOTE 11. SUBSEQUENT EVENTS

The State of Tennessee has refunded both the Revenue bonds, Series 1989 and the Revenue bonds, Series 1994 with State of Tennessee General Obligation bonds 2003 Series A on September 11, 2003. As a result, the Tennessee State Veterans' Homes Board has a loan payable to the State of Tennessee for the amounts previously reported as bonds payable.

The addition of a third facility in East Tennessee and additions to the current facilities have been approved. Construction on the additions is scheduled to begin in October 2004. Construction on the third facility is scheduled to begin in early 2005.

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]
7/01/01	$1,780	$1,780	$0	100%	$3,048	0%
7/01/99	1,134	1,134	0	100%	2,022	0%
6/30/97	645	645	0	100%	2,191	0%

Changes in Actuarial Assumptions

An actuarial valuation was performed as of July 1, 2001, to establish contribution rates as of July 1, 2002. 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 annual salary increases of 4.75% (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries), (c) projected 3.5% annual increase in the social security wage base, and (d) projected post retirement benefit increases of 3% annually.

Tennessee State Veterans' Homes Board
Supplementary Statement of Net Assets
June 30, 2003

	Murfreesboro	Humboldt	Foundation	Totals
Assets:				
Current assets:				
Cash	$ 977,710.05	$ 1,528,854.05	$ 30,341.04	$ 2,536,905.14
Investments	-	-	28,591.79	28,591.79
Resident accounts receivable, net of allowance for doubtful accounts of $1,701,233	190,369.39	227,522.53	-	417,891.92
Medicare cost settlement receivable	36,051.77	243,993.12	-	280,044.89
Due from Humboldt facility	142,602.57	-	-	142,602.57
Inventories	21,179.20	41,921.80	-	63,101.00
Prepaid items	4,657.40	4,311.47	-	8,968.87
Restricted cash	140,998.60	194,694.85	-	335,693.45
Total current assets	1,513,568.98	2,241,297.82	58,932.83	3,813,799.63
Noncurrent assets:				
Restricted cash	739,204.60	411,495.54	-	1,150,700.14
Unamortized bond issuance costs	18,562.28	80,235.39	-	98,797.67
Capital assets:				
Land and improvements	51,975.00	200,127.00	-	252,102.00
Infrastructure	153,970.00	522,368.00	-	676,338.00
Accumulated depreciation-infrastructure	(118,916.48)	(132,295.47)	-	(251,211.95)
Buildings and improvements	3,962,201.53	6,382,435.44	-	10,344,636.97
Accumulated depreciation - buildings and improvements	(1,181,182.07)	(1,196,044.45)	-	(2,377,226.52)
Furniture and equipment	939,223.87	943,122.73	-	1,882,346.60
Accumulated depreciation - furniture and equipment	(648,473.15)	(515,412.32)	-	(1,163,885.47)
Construction in progress	28,858.22	16,875.00	-	45,733.22
Total noncurrent assets	3,945,423.80	6,712,906.86	-	10,658,330.66
Total assets	5,458,992.78	8,954,204.68	58,932.83	14,472,130.29

Tennessee State Veterans' Homes Board
Supplementary Statement of Net Assets (Cont.)
June 30, 2003

	Murfreesboro	Humboldt	Foundation	Totals
Liabilities:				
Current liabilities:				
Accounts payable and accruals	414,561.93	391,702.05	17.96	806,281.94
Due to primary government	306,299.52	119,874.20	-	426,173.72
Checks payable	-	16,610.77	-	16,610.77
Amounts held in custody for others	23,269.78	86,302.09	-	109,571.87
Medicaid current financing	194,689.01	98,982.81	-	293,671.82
Due to Murfreesboro facility	-	142,602.57	-	142,602.57
Bonds payable	105,000.00	75,000.00	-	180,000.00
Loan from the State of Tennessee	20,000.00	-	-	20,000.00
Total current liabilities	1,063,820.24	931,074.49	17.96	1,994,912.69
Noncurrent liabilities:				
Bonds payable, net of unamortized discount	1,553,197.35	2,666,736.81	-	4,219,934.16
Loan from the State of Tennessee	130,000.00	-	-	130,000.00
Total noncurrent liabilities	1,683,197.35	2,666,736.81	-	4,349,934.16
Total liabilities	2,747,017.59	3,597,811.30	17.96	6,344,846.85
Net Assets:				
Invested in capital assets, net of related deb	1,379,459.57	3,479,439.12	-	4,858,898.69
Restricted for:				
Debt service	299,545.82	313,955.62	-	613,501.44
Repairs and replacements	505,490.50	130,285.22	-	635,775.72
Foundation activities	-	-	10,541.07	10,541.07
Unrestricted	527,479.30	1,432,713.42	48,373.80	2,008,566.52
Total net assets	$ 2,711,975.19	$ 5,356,393.38	$ 58,914.87	$ 8,127,283.44

Tennessee State Veterans' Homes Board
Supplementary Statement of Revenues, Expenses, and Changes in Net Assets
For the Year Ended June 30, 2003

	Murfreesboro	Humboldt	Foundation	Totals
Operating revenue:				
Resident service revenue less contractual adjustments of $53,213.24 and provision for bad debts of $238,580.33	$ 6,126,983.45	$ 5,900,699.83	$ -	$ 12,027,683.28
Total operating revenue	6,126,983.45	5,900,699.83	-	12,027,683.28
Operating expenses:				
Administrative and general	1,001,833.39	990,523.19	-	1,992,356.58
Nursing services	2,763,861.76	2,383,400.27	-	5,147,262.03
Central services	166,184.47	130,317.34	-	296,501.81
Ancillary departments	488,387.81	477,282.41	-	965,670.22
Dietary	504,327.85	505,056.29	-	1,009,384.14
Activities	91,673.69	83,986.14	-	175,659.83
Social services	76,599.41	78,472.15	-	155,071.56
Housekeeping services	254,428.08	232,770.68	-	487,198.76
Laundry and linens	90,468.24	88,805.85	-	179,274.09
Plant operations and maintenance	319,988.62	338,233.94	-	658,222.56
Depreciation	173,884.61	247,974.85	-	421,859.46
Total operating expenses	5,931,637.93	5,556,823.11	-	11,488,461.04
Operating income	195,345.52	343,876.72	-	539,222.24

Tennessee State Veterans' Homes Board
Supplementary Statement of Revenues, Expenses, and Changes in Net Assets (Cont.)
For the Year Ended June 30, 2003

	Murfreesboro	Humboldt	Foundation	Totals
Nonoperating revenue (expenses):				
Interest revenue	28,841.18	31,346.32	963.50	61,151.00
Miscellaneous revenue	1,410.99	4,323.97	33,417.85	39,152.81
Interest expense	(131,077.60)	(187,131.26)	-	(318,208.86)
Amortization of discounts and issuance costs	(3,813.84)	(5,033.04)	-	(8,846.88)
Equipment donation	-	4,140.00	-	4,140.00
Equipment expense	-	-	(4,140.00)	(4,140.00)
Loss on disposal of equipment	(5,866.30)	(4,304.44)	-	(10,170.74)
Miscellaneous expense	-	-	(32,432.60)	(32,432.60)
Total nonoperating revenues (expenses)	(110,505.57)	(156,658.45)	(2,191.25)	(269,355.27)
Increase (decrease) in net assets	84,839.95	187,218.27	(2,191.25)	269,866.97
Net assets, July 1	2,627,135.24	5,169,175.11	61,106.12	7,857,416.47
Net assets, June 30	$ 2,711,975.19	$ 5,356,393.38	$ 58,914.87	$ 8,127,283.44

Tennessee State Veterans' Homes Board
Supplementary Statement of Cash Flows
For the Year Ended June 30, 2003

	Murfreesboro	Humboldt	Foundation	Totals
Cash flows from operating activities:				
Receipts from residents and third party payors	$ 6,531,179.49	$ 6,218,197.41	$ -	$ 12,749,376.90
Other miscellaneous receipts	1,410.99	4,323.97	-	5,734.96
Payments to service providers and vendors	(2,182,050.44)	(2,426,626.86)	-	(4,608,677.30)
Payments to employees	(3,691,316.95)	(3,196,307.91)	-	(6,887,624.86)
Other miscellaneous payments	(12,513.71)	(7,847.84)	-	(20,361.55)
Net cash provided by operating activities	646,709.38	591,738.77	-	1,238,448.15
Cash flows from noncapital financing activities:				
Principal paid on loan from the State of Tennessee	(10,000.00)	-	-	(10,000.00)
Negative cash balance implicitly financed (repaid)	(12,558.27)	16,610.77	-	4,052.50
Foundation donations	-	-	33,417.85	33,417.85
Expenses paid by the foundation	-	-	(32,632.75)	(32,632.75)
Net cash provided by (used for) noncapital financing activities	(22,558.27)	16,610.77	785.10	(5,162.40)
Cash flows from capital and capital-related financing activities:				
Purchase of capital assets	(143,464.44)	(118,200.85)	(4,140.00)	(265,805.29)
Principal paid on bonds	(95,000.00)	(75,000.00)	-	(170,000.00)
Interest paid on bonds	(132,275.00)	(186,912.50)	-	(319,187.50)
Net cash used for capital and capital-related financing activities	(370,739.44)	(380,113.35)	(4,140.00)	(754,992.79)
Cash flows from investing activities:				
Interest received	28,841.18	31,346.32	157.78	60,345.28
Net cash provided by investing activities	28,841.18	31,346.32	157.78	60,345.28
Net increase (decrease) in cash	282,252.85	259,582.51	(3,197.12)	538,638.24
Cash, July 1	1,575,660.40	1,875,461.93	33,538.16	3,484,660.49
Cash, June 30	$ 1,857,913.25	$ 2,135,044.44	$ 30,341.04	$ 4,023,298.73

Tennessee State Veterans' Homes Board
Supplementary Statement of Cash Flows (Cont.)
For the Year Ended June 30, 2003

	Murfreesboro	Humboldt	Foundation	Totals
Reconciliation of operating income to net cash provided by operating activities:				
Operating income	$ 195,345.52	$ 343,876.72	$ -	$ 539,222.24
Adjustments to reconcile operating income to net cash provided by operating activities:				
Depreciation	173,884.61	247,974.85	-	421,859.46
Miscellaneous receipts	1,410.99	4,323.97	-	5,734.96
Decrease in net resident accounts receivable	120,215.61	(20,148.09)	-	100,067.52
(Increase) decrease in due from primary government	88,672.00	(1,508.37)	-	87,163.63
(Increase) decrease in Medicare cost settlement receivable	8,854.20	(14,190.33)	-	(5,336.13)
Decrease in due from Humboldt	7,889.75	-	-	7,889.75
Increase in inventories	(1,451.39)	(11,473.11)	-	(12,924.50)
Decrease in prepaid items	35,820.10	36,328.80	-	72,148.90
Decrease in noncapital accounts payable and accruals	(54,557.97)	(104,551.85)	-	(159,109.82)
Increase (decrease) in due to primary government	(11,612.65)	97,523.91	-	85,911.26
Decrease in amounts held in custody for others	(12,513.71)	(7,847.84)	-	(20,361.55)
Increase in Medicaid current financing	94,752.32	29,319.86	-	124,072.18
Decrease in due to Murfreesboro	-	(7,889.75)	-	(7,889.75)
Total adjustments	451,363.86	247,862.05	-	699,225.91
Net cash provided by operating activities:	$ 646,709.38	$ 591,738.77	$ -	$ 1,238,448.15