AUDIT REPORT

Tennessee State Veterans' Homes Board

For the Year Ended
June 30, 2004

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

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STATE OF TENNESSEE
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John G. Morgan
Comptroller

May 9, 2006

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, 2004. You will note from the independent auditor's report that a qualified opinion was given on the fairness of the presentation of the financial statements due to 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
05/056

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, 2004

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.

AUDIT FINDINGS

INTERNAL CONTROL FINDINGS

The Tennessee State Veterans' Homes Board Has Not Evaluated Fraud Risks and Does Not Have Adequate Policies and Procedures to Address Risks Which the Auditors Have Previously Identified

The auditors have previously identified fraud risks of misappropriation through manipulation of accounts receivable records, theft of equipment or supplies, theft of receipts, inappropriate use of credit, unauthorized purchases, and overstated travel claims. These risks have still not been adequately addressed. There are also risks of fraud related to financial reporting in the areas of accounts receivable, revenue, and equipment that have not been addressed. In addition to these long-standing risks, there are new risks identified in this audit related to payroll payments, cellular phone payments, and foundation funds, and there are other new risks created by the deficient policies and procedures and a lack of organization within the business offices. In addition, the board does not have complete and approved guidelines that address routine accounting functions or ensure compliance with applicable laws and regulations. Often the policies that have been approved by the board are not followed. As a result, the internal control at the board is not sufficient to protect the entity from fraud or misstatements (page 13).

For the Eighth Consecutive Year, Fraud Risks and Financial Statement Distortions Created by Inadequate Accounts Receivable Practices Have Not Been Mitigated**

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 balance includes significant negative balances, some created by Medicaid overpayments that were not appropriately adjusted and some for which the cause is unknown (page 18).

For the Third Consecutive Year, Accounting Records Do Not Portray a True Picture of Receivables, and the Risk of Theft of Resident Funds Was Not Addressed**

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).

For the Eighth Consecutive Year, Management Has Not Addressed the Risk of Theft of Board Capital Assets, and the Capital Assets Records Have Not Been Adequately Maintained**

Management has allowed significant deficiencies to continue to exist in internal control for capital assets. The major, ongoing deficiency noted is the inability of management to correlate the results of physical inventories with accounting records as a result of inadequate accounting records for equipment and inaccurate equipment listings. Other deficiencies contributing to the reporting and accountability problems include the absence of property tags on the equipment items, the undocumented location changes for equipment, donated items that are not recorded on equipment listings or accounting records, and equipment assumed to be surplused without proper approval or investigation (page 26).

For the Third Consecutive Year, Management Has Not Assessed and Mitigated the Risks of Lost Revenues Caused by the Lack of Collection Efforts for Accounts Receivable**

Collection efforts for accounts receivable at the facilities are not adequate. Written procedures to collect receivables are not followed, and actions are not documented (page 33).

The Board Still Did Not Address the Risk of Fraud and for the Second Consecutive Year, Has No Policies and Procedures in Place Regarding the Authorization or Use of Credit Cards and Open Accounts*

As noted in the prior audit, the board does not have adequate controls in place over the use of credit cards and open accounts. The board still has not adopted any policies for credit transactions (page 36).

For the Fifth Consecutive Year, the Board Has Not Addressed the Risk of Unauthorized Purchases**

As noted in the prior four audits, 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, as noted in last year's audit report, contract payments were not always properly invoiced or reviewed (page 40).

For the Sixth Consecutive Year, Management Has Not Assessed and Mitigated the Risk That the Facilities May Pay for Goods Not Received**

The verification of receipt of goods or services was still not consistently documented (page 44).

For the Third Consecutive Year, Because Management Has Not Assessed Risk, Internal Controls for Information Systems Are Not Adequate, Leaving the Board's Records Susceptible to Fraud and Improper Alterations**

Internal controls for information systems are not adequate. Among other weaknesses, access to the system was not controlled and the system reconciliations were not performed (page 49).

Management's Lack of Organization Increases Audit Risks and Is an Impediment to the Audit Process

Management did not retain all documentation necessary for the audit process. Not all documentation was available or readily available, nor was the documentation always complete (page 53).

The Tennessee State Veterans' Homes Board Has Not Segregated Duties Related to Payroll, Leaving the Board Vulnerable to Inappropriate Payroll Payments

The segregation of duties over the payroll function at both facilities does not appear adequate to prevent the possibility of fictitious employees being added to payroll or to prevent other fraudulent payroll activities (page 56).

The Board Paid $5,399 for an Employee's Board-Issued Cellular Phone for Nine Months After the Employee's Resignation

One individual at the Murfreesboro facility continued to use her phone for nine months after her resignation until the accounts payable clerk finally discovered the problem (page 57).

Duties for the Tennessee Veterans Home Foundation Are Not Adequately Segregated to Deter Receipting Fraud, and as Indicated in the Prior Audit, the Improper Accountability for Restricted Foundation Accounts Creates the Risk That Funds Will Not Be Used for Their Intended Purpose*

Most of the financial functions for the foundation are performed by one individual. The lack of independent checks and balances leaves the board exposed to thefts that could occur and go unnoticed. Also, for the second consecutive year, foundation restricted accounts sometimes have a negative balance, and the overall picture related to the restrictions was not analyzed by the foundation during the audit period (page 59).

COMPLIANCE FINDINGS

For the Fourth Consecutive Year, Management Has Not Assessed and Mitigated the Risks Associated With Travel Reimbursements, Resulting in Excessive Reimbursement of Over $1,350**

Board members and employees of the facilities have not completed travel claims in accordance with Comprehensive Travel Regulations, and a duplicate payment was processed (page 46).

The Murfreesboro Facility Had Medicaid Residents With Excessive Resident Trust Fund Balances That Jeopardized Their Medicaid Eligibility

Medicaid residents at the Murfreesboro facility maintained resident trust fund balances in excess of $2,000. The board did not follow its policy to notify the resident and then to notify Medicaid. Medicaid residents with such balances may lose their eligibility for the program (page 62).

The Board and Management Have Not Assessed the Risk of Noncompliance With Internal Revenue Service Regulations and as a Result Have Not Established Adequate Policies and Procedures to Report the Personal Use of the Executive Director's Car

There are no written policies and procedures regarding the car purchased by the board for the Executive Director's use. As a result, the board has not complied with certain Internal Revenue Service regulations (page 63).

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 65).

Bank Accounts Are Still 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 67).

The Board Failed to Submit a Title VI Plan Relating to Compliance With the Civil Rights Act of 1964 in a Timely Manner*

The board was not in compliance with state law regarding the submission of a Title VI implementation plan (page 69).

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

- The Tennessee State Veterans' Homes Board has not evaluated fraud risks and does not have adequate policies and procedures to address risks which the auditors have previously identified
- For the eighth consecutive year, fraud risks and financial statement distortions created by inadequate accounts receivable practices have not been mitigated

- For the third consecutive year, accounting records do not portray a true picture of receivables, and the risk of theft of resident funds was not addressed
- For the eighth consecutive year, management has not addressed the risk of theft of board capital assets, and the capital assets records have not been adequately maintained
- For the third consecutive year, because management has not assessed risk, internal controls for information systems are not adequate, leaving the board's records susceptible to fraud and improper alterations
- Management's lack of organization increases audit risks and is an impediment to the audit process
- The Tennessee State Veterans' Homes Board has not segregated duties related to payroll, leaving the board vulnerable to inappropriate payroll payments

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 misclassified receivable balances.

Audit Report
Tennessee State Veterans' Homes Board
For the Year Ended June 30, 2004

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Tennessee State Veterans' Homes Board
For the Year Ended June 30, 2004

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 Stated 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 its 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 is currently building 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 its management company as of December 1, 2001. The management company employed an Administrator to oversee daily operations of each facility. 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 purchased and implemented a new information system. After this information system was in place and was functioning properly, the board ended its contract with NHC in October 2004.

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

AUDIT SCOPE

The audit was limited to the period July 1, 2003, through June 30, 2004, 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. Financial statements are presented for the year ended June 30, 2004, and for comparative purposes, the year ended June 30, 2003. The Tennessee State Veterans' Homes Board has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report*.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

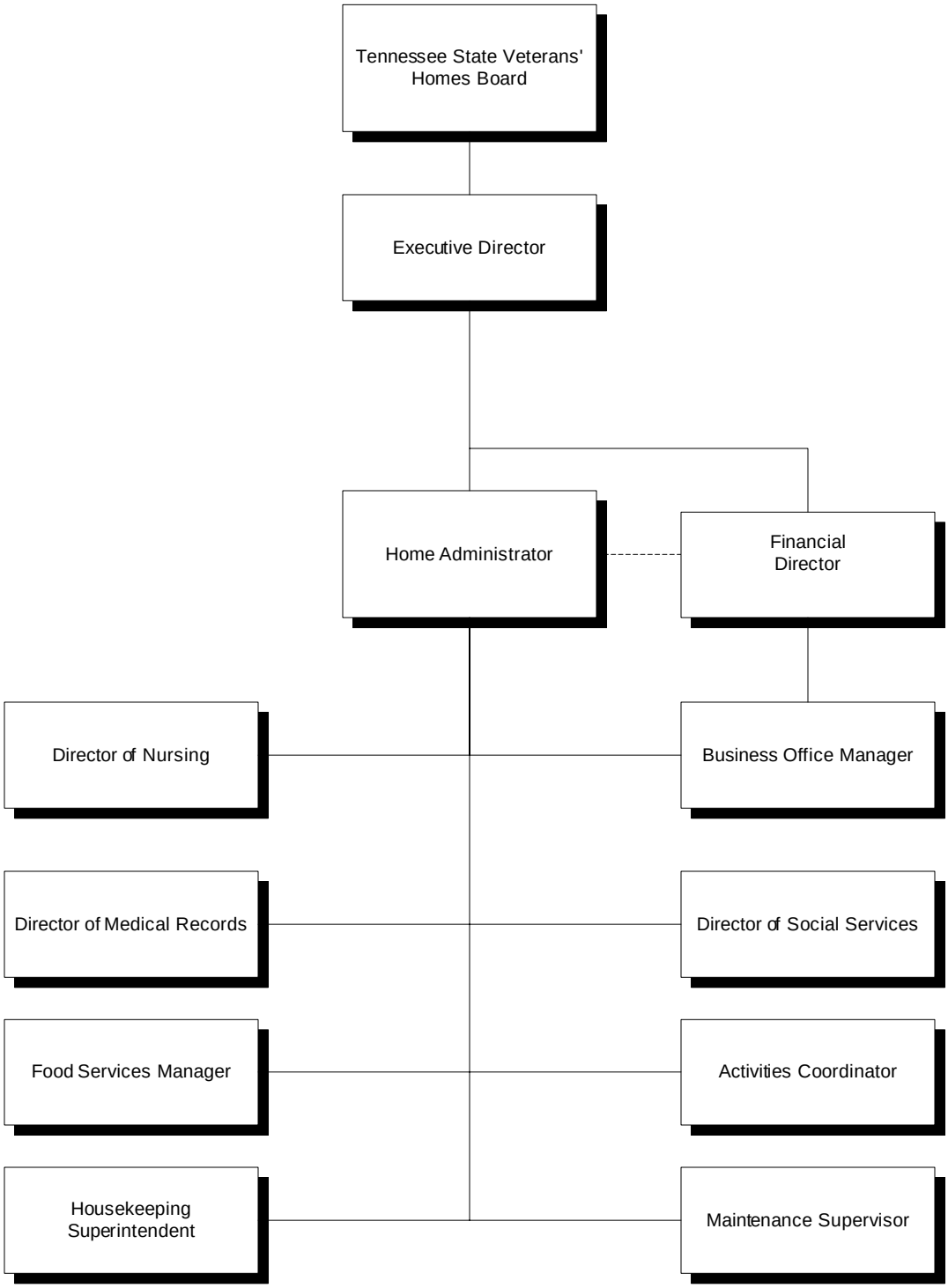
1. to consider the board's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;

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

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

4. to recommend appropriate actions to correct any deficiencies.

TENNESSEE STATE VETERANS' HOMES BOARD



PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The board filed its report with the Department of Audit on June 15, 2005. 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 segregation of duties of the receipting and disbursement functions at the facilities and has closed their petty cash accounts.

REPEATED AUDIT FINDINGS

The prior audit report also contained findings concerning accounts receivable practices, accounting records, collection efforts, controls over capital assets, charges to Medicaid residents, controls over the use of credit, purchasing, controls over information systems, compliance with Comprehensive Travel Regulations, accountability for restricted foundation accounts, compliance with Department of Finance and Administration Policy 07, Title VI, and the receipt of goods and services. These findings have not been resolved and are repeated in this report.

OBSERVATIONS AND COMMENTS

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit*, promulgated by the American Institute of Certified Public Accountants requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.

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 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. In recognition of the benefits of audit committees for government, the Tennessee General Assembly has enacted legislation known as the "State of Tennessee Audit Committee Act of 2005." This legislation requires the creation of audit committees for those entities that have governing boards, councils, commissions, or equivalent bodies that can hire and terminate employees and/or are responsible for the preparation of financial statements. Applicable entities are required to develop an audit committee charter and appoint the audit committee in accordance with the legislation. 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 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'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 the creation of its particular audit committee. There are also other audit committees which have already been established at other state agencies that the board may wish to contact for advice and further information.

EXAMINATION PERFORMED

The Medicaid/TennCare Section of the Division of State Audit has performed an examination of the Tennessee State Veterans' Home – Humboldt and of the Tennessee State Veterans' Home – Murfreesboro for the period July 1, 2002, through June 30, 2003. The results of those examinations have been issued in separate reports.

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, 2004, 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 and Other Matters

The results of our audit tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. Immaterial instances of noncompliance, along with recommendations and management's responses, are included in the findings and recommendations section.

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 misclassified receivable balances.

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Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

June 27, 2005

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, 2004, and have issued our report thereon dated June 27, 2005. Our report was qualified due to 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.

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 an opinion 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 the assertions of management in the financial statements.

The following reportable conditions were noted:

- The Tennessee State Veterans' Homes Board has not evaluated fraud risks and does not have adequate policies and procedures to address risks which the auditors have previously identified

- For the eighth consecutive year, fraud risks and financial statement distortions created by inadequate accounts receivable practices have not been mitigated

- For the third consecutive year, accounting records do not portray a true picture of receivables, and the risk of theft of resident funds was not addressed

- For the eighth consecutive year, management has not addressed the risk of theft of board capital assets, and the capital assets records have not been adequately maintained

- For the third consecutive year, management has not assessed and mitigated the risks of lost revenues caused by the lack of collection efforts for accounts receivable

- The board still did not address the risk of fraud and for the second consecutive year, has no policies and procedures in place regarding the authorization or use of credit cards and open accounts

- For the fifth consecutive year, the board has not addressed the risk of unauthorized purchases

- For the sixth consecutive year, management has not assessed and mitigated the risk that the facilities may pay for goods not received

- For the third consecutive year, because management has not assessed risk, internal controls for information systems are not adequate, leaving the board's records susceptible to fraud and improper alterations

- Management's lack of organization increases audit risks and is an impediment to the audit process

- The Tennessee State Veterans' Homes Board has not segregated duties related to payroll, leaving the board vulnerable to inappropriate payroll payments

- The board paid $5,399 for an employee's board-issued cellular phone for nine months after the employee's resignation

- Duties for the Tennessee Veterans Home Foundation are not adequately segregated to deter receipting fraud, and as indicated in the prior audit, the improper accountability for restricted foundation accounts creates the risk that funds will not be used for their intended purpose

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

A material weakness is a reportable 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 caused by error or fraud 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.

- The Tennessee State Veterans' Homes Board has not evaluated fraud risks and does not have adequate policies and procedures to address risks which the auditors have previously identified

- For the eighth consecutive year, fraud risks and financial statement distortions created by inadequate accounts receivable practices have not been mitigated

- For the third consecutive year, accounting records do not portray a true picture of receivables, and the risk of theft of resident funds was not addressed

- For the eighth consecutive year, management has not addressed the risk of theft of board capital assets, and the capital assets records have not been adequately maintained

- For the third consecutive year, because management has not assessed risk, internal controls for information systems are not adequate, leaving the board's records susceptible to fraud and improper alterations

- Management's lack of organization increases audit risks and is an impediment to the audit process

- The Tennessee State Veterans' Homes Board has not segregated duties related to payroll, leaving the board vulnerable to inappropriate payroll payments

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

Compliance and Other Matters

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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. We did, however, note certain immaterial instances of noncompliance that we have included in the findings and recommendations section of this report.

- For the fourth consecutive year, management has not assessed and mitigated the risks associated with travel reimbursements, resulting in excessive reimbursement of over $1,350

- The Murfreesboro facility had Medicaid residents with excessive resident trust fund balances that jeopardized their Medicaid eligibility

- The board and management have not assessed the risk of noncompliance with Internal Revenue Service regulations and as a result have not established adequate policies and procedures to report the personal use of the Executive Director's car

- Medicaid residents were charged more than private-paying residents

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

- The board failed to submit in a timely manner a Title VI plan relating to compliance with the Civil Rights Act of 1964

We also noted certain other less significant matters, 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. The Tennessee State Veterans' Homes Board has not evaluated fraud risks and does not have adequate policies and procedures to address risks which the auditors have previously identified

Finding

In all organizations, auditors and management are required to assess the risk of fraud in the operations of the department. The risk assessment is based on a critical review of operations considering what fraud could be perpetrated in the absence of adequate controls. The risk assessment by an organization's management is the primary method by which the entity is protected from fraud, waste, and abuse. The auditors' risk assessment is limited to the period during which the audit is conducted and is limited to the transactions that the auditors are able to test during that period. Since new programs may be established at any time by management or older programs may be discontinued, that assessment is ongoing as part of the regular operations of the department. Risks of fraud do not just originate at the beginning or end of an entity's fiscal year.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. It is management's responsibility to design, implement, and monitor effective controls in the department. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditors' testing is limited and is usually targeted to test the effectiveness of particular controls. Even if controls appear to be operating effectively during the time of the auditors' testing, they may be rendered ineffective the next day by management override or by other circumventions that, if left up to the auditor to detect, will not be noted until the next audit engagement and then only if the auditor tests the same transactions and controls. Furthermore, since staff may be seeking to avoid auditor criticisms, they may comply with the controls during the period that the auditors are on site and revert to ignoring or disregarding the control after the auditors have left the field.

The risk assessments and the actions of an entity's management in designing, implementing, and monitoring the controls should be adequately documented to provide an audit trail both for auditors and for management, in the event that there is a change in management or staff and to maintain a record of areas that are particularly problematic.

Risk assessment

Management of the Tennessee State Veterans' Homes Board is not effectively assessing the risk of fraud for the entity. As demonstrated by the issues noted throughout this report, management has not successfully identified fraud risks and, as such, has not developed appropriate controls to offset those risks. So the issue of monitoring controls cannot even be addressed until an effective system of internal control is functioning. In the limited areas where

effective controls appear to be in place, monitoring of those controls is definitely not occurring. As demonstrated particularly in the next nine findings numbered 2 to 10, all of which include fraud risks and all of which have been repeated for at least one to as many as eight years, management either does not have the ability or does not have the willingness to correct the problems known to the organization. The four findings numbered 11 to 14 demonstrate that there are also additional risks unidentified in past audits and potentially unknown to the organization that have not been addressed.

The completion of a risk assessment, including a review by the audit committee, is vital to address the fraud risks in the organization. It is essential that the board, by word and action, requires top management to establish an appropriate control environment—a firm "tone at the top" demonstrating top management's commitment to a strong control environment—to reduce the risks of fraud. Even when controls are designed, based on an appropriate risk assessment, ongoing monitoring responsibilities must be established to ensure that the controls are implemented and are operating as designed.

The auditors have previously identified fraud risks of misappropriation through manipulation of accounts receivable records, theft of equipment or supplies, theft of receipts, inappropriate use of credit, unauthorized purchases, and overstated travel claims. These risks have still not been adequately addressed. There are also risks of fraud related to financial reporting in the areas of accounts receivable, revenue, and equipment that have not been addressed. In addition to these long-standing risks, there are new risks identified in this audit related to payroll payments, cellular phone payments, and foundation funds, and there are other new risks created by the deficient policies and procedures and a lack of organization within the business offices. Of course, there may be other risks not identified by the auditors. In all engagements, the scope of the audit is not broad enough to encompass all operations of the entity. In the case of the Tennessee State Veterans' Homes Board, the auditors have to expend so much effort on the recurring risks, it is even more difficult for the auditors to examine the many operations of the entities. The board, or if necessary the primary government, should accept the responsibility to mitigate the risks.

Policies and procedures

The Tennessee State Veterans' Homes Board does not have complete and approved guidelines that address routine accounting functions. The board's policies also do not address procedures to ensure compliance with applicable laws and regulations. Some areas do not currently have written and approved policies, as noted in findings 6, 10, 12, 16, 17, and 18. The policies that have been approved by the board are sometimes inadequate, as noted in finding 4. Often the policies that have been approved by the board are not followed, as noted in findings 5, 7, 8, 9, and 13. As a result, the internal control at the board is not sufficient to protect the entity from fraud or from misstatements caused by carelessness. The conditions will continue to result in audit findings until an adequate system of internal control is established.

Section 58-7-103, *Tennessee Code Annotated*, gives the board the responsibility of adopting written policies and procedures to govern its internal operations. However, it does not appear that the board has complied with this duty.

At the beginning of audit fieldwork at the Humboldt facility in January 2005, we requested a copy of all policies and procedures in use at the facility. The packet received did contain some useful information, such as the Bylaws of the Board and the section of the *Tennessee Code Annotated* that established the board. However, the packet received also contained information that was obsolete. The copy of the Rules of the Department of Finance and Administration regarding personal service contracts was the April 1, 1977, revision. These rules have been updated as recently as March 2002. The copy of the Comprehensive Travel Regulations was the October 1993 revision. These regulations change often, with a major change occurring August 1, 1998.

The statewide regulations were not the only policies that were obsolete. Even some of the board-approved policies were outdated based on the auditors' knowledge of the board. For instance, the petty cash policy provided by the Administrator was approved August 2, 2001. As stated in finding 6, a new policy was approved by the board February 27, 2003. The payroll policies provided to the auditors referred to "Computdata Rate Code Entry." Based on testwork in the capital assets section in prior years, the Computdata system was the information system in use while the facilities were managed by BEP. This management company ceased all operations with the board in January 2002. The Nursing Salary Guidelines were also included in the information provided by the facility. However, these guidelines were effective September 26, 1993, and were no longer relevant.

The board has been working on several of its policies in response to repeated audit findings. The travel policy was updated in May 2004; the policy for collecting past-due accounts was updated in April 2004; and the property accountability and capitalization policy was revised in April 2004, March 2005, May 2005, and June 2005. However, many of these changes do not really correct the control issues that have continued to exist for several years.

As fieldwork was expanded to include the Murfreesboro facility and foundation, the audit team again requested a copy of all policies and procedures in use. At first, no policies were provided. Ultimately, the Humboldt facility sent to the Murfreesboro facility a copy of the packet given to the auditors when they were in Humboldt. These policies were then provided to the auditors. However, it appeared to be the first time that some of the business office employees were notified that the policies, in fact, existed. Several employees stated to the auditors that they had not seen or did not know of policies related to their business office duties.

During the past three years, the board has made the transition from being managed by a professional management company to using the management company strictly in a consulting role (January 2003), to being completely self-managed (October 2004). Because the board used many of the policies and procedures of the management company/consultant, it became necessary for the board to review and supplement its own policies prior to self-management. These transitions were planned by the board. Based on a review of the board meeting minutes,

the board was discussing the transition to self-management as early as February 2003. More than 17 months passed from that time until the contract with the consultant expired. From the time that the board decided to be self-managed, the Executive Director, with the help of the Financial Director, Administrators, and the business office managers, should have been determining what policies were required by the board and what procedures could be established in accordance with those policies to ensure the effective control environment for the board. However, the facilities appear to still be in the process of creating these policies.

At the October 28, 2004, board meeting, the month in which the board became completely self-managed, the approval of policies was discussed. Per the minutes from that meeting:

> The committee also discussed the writing and adoption of Policy and Procedures Manuals for the TSVHB. In the past, the facilities and the Board utilized the manuals provided by the Management Company, however, with self management it is necessary to create a TSVHB set of manuals. Because of the sheer volume of such manuals, and the fact that such manuals tend to be very similar among long term care facilities, it is the recommendation of the [Personnel] Committee that it is not necessary that the Board individually review each facility policy/procedure. They will be reviewed by the Executive Director and the Administrators, and in the event there is what they determine to be a significant change to prior policies/procedures this will be brought to the attention of the Committee so that the Board can be fully informed of such changes prior to approving the manuals upon completion.

The board should not ignore its duty established by *Tennessee Code Annotated.* It is the statutory responsibility of the board to ensure that policies and procedures are adopted and are in effect. As of the end of audit fieldwork, nine months after the board made the transition to complete self-management and more than two years after the initial discussions regarding a change in management structure, the board has not adopted a completed policies and procedures manual. As of the end of audit fieldwork, certain members of Humboldt's business office were working on policies and procedures; however, they had not been submitted to the board for adoption.

The inadequacy of policies and procedures is indicative of a larger problem with the internal control at the facilities. The ongoing control problems span the past six years, two management companies, and various Veterans' Homes Board administrations. For the years 1998 through 2004, the number of findings has been 3, 5, 11, 9, 14, 15, and 19, respectively. The number of findings repeated from previous years in each year's report has been 2, 3, 4, 6, 9, 9 and 13, respectively.

When auditors find that internal controls are not properly designed, or are not operating as designed or as appropriate in a particular area or when documentation is not readily available (as noted in finding 11), 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. Simply stated, the weaker the internal controls, the greater the risk of fraud.

Until the issues addressed in this finding and 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, will only be effective for the period covered by the auditor's work.

Recommendation

The board should ensure that the Executive Director immediately coordinates the efforts of the Financial Director, the Administrators, and business office personnel to perform risk assessments. The risk assessments should be applied across all board activities, at every home and in every class of transactions, and should identify potential events that may affect the board. The assessment process should be adequately documented. After the assessments are completed, the board should ensure that management addresses the risks.

Through the risk assessment process, the Executive Director and top management should thoughtfully develop policies and procedures that will be effective in creating internal controls within the facilities that adequately address the risks identified. The link between risks and controls should be clearly documented. Also, laws and regulations applicable to the board should be researched, and the policies should be drafted to ensure compliance with laws and regulations. The policies and procedures developed should be carefully considered by the board. Once approved, the Executive Director and Administrators should ensure compliance with these policies and procedures and ensure appropriate action is taken when deviations are discovered. An appropriate training program should be initiated to familiarize the employees with their responsibilities under the new policies and procedures.

The board should set clear deadlines for management solutions to offset risks, and management should be held accountable to meet the deadlines imposed. After the controls are in place, based on the risk assessment, ongoing monitoring responsibilities must be established by the board and implemented to ensure that the controls are operating as designed. The monitoring procedures and monitoring activities and results should be adequately documented.

As new activities are authorized at the facilities, such as implementations of new payment methods, policies and procedures should be developed and documented before the new activities begin. All necessary policies and procedures must be in place before the opening of a new facility. The policies and procedures for each facility, including new facilities, should reflect that facility's needs and operations.

Management's Comment

We concur the Board did not have adequate policies and procedures during fiscal year 2004. At that time, the Board was using the policies and procedures manuals of NHC, our former management company, in the operation of its homes.

TSVHB understands that management is responsible for establishing effective internal controls and is currently in the process of developing policies and procedures that address the administrative and accounting functions of the facilities and board.

In September 2005, the State Funding Board entered into a contractual agreement with Horne LLP to review the accounting and business practices of TSVHB and to report those findings to the State Funding Board. The purpose of the review was to provide a clear understanding of the accounting and business practices and to make recommendations that would provide assistance for TSVHB in addressing the repeat audit findings.

The report issued by Horne LLP made five recommendations; all of which have been funded either by the State Funding Board or TSVHB. Assistance in the development of a comprehensive set of written policies and procedures is one of the five recommendations and is to begin immediately with a targeted completion date of April 2006. These policies and procedures manuals are to be developed and available to the board and staff prior to the opening of the Knox County home.

As policies and procedures are developed, a formal training program will be instituted so that staff is knowledgeable and understand their responsibilities under the new policies and procedures.

Monitoring and testing for compliance with the approved policies and procedures will be done internally for management's evaluation. We have just begun the process for compliance testing by management. The findings will be used to modify and strengthen internal controls. Other independent sources will be used to test the internal controls and report the findings to the Audit Committee.

2. For the eighth consecutive year, fraud risks and financial statement distortions created by inadequate accounts receivable practices have not been mitigated

Finding

As reported in the prior seven 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's accounts receivable balance has significant negative balances, some created by Medicaid overpayments that were not appropriately adjusted and some for which the cause is unknown. In the audit report for the year ended June 30, 2003, we reported estimated Medicaid negative balances of $689,556 related to

Medicaid overpayments and $213,077 for which the cause was unknown. In the current audit, the board identified Medicaid negative balances of $846,218 related to Medicaid overpayment and $755,147 unknown. Other unresolved negative balances also exist for different payor sources as of June 30, 2004. Negative balances totaling $1,114,723 ($544,447 in Murfreesboro and $570,276 in Humboldt) are related to Hospice, insurance, Medicare, or private pay.

Medicaid overpayments were first noted by the auditors during the audit for the year ended June 30, 1997. In response, the board did not concur that the overpayments should be refunded to the Medicaid program, even though the board had been occasionally refunding the Medicaid overpayments. In response to the audit for the year ended June 30, 1998, the board did concur. Management promised additional training and a written policy. The training was performed and a policy was developed, but the problem was not resolved by these efforts. In response to the audit for the year ended June 30, 1999, the board concurred and stated that the 1998 responses were still appropriate and accurate. They stated that the policy in place after the conclusion of the audit would prevent the same problem from recurring in the future, but it obviously did not.

The first year that the negative balances other than Medicaid negatives were noted by the auditors was during the audit for the year ended June 30, 2000. This component of the findings was in addition to the Medicaid overpayment problem that was still occurring. In response, management concurred, referred to the policy that was in place, and stated that the board on a monthly basis would review negative balances. However, this did not occur. So the finding was again repeated for the year ended June 30, 2001. This time management did not concur. They stated,

> While certain credit balances exist for Medicaid Recipients that date as far back as 1993, many of the credits have corresponding debits for the same dates of service that indicate payments or revenue that were not recorded correctly. Taking into consideration the debits, which correspond to the credits, the credit balances would be substantially lower. The process of collecting, adjusting, and refunding these credit balances is very complex and will take a substantial amount of time since so much time has passed with limited activity. Business Offices of the Humboldt and Murfreesboro facilities will research the "other" credit balances as time and staff permit. As the nature of the credit balance is identified the appropriate actions will be made to correct the credit balances.

Management later stated that they did not have time to do this research.

The finding was again repeated for the year ended June 30, 2002. Management stated that they concurred and that "old credit balances should be researched and adjusted. This will require the employment of additional staffing. These staff members will be hired immediately and all efforts will be made to resolve these accounts before conversion to the new accounting system." All efforts were not made. The two temporary staff hired were soon reassigned to other tasks and no significant changes were noted in negative balances.

So the finding was repeated in the audit for the year ended June 30, 2003. Management concurred and stated that they had "continued to make progress in clearing the overpayments." They also contended that additional employees hired did make progress and that void adjustments submitted to the Medicaid department (Bureau of TennCare) but not yet processed totaled $846,218 and that over $1,000,000 was submitted subsequently. In addition, they concurred that other negative balances are a significant portion of patient accounts receivable and that as they researched the patient accounts over the next months, the negative balances would be handled appropriately. The repayments did, in fact, occur, but the repayments involved recently recreated negative receivables, and the promised research was not performed. Therefore, the negative balances are still unresolved. Management has now decided to outsource the task with a resolution target date of March 2006.

The Veterans Health Program Improvement Act of 2004 nullified the agreement between the board and the state to return certain portions of the U.S. Department of Veterans Affairs payments to the Tennessee Medicaid program. However, prior to the passage of the act, the payments were determined to be necessary since the Medicaid program is the payor of last resort. The board did not regularly make the payments, and this created most of the negative Medicaid balances.

Other negative balances were created from the failure to recognize revenue for certain individuals with large patient liability amounts, improper coding, or a failure to refund resident overpayments. Some of the same negative balances still exist in the accounts receivable records from at least four years ago, when this problem was first identified in the finding. These accounts still haven't been researched and corrected. The negative balances will remain in the accounting records until they are researched by board staff and appropriately resolved. Even subsequent to the audit period, in 2005, management was given the opportunity to provide further information on these still unidentified negative balances. A temporary staff member was hired to perform this research. The individual did not have the knowledge and was not given adequate direction to research these negative balances, so any work that the temporary worker performed was worthless.

As demonstrated by the failed efforts and, in some cases, the lack of effort, the resolution of these negative balances has not been a priority with the board. There has been no relevant action on these particular issues over the course of the eight years since the negative balances were identified. There are always more important tasks to assign staff to, even though the negative amounts are very large and continue to skew the financial statement amounts. As the amounts become more distorted, financial decision making or monitoring may be affected. Fraud schemes could occur and go unnoticed when the accounts receivable records are not accurate. In addition, funds may be owed back to the residents for overcollections. Also, when negative amounts are included in the receivables, the board may not have an accurate portrayal of the amounts that the board must attempt to collect. The board has neglected to place the appropriate amount of emphasis on these issues and has not resolved to correct the problems.

Recommendation

The Executive Director should make a serious attempt to resolve these issues. The board should determine why management failed to adequately address the Medicaid balances eight years ago and why management failed to adequately address the other negative balances five years ago when the problems were first identified and when resolution would have been more feasible. The board should resolve not to continue this pattern of promises and inaction. Efforts to resolve the finding should be documented, and the results should be provided to the auditors for consideration during the next annual audit.

The board should immediately designate the resources to individually research and resolve the negative balances.

Management should carefully evaluate the current accounts receivable practices as part of its documented risk assessment activities. The Executive Director should identify specific staff to develop, document, and implement necessary policies and procedures to establish internal controls to prevent and detect exceptions timely. The policies should include a periodic review of all negative balances as well as a review of all resident accounts to ensure receivables are properly stated. The Executive Director should carefully supervise operations. He should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt action should exceptions occur.

The board should carefully review management's risk assessments and related controls for sufficiency.

Management's Comment

We concur that significant credit balances exist in accounts receivables.

The majority of credit balances on the books of TSVHB are created by the application of the VA subsidy to accounts of residents who are eligible for Medicaid.

The federal law, as amended, does not say that it is a clarification of the intent on per diem payments. However, the House Resolution that amended the federal law <u>does</u> say that the reason the amendment was being proposed was to "clarify" the original intent.

TSVHB proposes to pursue its request that monies recouped through the void-adjustment process be refunded to it and that any unprocessed void-adjustments be officially released by the Medicaid department.

Other credit balances do exist and will be researched and addressed either by Horne LLP if the date of service is October 2004 and prior or by TSVHB staff if the date of service is November 2004 to current date.

Auditor's Comment

According to a CMS Program Issuance Transmittal Notice (dated April 18, 2005), which discusses the ramifications of the Veterans Health Program Improvement Act of 2004, the VA subsidy payments to Veterans nursing homes were considered a third-party resource and appropriately offset the Medicaid payment to the homes prior to enactment of this law. The notice also specifies the effective date when these subsidies are no longer considered a third-party resource. That effective date is expressly stated as November 30, 2004.

3. For the third consecutive year, accounting records do not portray a true picture of receivables, and the risk of theft of resident funds was not addressed

Finding

As stated in the prior two audit reports, 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. When the account receivable records are not correct, theft of resident funds could occur and go unnoticed. Any cash amounts that were paid by resident families but not posted to the residents accounts would be assumed to be an accounting error instead of a fraud. Misstatements in the financial reports could occur and go unnoticed as well if errors in the accounting records are allowed to continue.

In response to the June 30, 2002, finding, the board concurred and stated that old accounts should be researched and written off. According to the board, this would require at least three additional staff that would be hired immediately. The board's plan was to resolve the issue prior to converting to the new accounting system and to submit applicable accounts for write-off. They also stated that they were adopting a policy to require a periodic review of all credit balances and that adjustments resulting from the review would be submitted to management for approval. The board, however, did not research the accounts and therefore did not submit any accounts for write-off. They also could not provide a copy of the policy that they had planned to adopt.

Management concurred with the June 30, 2003, finding and stated that the amounts shown on the balance sheet do not accurately reflect amounts of patient accounts receivable and that old accounts should be researched and collected or written off. However, management also stated that the research was time consuming and staff intensive. They also stated that limited staff as well as a cumbersome accounting system hindered their ability to concentrate on researching and resolving these accounts. To help the situation, two positions were added in each business office. The two positions in Murfreesboro were filled in May of 2004; the two in Humboldt were filled in October of 2003 and January of 2005. With these new positions, it was the stated goal of management to focus on, correct, and bring to resolution accounts receivable balances. However, management now has stated that it does not have a target date to resolve this

issue until March 2006. Management recognized the loss of faith involved when current residents are billed incorrectly or retain balances from prior periods which are incorrect. Management has claimed that each facility reviewed the files of current residents to resolve any incorrect postings and to obtain current insurance information and that each facility has made adjustments that are necessary to correct the accounts, but these claims were not confirmed through testwork.

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. The total balance of the "Prior" account at June 30, 2004, was $679,012 for the Murfreesboro facility and $475,190 for the Humboldt facility. These balances have not substantially changed since the inception of the accounts.

In addition to the "Prior" account balances, receivable balances for the different payor sources (private, Medicaid, Medicare, VA, hospice, private insurance) for the "Patient" receivable account, at June 30, 2004, may not be representative of actual amounts owed to the board. Along with the "Accounts Receivable Prior" account having unresolved credit and debit balances, it was noted that occasionally the charges are incorrectly set up within the system 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. Manual adjustments are then needed to correct this, but they are not always made. The situation also causes a receivable for a particular payor source to still exist when the payment was already received.

Several other problems were noted. A payment from Medicare was received by the Murfreesboro facility in June 2004. However, as of September 30, 2004 (the final day under the NHC information system), this payment of $42,864 had still not been posted to the individual resident accounts. In Humboldt, a payment from Medicaid was received by the facility in May 2004. However, as of March 30, 2005, this payment of $3,921 had still not been posted to the

individual resident's account. As a result, the individual resident accounts still showed these funds as money owed to the facility, even though the facility had already received the funds. The Murfreesboro facility received a November 2003 payment from Medicare and Medicaid for a resident for the same month of service when Medicare was the appropriate payor. The payment received from Medicaid should have been returned, but as of June 20, 2005, $1,022 had still not been returned.

This situation is further aggravated by the use of unsupported or incorrect manual adjustments that clear out certain credits to balance residents' accounts in both facilities. Instances were noted at both facilities where the receivable set up in the system for the different payor sources for several residents was different than the amount billed. Once the payment was posted to the resident's account, it created a credit balance under one payor source, and a debit balance still remained under another payor source. Both facilities made several adjustments to the various accounts and different payor sources in order to "correct" the receivable balances. However, facility personnel could not explain the methodology behind these adjustments or explain the calculations used in these adjustments. In Murfreesboro, one resident's account had so many adjustments, facility personnel were having difficulty in even researching the account after being questioned by the auditors. Due to these situations, the staff is not able to assess whether a certain payment has been received or why an account was manually adjusted.

As some payors have very specific guidelines for billing, failure to bill 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, 2004, 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. The "Prior" account is not the only account affected by this problem. The account balance representing accounts receivable for dates of service between January 2002 and January 2004 also contained balances that may not be received due to time constraints. An instance was noted where the Murfreesboro facility did not bill Medicare for one resident's July 2003 dates of service until May 2005. The facility submitted the bill after it was discovered by the auditors. It is not likely that the facilities will be able to collect these funds due to the time limits imposed by these payors. This particular issue has been included in a finding since the audit of the fiscal year ending June 30, 2002. However, there does not appear to be improvement in this area.

As noted in the past two audit reports, when individuals call the board to see what they owe or call to question a bill, 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 a 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 immediately dedicate resources and 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. 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 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.

The board should determine why management has not taken adequate action to resolve the problems with the accounts receivable records. The board should take action to ensure that resolution is proceeding with a stated time frame for completion. If the issue is not resolved by the completion date, disciplinary action should be taken. 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.

The Executive Director should ensure that risks such as those noted in this finding are adequately identified and assessed in the entity's documented risk assessment activities. The Executive Director should identify specific staff to be responsible for the design and implementation of internal controls to prevent and detect exceptions timely. The Executive Director should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt action should exceptions occur.

Management's Comment

We concur that carrying old accounts receivable no longer collectible on our books distorts the true receivables balances. At its October 27, 2005 meeting, the TSVHB approved $179,247 in write-offs for submission to the State Comptroller's Office. An additional request is to be presented at the January 2006 board meeting for approval. The accounts to be included in the January 2006 request are for residents with verified dates of death over one year ago and accounts that no longer meet timely filing guidelines. These accounts represent a significant number of total accounts receivable and have accumulated and grown over several years with little or no action taken for collections. Although the write-off is necessary, TSVHB will not tolerate practices of the past to continue for current and future billings. With the elimination of these accounts, the business office staff will be able to focus on current residents and current claims.

TSVHB recognizes the loss of revenues created when collection of debt is not strongly pursued. Both business offices are now working closely with the Attorney General's Office in

pursuing receivables. Discharge of residents is used as recourse for those who fail to pay their bills.

Both facilities did an audit of the accounts of all current residents and are able to produce accurate statements for all current residents.

A report of daily cash receipts is maintained manually by the business office managers. This report ties to the deposit recorded at either the lockbox or at the local banks used for deposits received at the facilities. These amounts are then reconciled to the daily cash posted by the accounting system and credited to patient accounts receivable.

The current accounting system allows for billing to be generated for only one payor source and keys from the resident type assigned throughout the month. For example, a resident may be admitted as a Medicare patient and remain in that status for eight days. If, at the end of the eight days, the skilled services are no longer necessary, the patient would change status from Medicare to another payor source. He/she could become private pay or Medicaid, depending on the circumstances. The accounting system will bill Medicare for the first eight days and the next payor source for the other days.

A review of the aging reports is done by the business office managers and by the finance department. Uncollected claims for the current year are followed up timely and resubmitted for payment. Private pay accounts are followed up monthly for current year amounts due.

The petty cash for residents is counted and reconciled daily. Statements for resident trust accounts are sent out quarterly and show all activity in the account including petty cash withdrawals, deposits, and payments applied to accounts receivable at the facility. Questions from the resident or his/her responsible party are answered fully and resolved.

4. For the eighth consecutive year, management has not addressed the risk of theft of board capital assets, and the capital assets records have not been adequately maintained

Finding

Management has allowed significant deficiencies to continue to exist in internal control for capital assets. The major, ongoing deficiency noted is the inability of management to correlate the results of physical inventories with accounting records as a result of inadequate accounting records for equipment and inaccurate equipment listings. Other deficiencies contributing to the reporting and accountability problems include the absence of property tags on the equipment items, the undocumented location changes for equipment, donated items that are not recorded on equipment listings or accounting records, and equipment assumed to be surplused without proper approval or investigation.

Without adequate internal control over equipment, assets of the board could be stolen and the theft may not be detected. The risk of these types of frauds should be addressed, and

management should design controls to offset those risks. Also, financial statement frauds related to equipment could easily occur undetected since the financial statement equipment amounts are not accurate, and management does not know the amount that is accurate. This risk of fraud has not been addressed by management or the board.

Similar deficiencies have been reported in prior findings in the last seven audit reports. Management has not taken seriously the deficiencies noted and has not taken sufficient corrective action. Attempts to solve the problem were not appropriately executed, and as a result, those attempts consistently failed.

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 three audits, and problems still remain. By far the riskiest problem noted in this finding is the lack of a reconciliation between the capital asset records that support the financial statements and the records maintained as a result of the physical inventory. In the June 30, 1997, audit, management did not perform a physical inventory of equipment but approved a policy for performing the inventory. In response to the finding in the June 30, 1998, audit, management stated that they intended to complete an inventory by June 30, 2000. They stated that the financial reports would not be prepared until the inventory was complete. In response to the June 30, 1999, audit, management stated that the 1998 comments still stood and that the 2000 inventory had been completed. However, that physical inventory was performed without tying the results to the listing that supports the financial statements. In response to the June 30, 2000, repeat of the finding, management stated that progress had been made, but more work was necessary and that in some cases they could not match up the capital assets between the financial records and the physical inventory. So the finding was repeated again in June 30, 2001. In response, management stated that the inventory had been performed and that a reconciliation would be accomplished, but it was not. That attempt to reconcile was inaccurate.

The finding was again repeated in the June 30, 2002, audit report. Management concurred and stated that they "failed to complete this action." They again promised to perform the inventory and to reconcile to the financial information, but that attempt to reconcile was inaccurate. In response to the June 30, 2003, finding, management concurred and again promised a physical count and a reconciliation, now with a 2005 completion date. They stated that the asset property tag numbers would be used in the accounting records to identify specific assets. More work was performed to reconcile the information, but the results were again inaccurate. Management claimed that the accounting records for the June 30, 2005, fiscal year would match the physical count, but as of June 30, 2005, an accurate reconciliation has still not been performed.

Management also stated that the capitalization policy would be clarified and would address donated items and the addition and deletion of items. The policy has been changed multiple times in recent months, but the policy still does not address all issues. In response to the finding in a prior year, 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. Management still has not resolved the issues at hand.

Capital asset records do not agree to the physical inventory

Capital asset records continue to be inadequate. When the physical inventories were initially performed, 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. Management of the homes attempted to keep the physical inventory records updated but had failed to carry the changes forward to the capital asset records, and the capital asset records have become increasingly inaccurate.

During one of the attempts to reconcile the capital asset records to the physical inventory, management added the randomly assigned asset number from the capital asset records to the physical inventory records. Although the matchup was not done correctly, adding the asset number was a step in the right direction for reconciling the listings. This asset number is still included in the physical inventory records for most items at the Humboldt facility but has been removed from the physical inventory records for the Murfreesboro facility, thus breaking any link between the physical inventory records and the capital asset records. The results of the physical inventories have still not been adjusted in the capital asset records or the general ledger. Management has added some cost information to the physical inventory records during the most recent attempts to reconcile, but this information is not included on a consistent basis. Therefore, the total amount of capital assets at the facilities is still unknown. The differences between the capital asset records and the physical inventory records are significant. As discussed in Note 6 to the financial statements, the board changed its capitalization policy during the fiscal year under audit. However, the physical inventory records did not take this change into consideration. As a result, the differences became even larger. At the Murfreesboro facility, the total historical cost per the physical inventory records (for those items with a cost assigned) was $5,475,783. The total historical cost for items included in the capital asset records (and, thus, included in the financial statements) was $4,968,490, a difference of $507,293. At the Humboldt facility, the total historical cost per the physical inventory records (for those items with a cost assigned) was $8,386,337. The total historical cost for items included in the capital asset records was $7,948,357, a difference of $437,980.

Capital asset records are not accurate

Because of the lack of the reconciliation to the physical inventory records mentioned previously, management has not been updating the capital asset records for missing, surplused, or stolen equipment. Over time, the capital asset records have become increasingly inaccurate. The board is not even correcting the capital asset records for known differences. Several issues that have been noted in prior audits have still not been corrected by board personnel, including misclassifications between depreciable and nondepreciable items, errors in the determination of useful lives for certain assets, and items known to be removed from the homes. Specific

equipment additions of at least $35,000 have been reported to the board in prior years and still have not been added to the records. Specific equipment deletions of at least $58,000 still have not been removed from the records.

Each year more items are added to the list of adjustments needed. This year a donated van valued at over $27,000 was not added to the capital assets listing. This is a recurring problem for donations because there are still no procedures in place for ensuring that donated assets are properly added to the capital asset listing. We also noted an item on the capital asset records that did not exist. The questions raised by the auditor caused management to determine that they had overpaid a vendor $5,981. The overpayment had been included in the capital asset records and depreciated as if it was equipment.

Entries with grouped assets on the capital asset listing have not been handled correctly. Based on review of items removed from the capital asset listing at the Humboldt facility, 3 of 11 deleted items (27%) do not appear to be proper. Based on surplus documentation, one or more of the items within these groups were surplused. However, it does not appear that, in these instances, all of the items within these groups were surplused as the physical inventory records still contain items with the corresponding asset number that has now been deleted from the capital asset listing. The problems noted included an entry for five computers that were removed from the capital asset listing when only 3 monitors, 3 keyboards, and 1 hard drive were actually surplused; and an entry for 3 computers removed when one was still present at the facility.

Because the capital asset records do not include property tag numbers, it is vital for the reconciliation process that the descriptions of equipment items are 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. For example, a freezer had the description "recliners" and a drain cleaning machine had a description of "chairs." Although these instances were reported to management in the audit for the year ended June 30, 2002, the descriptions were not corrected. When board personnel were implementing the change in accounting principle as described in Note 6, these items were removed from the capital asset records. The items should not have been removed as each item, had the description been accurate, would meet the capitalization criteria.

Physical inventory listings are not accurate

Beyond the deficiencies noted with the capital asset listings, there were problems with the physical inventory listings as well. At each facility, there was some difficulty in requesting and receiving the most current physical inventory records. The responsibility for maintaining these records has been given to several different individuals at different times. The most current physical inventory records were requested from the Humboldt facility on January 13, 2005. An electronic version of the records was obtained on February 7, 2005. However, during the course of testwork, it was discovered that this version was not current as it had not been updated since approximately March 2004. On March 7, 2005, another electronic version of the physical inventory records was obtained. At the Murfreesboro facility, the electronic version of the physical inventory records did not reconcile to the actual equipment items in the facility. Even

though multiple versions of the physical inventory records were obtained by the auditor, none had been updated with the tag numbers matching the tags that were physically located on the equipment items. The confusion among facility personnel about responsibility for maintaining the physical inventory records made it extremely difficult to determine what records should even be considered the official records of the board. This issue added a considerable amount of time to the audit process and impedes the board's efforts to correct this problem as well.

When the capital asset listing was compared to the physical inventory records, several problems were noted. These problems noted through a limited review are indicative of large problems with the physical inventory records. For example, an entry for 52 televisions on the capital assets listing was matched with 65 televisions and one oak chest on the physical inventory records, and an entry of 62 mirrors is matched with 1 television. As the cost information is added to the physical inventory records based on these erroneous matches, the physical inventory records become inaccurate. The same inaccuracies are being created with the newer assets. The asset numbers for certain additions purchased during the year were not matched properly with the physical inventory records. These newer assets were assigned asset numbers, costs, and accumulated depreciation related to purchases that had been made in previous years.

We also observed on the physical inventory records that items that staff could not match with the capital asset listing were sometimes noted as being surplused, whether or not staff had documentation to support that assumption. The Murfreesboro physical inventory listing in particular had some items that were removed from the physical inventory listing as surplused even though the auditors have observed the items in question as still being present at the facilities.

Equipment tag numbers and locations did not agree with the physical inventory records

During testwork at the Murfreesboro facility for 100% of the 36 items tested, the tag number on the item did not agree with the tag number on the physical inventory records. The Murfreesboro facility changed tag numbers multiple times on its equipment. There is no audit trail to show what the original tag number was and what tag number is actually on the equipment at this time. This condition is further complicating the reconciliation process.

The location noted for equipment items on the physical inventory records was not accurate either. For 106 of 123 equipment items tested (86%), the equipment's actual location did not match the location designated on the physical inventory accountability records. At the Humboldt facility, for 9 of 93 equipment items tested (10%), the equipment's actual location did not match the inventory accountability listing.

Management does not investigate lost equipment

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. To add to the problem, items that are surplused are not always removed from the listings.

Conclusion

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 and if the noted location is incorrect. When additions or donations are not reported to management or when management ignores known changes, necessary adjustments to the furniture and equipment account and related depreciation are not recorded. When items are deleted without investigation, errors regarding the amount of missing equipment occurs, and employee theft could go unnoticed. Amounts recorded may not represent the actual amount of capital assets held, and insurance coverage based on the erroneous amounts may be inadequate. 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 could unnecessarily increase the rates paid by the veterans.

Because of the lack of accurate equipment records, it was impossible to positively identify any of the items we examined for testwork. The guesswork involved added time and risk to the audit work required to determine if the financial statement amounts were materially misstated.

Recommendation

The Financial Director should immediately attempt to resolve this material weakness. The board should determine why the reconciliation has still not been performed eight years after the inventory problem was originally noted. 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 any reconciliations performed between the physical inventory and the accounting records for capital assets. The Financial Director should designate the individuals responsible for each step of this process to ensure that there is no confusion among the interested parties as to their responsibilities in this matter. 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. All equipment locations should be updated in this process.

The property officer should forward the information necessary to record all additions and deletions of equipment in the accounting records to the business office with proper supporting documentation. Acceptance of donated property items including donations from the foundation or any other organization 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. Any changes requested as a result of the reconciliations should be thoroughly reviewed and approved by the Financial Director.

A thorough, documented risk assessment regarding capital assets should be performed and approved by the audit committee. Policy changes should be proposed based on the risk assessment. After such a policy is implemented, the Financial Director should ensure that each facility complies with the policy. Specific staff should be assigned the responsibility of ongoing monitoring for compliance with policies and procedures and taking prompt action should exceptions occur. Management should resolve to finally correct this finding and should document the steps taken to address this material weakness. That documentation should be made available for review in the next audit.

Management's Comment

We concur that the capital assets carried on the books did not match the physical count of the facilities.

Horne LLP has provided assistance in the reconciliation of physical property records to the financial records for property and equipment as per its contractual agreement with the State Funding Board. This reconciliation is made to correspond with the end of the June 30, 2005 fiscal year. Once imported into the general ledger software, current year acquisitions, donations, disposals, and depreciation expense calculations will be maintained in the fixed asset module of the accounting system of TSVHB.

Management had hoped to have this corrected and restated for the audit of our June 2005 books. It now appears this will need to be treated as an adjusting journal entry made after the beginning of the auditor's field work. The listings maintained by the facility property managers contain all items purchased by the facilities, including those that do not meet the criteria for capitalization. From information provided by Horne LLP, it appears the adjustment will not be as significant as feared. Indications are that the increase to capital assets to be booked at Murfreesboro is less than $15,000 and less than $50,000 at Humboldt. As part of the reconciliation of capital assets, recommendations will be made to strengthen internal controls and improve procedures.

Monitoring and testing for compliance with the approved policies and procedures will be done internally for management's evaluation. We have just begun the process for compliance testing by management. The findings will be used to modify and strengthen internal controls. We anticipate that other independent sources will test the internal controls and report the findings to the Audit Committee.

5. For the third consecutive year, management has not assessed and mitigated the risks of lost revenues caused by the lack of collection efforts for accounts receivable

Finding

As noted in the prior two audit reports, 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, 2004, resident accounts receivable from private payor sources was $1,734,008. Of this amount, $1,398,636 was over 180 days past due.

Although the board has been notified by the auditors of this risk as far back as June 2000 for Humboldt and June 2001 for Murfreesboro, the first time a finding was developed was in the audit for the year ended June 30, 2002. In response to the finding, management concurred and stated that the collection efforts were not adequate until November 2003 in Murfreesboro and December 2003 in Humboldt. This statement implies that the situation was corrected in those months. However, the work that we performed regarding collection efforts extends through the spring of 2005, and the collection efforts are still not occurring. The error rates in the sample are so high that it is clear that corrective measures were not taken in response to the 2002 audit report.

In response to the finding for the year ended June 30, 2003, management concurred and stated that reconciliations of the resident accounts were necessary prior to collection efforts and that this step would slow the process but was needed to ensure that correct and accurate balances are reflected on the accounts. Management stated that the focus was on the current residents first, those amounts due that are near the timeliness deadlines second, and older receivables third. However, the results of these stated efforts were still not visible in the testwork performed, and since the reconciliations of resident accounts have not been performed, little progress has been made to collect on the outstanding balances. Management then promised to review collection policies for effectiveness, then review the policies with current staff. According to Humboldt staff, this review occurred in January of 2005. According to current Murfreesboro staff, there has been no management review of any policies with staff. It was also documented that the board's stated goal was to submit accounts for write-off during fiscal year 2005. However, due to the lack of collection effort documentation, no accounts were submitted for write-off during fiscal year 2005. This repeat finding again demonstrates the lack of commitment by management to resolve their known weaknesses.

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 is to send accounts to a collection agency to further attempt to collect on accounts

receivable before write-off. In addition, both facilities may 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, from private-pay sources, in both the "Prior" account at June 30, 2004, as well as those with balances over six months old in the "Patient" account at June 30, 2004. The "Prior" account represents any accounts receivable at December 31, 2001, the day prior to the conversion to the information system used by National HealthCare Corporation. The "Patient" account represents any accounts receivable from January 1, 2002, to June 30, 2004. At June 30, 2004, these accounts totaled $1,398,636 and are, at a minimum, 6 months old in the "Patient" account and 30 months old in the "Prior" account. Documentation of any collection efforts on the selected accounts was requested including any efforts made until testwork dates of February 2005 for the Humboldt facility and April 2005 for the Murfreesboro facility.

For the Murfreesboro facility, the efforts to collect from 13 of the 286 residents with prior private-pay receivables were reviewed. The total of these 13 balances at June 30, 2004, was $95,745. As of April 28, 2005, the balance remained $95,745. Results from this testwork revealed that documentation of adequate collection efforts did not exist in 11 of the 13 residents' balances (85%). For the Humboldt facility, the efforts to collect from 13 additional residents of 196 were reviewed. The total of these 13 balances at June 30, 2004, was $37,414. As of February 29, 2005, the balance of these accounts was $37,339. Results from this testwork revealed that documentation of adequate collection efforts did not exist in 10 of the 13 residents' balances (77%).

In general, accounts are not submitted to the collection agency. Over the years, as of April 28, 2005, Murfreesboro had only submitted 11 of the 286 accounts to the contracted collection agency, and no accounts were submitted to the Attorney General. All of these were submitted prior to the fiscal year under audit. For Humboldt, as of February 29, 2005, 3 of the 196 past-due accounts had been turned over to the contracted collection agency, and only 18 accounts have been submitted to the Attorney General's Office. The 3 accounts turned over to collections and 8 of the 18 accounts turned over to the Attorney General have been submitted since March 2, 2004.

Before accounts may be submitted to either the collection agency or the Attorney General's Office, the board must have exhausted its efforts in collections. Problems were noted in other testwork regarding valid addresses of the responsible parties. Fourteen receivable balances were randomly selected at each facility for confirmation testwork. Of the 14 accounts at the Murfreesboro facility, personnel could not provide valid contact information for 2 of the responsible parties (14%). Of these two residents, one passed away in 1999. Although personnel are aware of this, the account has not been turned over to the Attorney General's Office as of June 30, 2005. The dates of service related to these two accounts ranged from 1996 to 2000. Of the 14 accounts at the Humboldt facility, personnel could not provide valid contact information for 5 of the responsible parties (36%). The dates of service related to these five accounts ranged from 1999 to 2003. If the facilities cannot even provide a valid address, it is unclear how seriously the board is attempting to collect on outstanding receivables.

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 determine why management continues to fail to correct this weakness. The board should ensure that collection policies and procedures 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. Extensive attention should be directed towards the receivable balances over 180 days old as they are the majority of the outstanding private receivables. 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. Known changes in resident status or addresses should be documented, as applicable, and the information should be sent to the collection agency.

The Executive Director should ensure that risks related to lost revenues from unpursued receivables are adequately identified and assessed in the board's documented risk assessment activities. The policies and procedures in place should be evaluated to ensure proper internal control to prevent and detect exceptions timely. The Executive Director should identify specific staff to be responsible for ongoing monitoring for compliance with the policies in place and to be responsible for taking prompt action should exceptions occur.

Management's Comment

We concur that collection efforts were not adequate for fiscal year June 2004.

The board policy on collections approved September 29, 2005 clearly establishes minimum requirements for the facilities' efforts in the collection of accounts receivable.

Both facilities have completed a review of the accounts of current residents and made any correction to the account deemed appropriate and necessary. Focus in the business office is placed on billing current claims properly and collections of those claims. Although different schedules are followed, both facilities are actively working all outstanding balances for all current residents and any outstanding third party claims within timely filing requirements.

With approval of the write-off request expected to be taken to the board in January 2006, the number of accounts on our books will be significantly reduced, which should allow the business offices to focus time and energies on those current claims.

6. The board still did not address the risk of fraud and for the second consecutive year, has no policies and procedures in place regarding the authorization or use of credit cards and open accounts

Finding

As noted in the prior audit, the board does not have adequate controls in place over the use of credit cards and open accounts. The board has not adopted any policies to address who is authorized to request credit with vendors. The facilities do not have written policies and procedures outlining safeguard measures for the physical possession of the cards, nor do the facilities maintain a complete 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 an open account, 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. In response to the prior audit finding, management stated that they would develop appropriate policies to address auditor recommendations in fiscal year 2005. However, as of June 30, 2005, policies had not been approved.

The fraud risks associated with individuals with uncontrolled access to the board's credit are obvious. The board could easily pay for the personal purchases of cardholders. The board could become responsible for these charges until repayment is collected from the employees, or the personal purchases could easily go undetected. This risk was pointed out to the board in July 2004, and due to the implications, should have been addressed immediately. However, as of a year later, the risk has still not been mitigated.

During the period under audit, the Humboldt facility had credit cards or open accounts with 13 vendors. Of these accounts, five gave the facility a specific limit to the credit extended, and eight were open-ended accounts with no limits. The limited credit extended to the facility totaled $35,000. During the fiscal year under audit, the facility made purchases exceeding $42,800 through this credit. The Murfreesboro facility has had credit cards or open accounts with at least 12 vendors. Of these accounts, three gave the facility a specific limit to the credit extended, and nine were open-ended accounts with no limits. The limited credit currently extended to the facility totals $19,500. During the fiscal year under audit, the facility made purchases totaling approximately $48,400.

Lack of proper approvals

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 was not even required before purchase. Items could be purchased that would not have been approved. Also, even though eventually purchase orders were required to be completed that document approval for payment, the completion of the purchase orders is not always done and is not always timely. In response to the prior-year finding, management stated that purchases by credit cards require the same approval process and should not be used in a manner that

circumvents the purchasing policy. However, based on the testwork performed, this practice is not followed. During the Humboldt testwork, 48 instances were noted in which no purchase order was completed for five different vendors. During the Humboldt testwork, 15 instances were noted in which the purchase orders were not completed until the day after the purchase or even later. The time frames noted ranged from one day after the purchase to ten days after the purchase. Three additional purchase orders were observed without dates. During the testwork in Murfreesboro, 11 instances were noted in which no purchase order was completed for three different vendors. During the testwork in Murfreesboro, 45 instances were noted in which the purchase orders were not completed until the day after the purchase or even later. The time frames noted ranged from one day after the purchase to 44 days after the purchase. One additional purchase order was observed without a date. In addition, there was one vendor that did business with both facilities for which no purchase orders were ever completed during the entire audit period.

Payments without adequate support

In addition to untimely or improper approval for purchases, certain purchases were not supported adequately. There were five unsupported payments at the Humboldt facility. One was the 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 as support for the fuel payment. However, the documentation retained as support for payment was a monthly report that did not show any of this detail. The weekly reports or receipts were not always available to support the payments. The additional four instances in Humboldt were for different vendors where the support for payment was a copy of the statement. No receipt had been given to the receptionist for payment, and no purchase order had been completed until the statement had been received. There were 18 unsupported payments at the Murfreesboro facility. Seventeen were the payment of the fuel card balance, and the receipts for the individual purchases that should have been included on those statements were not retained. In addition, six of the weekly reports were not retained. The additional instance in Murfreesboro was for one vendor where the support for payment was only a copy of the monthly statement. No receipt was on hand, and the purchase order had not been completed in a timely manner.

Purchase receipts not reconciled with billing statements

Reconciliations were not performed during part of the fiscal year under audit at Humboldt, and no reconciliations were performed in Murfreesboro during the fiscal year under audit to ensure all charges on the vendor statements were authorized and paid or were in the process of being paid. In fact, only certain statements for the Murfreesboro facility were available for auditor review. Based on discussions held with facility personnel during the prior audit and the current audit, many statements were simply thrown away.

The facilities sometimes paid vendors based solely on receipts submitted by employees. At other times the facilities paid vendors based solely on monthly statements submitted by vendors. When the vendors are paid based only on submitted receipts, additional charges could

be present on the statements that are unauthorized. These charges may go unnoticed, unpaid, and uninvestigated. Conversely, when payments are based only on monthly statements, payments might be for inappropriate purchases. 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 interest fees on 15 occasions, and one account had a balance that was carried forward month after month. Discussions with a Murfreesboro vendor revealed that one vendor had closed the facility's account in September 2003 due to delinquency. Based on review of the statements that were retained, the Murfreesboro facility incurred interest and late fees on 11 occasions.

Unauthorized card holder

For one vendor providing credit, Humboldt management documented a list of eight authorized users in the vendor file after the prior audit finding. One employee in the activities area who was not on this listing used the activities director's credit card. This same employee was later given a credit card without being added to the list of authorized users.

Employees not using the credit card log appropriately

As the lack of controls surrounding credit cards and lines of credit was brought to the attention of management during the prior audit, some improvements have been made subsequent to the audit period to the procedures followed by the facilities. In response to the prior-year finding, management stated that the cards would be maintained in a locked cabinet or drawer with limited access. As a result, physical access to the cards is now being controlled with only one person at each facility maintaining custody of the cards. The cards are kept in a locked safe in the receptionist's office at each facility. Although the safeguarding procedures have changed, they have still not been written into an approved policy. Management also stated that the unwritten procedure was that an individual wishing to use a credit card "must receive prior authorization and approval of purchases and sign a log when taking a card for use." While the receptionist is currently requiring individuals to sign a log, it does not appear that the authorization and approval of purchases is documented consistently.

Credit cards not controlled

In addition, there were not even any unwritten policies during the audit period, and there were several additional internal control issues as a result. Physical access to the cards was not controlled appropriately. The business office manager was not aware of all credit accounts that existed. At the Murfreesboro facility, credit cards were not always obtained from employees upon termination.

Conclusion

With management's continued lack of policies regarding authorized credit card users and without advance approvals, the board may become responsible for charges that are not related to

board activities. The lack of reconciliations between purchase receipts and statements could also result in payments for inappropriate purchases as well as interest and penalty charges. Without control, the credit cards can be used to avoid following existing 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. Credit should not be used until a risk assessment is performed, policies and procedures are approved, and the internal control is established. The board should determine why this important fraud risk was not addressed more timely. The managers should be aware of the possession of credit cards at all times, and responsibility for the cards should be 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. Credit card purchases should be scrutinized frequently by the authorized purchaser's supervisor. 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. Written policies should make it clear that the credit cards should not be used to circumvent regular approvals and bidding requirements. The Executive Director should require reconciliations of billing statements to the receipts approved by the supervisors. Any charges without approved receipts should be investigated immediately.

Management's Comment

We concur there was no board policy on the use of credit for fiscal year June 2004. The board approved such a policy at its September 29, 2005 board meeting.

Staff at both facilities has been in-serviced on purchasing procedures. With the implementation of new accounting software, it is now required that a requisition be completed and approved prior to a purchase order being issued. With a few exceptions, all purchases require documentation of an approved purchase order prior to placing an order or otherwise committing TSVHB funds.

An internal review of the accounts payable offices shows that invoices are still being paid without all appropriate documentation. Accounts payable personnel at both facilities have been reprimanded. Additional in-service and training will take place to reinforce the need for better job performance.

A log for use with the credit cards has been developed and is in use at both facilities and at the executive office. The log requires any individual using a credit card to sign the card out, provide the purchase order number, sign the card back in, and provide a receipt number for purchases made.

Steps are being taken at both facilities to close all open accounts and inform those vendors that all purchases require an approved purchase order prior to placing any order. A review of the actual need and dollar limitation of credit cards is also in process.

7. For the fifth consecutive year, the board has not addressed the risk of unauthorized purchases

Finding

As noted in the prior four 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, as noted in last year's audit report, contract payments are not always properly invoiced or reviewed. Again, because of a lack of action by management, the board has not mitigated the risks associated with disbursements, such as payments for personal items or payments for services that the board would not have otherwise been obligated to make. For this five-year period, management has not adequately assessed the risks associated with purchasing activities and has not monitored controls to ensure that the risks were addressed.

Purchasing policies and procedures not followed

For the purchasing deficiencies noted in the audit for the year ended June 30, 2000, the board stated that they would see that practices were consistent with board policy. But the same condition was noted in the next audit for the year ended June 30, 2001. The board concurred and made the statement that policies and procedures were currently being followed. However, the same condition was again noted in the audit for the year ended June 30, 2002. Management's written response to the June 30, 2002, finding was unresponsive to this issue. So, again, the issue was noted in the audit for the year ended June 30, 2003. In response to that audit, management concurred with the finding and stated that they would develop appropriate practices to match the policy in fiscal year 2005. They also stated that staff responsible for accounts payable and department supervisors would be trained during fiscal year 2005. On June 17, 2005, the accounts payable staff from both facilities were trained. However, the department supervisors had not been trained by the end of fiscal year 2005. As of the end of fieldwork, it is unknown whether this training will have a significant effect on the employees' disregard for existing policies and procedures. During the audit period, the purchasing policies were still not followed on a consistent basis.

The written policies and procedures 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 purchase order exists. The accounts payable clerk is to maintain all standing purchase orders. Policies require

purchases over $1,000 to have the additional approval of 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. The purchasing policy also states that the purchase order should include, among other things, a description of the item, quantity, approximate price, date, and the preferred vendor to be used. 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:

- Two of 19 disbursements tested at the Humboldt facility (11%) and 4 of 15 disbursements tested at the Murfreesboro facility (27%) were not supported by a purchase order.

- Of the 11 disbursements examined that did have purchase orders at the Murfreesboro facility, 2 purchase orders (18%) were not dated. As a result, it was impossible to determine whether the purchase orders had been completed timely.

- Of the 17 disbursements tested at the Humboldt facility that were supported by purchase orders, 2 purchase orders (12%) were dated after the services were rendered, indicating that the purchase order was not approved prior to purchase. Of the 9 disbursements tested at the Murfreesboro facility supported by a dated purchase order, 5 purchase orders (56%) were dated after the services were rendered.

- Seven of the 17 purchase orders tested at the Humboldt facility (41%) were not completed properly. The purchase orders did not include a description of the item, quantity, approximate price, or the preferred vendor.

- One of the 17 purchase orders tested at the Humboldt facility (6%) was not properly approved. In addition, two purchase orders totaling over $200,000, which were used for the purchase of the new information system, were not properly approved. One of the 11 purchase orders tested at the Murfreesboro facility (9%) was not properly approved.

In addition to the problems noted during the examination of documents, problems were also noted during discussions with various facility personnel. Staff at the Murfreesboro facility stated that most purchase orders were prepared on the date the invoice and/or goods were received from the vendor. Another staff member signed and dated the purchase order as received without actually seeing the goods or knowing the services were received. According to the staff at the Murfreesboro facility, standing purchase orders were not utilized by the facility during the audit period; however, most contracted or routine services did not have a purchase order. In

addition, no documentation of quotes or formal bids could be provided by staff at the Murfreesboro facility, and staff stated 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. Also, Administrator approvals for payment were made without the Administrators being provided with the accompanying support. Again, failure to follow purchasing and cash disbursement policies and procedures could result in fraud, abuse, or waste. The combination of the lack of approvals on the front end of the transaction with the lack of appropriate review prior to payment could result in significant, undetected, improper payments.

Contract approvals required by state law not obtained

In response to the prior audit findings regarding contract approvals, in fiscal year 2000, management stated that service contracts would be established and approved to the extent possible. This was obviously not a priority for them though and the finding was repeated in the next audit. In response to the June 30, 2001, finding, management again concurred and stated that they had updated 22 of 63 contracts and the rest were being continued with existing rates. They stated they would continue to update as time and staff constraints allowed. The finding was repeated again in the June 30, 2002, audit and this time management's response was very different from the prior year. They stated that they had *begun* the process of identifying the contracts that should be obtained or updated. They stated that it was an overwhelming task and that a timeline would be developed for obtaining compliance. They even stated that they anticipated measurable progress to be shown by the end of the current fiscal year. However, progress in this area could not be demonstrated by management. In response to the finding for the year ended June 30, 2003, management shifted from the stance of promising measurable action to blaming the state government for what they referred to as a burdensome process. Management has since stated that an emphasis was placed on submitting contracts for approval through the Office of Contract Review. The results of this increased emphasis have not been observed. The conditions still exist. The board is still not in compliance with state law.

Service contracts are still not being prepared and sent to the Commissioner of the Tennessee Department of Finance and Administration for approval. To test compliance, we reviewed service vendors with more than $5,000 in purchased services. For 10 of 11 service vendors tested in Murfreesboro (91%) and one of 4 service vendors tested in Humboldt (25%), a service contract that was valid at June 30, 2004, could not be provided. Two service vendors in Murfreesboro had contracts with the board in the past; however, their contracts had expired. One contract at the Murfreesboro facility had been approved by the vendor; however, no one at the facility could provide a copy of the contract signed by board personnel. Another contract at the Murfreesboro facility was approved subsequent to June 30, 2004. In addition, two of the contracts at the Humboldt facility and two at the Murfreesboro facility had been approved by the Administrator of the facility only. None of these contracts were approved by the Commissioner of the Tennessee Department of Finance and Administration as required by Section 12-4-109, *Tennessee Code Annotated*. 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.

Contract payments not properly invoice or reviewed

The board does not have internal controls in place to prevent exceeding approved contract amounts and to ensure services were received. This problem was noted in the prior audit, but management's reply was not responsive to this issue. When a payment to each of the five vendors with Murfreesboro contracts was reviewed, one of the five payments to Murfreesboro service vendors (20%) exceeded the maximum rate per individual service as stated in the contract. When one payment to each of the vendors at each facility was reviewed, 3 of 4 payments from the Humboldt facility (75%) and 3 of 11 payments from the Murfreesboro facility (27%) did not have adequate supporting documentation in the request for payment. For example, time sheets 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. Also, one invoice and the related supporting documentation could not be tested at the Murfreesboro facility as it could not be located by facility personnel.

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, and a standing purchase order should be maintained for contracted or routine services. The Financial Director should ensure that bids and price comparisons are performed as required by the board policy and properly documented. 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. Management should also retain all invoices and supporting documentation for vendors. 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.

The board should complete a serious evaluation of management's response to this control weakness to determine why it has not been addressed and why management has not followed through with promised actions.

The Executive Director should ensure that risks related to unauthorized purchases are adequately identified and assessed in the board's documented risk assessment activities. The policies and procedures in place should be evaluated to ensure proper internal control to prevent and detect exceptions timely. The Executive Director should identify specific staff to be responsible for ongoing monitoring for compliance with the policies in place and to be responsible for taking prompt action should exceptions occur.

Management's Comment

We concur that purchasing procedures were not being followed by facility staff in fiscal year June 2004. With the implementation of new accounting software and the required use of electronic requisitions, staff was in-serviced on the new procedures as well as purchasing policies. Facility staff will be held accountable for purchases made without a purchase order and accounts payable personnel for making payment to vendors without proper documentation.

In order to ascertain compliance with board policy, all accounts payable invoices and supporting documentation are reviewed by the staff accountants prior to being processed for payment.

It is a stated goal of the TSVHB to provide the best possible service to our residents at the best possible cost. In order to do so, and in fact, provide for the prudent management of financial resources, it is apparent that bringing contracts up to date must become a higher priority than working on this project as time and staff constraints allow. Staff work time will be allocated to correcting this deficiency, and a schedule will be developed for contract review and update. Procedures currently being developed will include provisions for review of contract requirements and payment methodologies prior to disbursing funds and for monitoring amounts outstanding on contracts.

8. For the sixth consecutive year, management has not assessed and mitigated the risk that the facilities may pay for goods not received

Finding

As noted in the prior five audits, internal control for payables is not adequate. The board has not fixed the condition and therefore has not adequately addressed the fraud risk of employee theft of newly received equipment and supplies. When bills are submitted for payment without an individual taking responsibility for having received the goods paid for, accountability is not established and theft could occur, leaving board management without an individual to hold accountable.

This finding was first noted in the audit for the year ended June 30, 1999. Management concurred and stated that their efforts would continue to provide proper verification of receipt. After the finding was repeated for the year ended June 30, 2000, management stated that the Administrators would ensure that invoices were stamped and dated. But this did not occur. No evidence of Administrator monitoring could be provided. In response to the finding for the year ended June 30, 2001, management stated that improvements had been made but that there were still some instances of noncompliance. They again promised that the Administrators would review to see that proper documentation was occurring. Again, this was not the case. In response to the finding for the year ended June 30, 2002, management went as far to say that the Administrators had ensured compliance as of September 1, 2003, in Murfreesboro and November 1, 2003, in Humboldt. But this compliance was not ensured, and management could not provide

documentation on what they were doing to provide that assurance. In response to the repeated finding for the year ended June 30, 2003, the board stated that employee education would be conducted in fiscal year 2005. This education occurred at the Humboldt facility in January of 2005. However, the current payables clerk at the Murfreesboro facility stated that she did not receive any training, concerning payables, before being placed in the position. During the year audited, verification of receipt was still not consistently documented. As the repeat findings continue, it's becoming clear that either management has not made an effort to resolve the finding or management is not capable of affecting the behavior of the board employees.

We tested ten purchases of goods for the year ended June 30, 2004. Five of the ten (50%) 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 this verification, 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.

It was also noted, in other instances, that the board's policy for receipting goods was not followed. The policy states, "The department supervisor will, in conjunction with another individual employed by the Home, verify the receipt of all items on the purchase order. Both individuals will sign and date the purchase order." Four of ten disbursements tested (40%) only had the signature and date of one individual verifying the receipt, instead of the two as required. At the Humboldt facility, it was also noted that the signatures indicating that items were received were on the invoice itself and not the purchase order. As a result, there is no documentation of the purchase order being compared to the actual invoice. Overall, problems with the receipt of goods were noted in eight of ten disbursements tested (80%).

Recommendation

Management should take the resolution of this finding seriously. If occasional monitoring is occurring by the Administrator but that monitoring is not effective to control the actions of employees, then the Financial Director should monitor 100% of these types of payments and take disciplinary action as necessary until the finding is resolved. Monitoring should be established after that point to ensure that the employees continue to do their jobs as directed. Actions taken to resolve the finding should be documented, and management should not allow this noncompliance with policy to continue. No payments should be made on items for which the policies have not been followed. A checklist should be established for accounts payable personnel to complete to ensure that prior to payment they have checked the documentation for all approvals and verifications that are required by policy.

The board should determine why management has consistently failed to address this risk that was noted six years ago. Based on the error rates noted, the board should evaluate if management really was performing the monitoring promised.

The Executive Director should ensure that risks related to unauthorized payments are adequately identified and assessed in the board's documented risk assessment activities. The policies and procedures in place should be evaluated to ensure proper internal control to prevent and detect exceptions timely. The Executive Director should identify specific staff to be responsible for ongoing monitoring for compliance with the policies in place and to be responsible for taking prompt action should exceptions occur.

Management's Comment

We concur that documentation of receipt of goods is not adequate. An internal review of the accounts payable offices shows that documentation of receiving goods is not in compliance with board policy and that invoices are being paid without this documentation. Accounts payable personnel at both facilities have been reprimanded. Additional in-service and training will take place to reinforce the need for better job performance.

In-service and training with other staff who receive goods will take place at both facilities by the finance director. Personnel will be held accountable if procedures are not followed.

9. For the fourth consecutive year, management has not assessed and mitigated the risks associated with travel reimbursements, resulting in excessive reimbursement of over $1,350

Finding

As noted in the three 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 travel by employees of the homes as for board members. If management does not follow established policies for travel claims, the board risks making excessive reimbursements.

In response to the finding for the year ended June 30, 2001, management stated that they would conduct training and that the accounts payable clerk would review all travel claims. Also, the executive assistant would spot-check the travel claims for compliance. Documentation that this monitoring occurred was not provided, and the problems continued. In response to the finding for the year ended June 30, 2002, management stated that training would be performed in March and December of 2003. Management also stated that the Administrators would ensure

compliance. However, the Administrators either did not take the issue seriously or were unable to affect the behavior of their employees. The finding was repeated for the year ended June 30, 2003. In response to the finding, management concurred and stated that training was provided for the Humboldt and Murfreesboro accounts payable staff on June 17, 2005, and they stated that the department heads would be trained as soon as a time was set. The board also approved a new travel policy on May 27, 2004, which states that the Administrators should approve all travel claims of employees of the individual homes. This change in policy was made to eliminate the wording in the old policy that the board would approve all the claims since that was not being done consistently. It is yet to be seen whether the June 2005 training will have an effect, but for the year ended June 30, 2004, travel claims were still not in compliance.

There were 582 travel claim expenses submitted by the staff or board members of the Tennessee State Veterans' Homes Board for the year ended June 30, 2004, totaling $58,448. Sixty claims, 30 in Humboldt and 30 in Murfreesboro, were selected for review, as well as testwork performed on the Executive Director's travel claims.

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, 2 of 25 claims tested (8%) and in Murfreesboro, 5 of 29 claims tested (17%) included mileage totaling $171 that appeared excessive.

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 Humboldt, 2 of 18 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, 3 of 17 claims tested (18%) exceeded allowable per diem amounts. In Humboldt, one of 21 claims tested (5%) exceeded the allowable per diem amount. Also, personal phone calls were claimed in excess of the per diem for three claims. In total, the allowable per diems were exceeded by $171 for the items sampled.

In addition to the travel claim testwork mentioned above, the auditor tested the Executive Director's travel claims that included mileage. Based on the testwork performed, it appears that the Executive Director was reimbursed twice for the same travel claim. Two checks were written for the same amount. Support could be provided for one of the disbursements, but not for the other. The amount of the claim was $1,003. In addition, the Executive Director submitted two separate forms requesting reimbursement for posting job opportunities on the Internet. The fee for the posting was $42. One form was supported by the Executive Director's credit card statement; the other, an invoice from the vendor.

Also, the support for two disbursements that appeared to be travel claims totaling $692 could not be located by the Murfreesboro facility. Therefore, these items could not be tested for compliance with policies.

The appropriate signatures and approvals for travel claims were not always obtained. Numerous travel claims were not approved by the designated individuals. The veterans' home travel policy prior to May 27, 2004 stated, "The fiscal agent or his designee will complete and submit all travel reimbursement forms 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." On May 27, 2004, a new travel policy was approved. The approval portion of this policy is as follows:

> For Board members and the Executive Director, the Executive Director or his/her designee will complete and submit all Travel Reimbursement Forms to the Board Chairman for approval and signature. In the absence or unavailability of the Board Chairman, the Vice Chairman or the Secretary/Treasurer of the Board shall be the designated signatory. Travel Reimbursement Forms for the Board Chairman shall be approved and signed by the Vice Chairman or the Secretary/Treasurer of the Board. Travel Reimbursement Forms for the Administrators, the Executive Assistants, and other employees under the direct supervision of the Executive Director shall be approved and signed by the Executive Director or the Board Chairman. Travel Reimbursement Forms for all other employees of the facilities shall be approved and signed by the appropriate Department Head within the facility, and approved and signed by the Administrator.

Each travel claim was tested according to the policy that was in effect at that time. In Murfreesboro, 16 of 30 claims tested (53%) and in Humboldt, 20 of 30 claims tested (67%) were not properly approved for payment.

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 Humboldt, 2 out of 30 claims tested (7%) were submitted late. The two travel claims were submitted 35 and 36 days after the completion of travel. In addition, in Murfreesboro, 7 of 30 travel claims tested (23%) were not dated. In Humboldt, 5 of 30 (17%) were not dated by the claimant.

As a result of not adhering to the travel regulations, numerous travel claims were overpaid. The board appears to have made overpayments in the amount of $1,387.

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 Financial Director should monitor this process to ensure that overpayments do not continue. The individuals responsible for accounts payable should be held responsible for ensuring that any travel claims approved for payment comply with the travel regulations. 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. Duplicate payments should be researched and recovered.

As part of a comprehensive risk assessment, the travel claim process should be reviewed. The board should determine why management has not resolved this finding in the four years since it was first noted.

Management's Comment

We concur that travel claims paid were not always in compliance with state travel regulations.

The board chairman gave written authorization for the payment of the executive director's travel after the travel claims had been reviewed by either the executive assistant or the executive secretary. Once reviewed, a copy of the travel claim was sent to accounts payable for payment. The original travel claim would then be held for the chairman's signature at the next board meeting. Once signed by the chairman, the original was sent to accounts payable to be filed in the paid invoices files. On a few occasions, the travel claim was paid a second time, when the originals were received. An internal review of the executive director's travel claims was made and it was noted that there was another incident of his receiving two payments for the same travel. The overpayments were reimbursed to TSVHB and steps put into place to preclude this from recurring. A cover sheet is attached to all travel claims for the executive director that notifies accounts payable that the claim is to be paid or is to be filed in the paid invoice folder. Additionally, the executive secretary matches the check copies with the travel claims filed to mitigate the possibility of duplicate payments being processed.

10. For the third consecutive year, because management has not assessed risk, internal controls for information systems are not adequate, leaving the board's records susceptible to fraud and improper alterations

Finding

As noted in the prior two audits, internal controls for information systems are not adequate. The findings in the prior audits related to the information system developed and maintained by National HealthCare Corporation (NHC), which has served the board in the capacity of management company and consultant. In October 2004, the board implemented a new information system that was developed by Monette Information Systems. In response to the

finding from the year ended June 30, 2003, management stated that the information system function had been brought in-house and that policies and procedures had been developed and approved. In response to the finding included in the audit of fiscal year ending June 30, 2002, management stated that it would take the recommendations of the auditors under consideration during the process of developing these procedures. Although some parts of the finding were addressed in the new policies and procedures for the new system, there are still significant weaknesses, particularly with access to the system.

A lack of control over an accounting system has widespread fraud risk implications. When transactions can be altered or added by individuals who should not have the ability to do so, it affects all aspects of the risk assessment of an entity. Thefts could easily be covered up by individuals with inappropriate access to the system. Also, there are other risks that the board leaves itself exposed to such as disgruntled employees or hackers getting into the system and intentionally sabotaging the records contained within. This issue, in combination with the other significant control issues noted throughout this report, could allow fraud or intentional alterations of data to occur in large amounts and to go undetected by management.

The Monette system 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. Several instances of improper access to the system were noted.

- Seven of 43 employees tested (16%) did not have a written request from management granting them access.

- Sixteen of 36 employees tested (44%) had an incomplete request. The request did not indicate the type of access to be given.

- Two of 36 employees tested (6%) did not have a properly approved request. The board's policies and procedures state, "A signed System Access Request must be completed and presented to the system administrator" before the employee is granted access to the system. Based on the System Access Request form, all requests are to be approved by the employee's department head and the facility's Administrator. One employee approved his own request, and the other employee's request was approved only by the system administrator.

- During access testwork, one written request was noted that did not indicate when access was changed. Since this was not indicated on the request, the auditor could not determine whether or not access was approved before it was changed.

- Three of 35 employees tested (9%) had access established before the written requests were properly approved.

- One of 36 employees tested (3%) had access other than what was requested. The written request indicated that the employee should receive "Receptionist" access, but she received access to Patient Trust.

- Four of 14 people tested (29%) who were no longer employees of the facility still had access to the system. These individuals' employment had been terminated between one month and five months prior to the date of the report listing individuals with access to the system.

- Two employees actually had two user IDs. For each of the employees, one of the user IDs had been disabled in the system. However, there is no way to determine when a user ID is created and when a user ID is disabled.

The auditors also could not determine whether a complete listing of users was received. When the auditors requested a listing of all users on the Monette System, management did not provide a complete listing. This error was discovered during testwork as two key business office employees from the Humboldt facility were not on the list of users. After discussions with the information technology manager, it was determined that the listing that was provided to the auditors pertained only to the Ultracare system. Additional listings including the names of those individuals with access to the MAS 200 system, the system containing the financial information; and Abra, the payroll system, were later obtained. From observation of both listings, the auditor determined that there were three users who were on the additional listings but were not on the first listing. Additional testwork was required due to the management oversight.

While performing the auditor walkthrough of the information system, several other problems were noted concerning internal controls, documentation, and reconciliations.

- The server rooms were not restricted to authorized personnel. The auditor observed employees entering and leaving the rooms frequently to obtain files or office supplies. Before May 19, 2005, the rooms were not locked consistently. After this date, the server rooms were locked and restricted to authorized personnel.

- There is no documentation of the IT Steering Committee meetings. The Executive Assistant in Humboldt does take notes and discusses the issues in the notes with the chairman of the committee, but there is no formal documentation to show what was discussed at the meetings.

- The reconciliation of Ultracare (the portion of the system related to resident care and resident billing) to MAS 200 (the portion of the system related to the general ledger) is performed at each facility on a monthly basis. However, the reconciliation for the Murfreesboro facility for January 2005 does not reconcile. At that point, the two systems were out of balance by $322,479. According to the Business Office Manager, these reconciliations have not balanced for the past few months. The auditor reviewed the September 2004 reconciliation; it did not reconcile. Therefore, this is an ongoing problem. The Business Office Manager stated that Monette

Information Systems, the vendor for the information system, has been contacted about the problem, but no solution has been found as of June 22, 2005.

- A formal disaster recovery plan has not been developed or approved. Also, no alternate processing site has been established.

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. Also, weak controls increase the risk of fraud. Weak controls, with the computer system in particular, could allow employees to conceal fraudulent activities.

Recommendation

The risks identified in this finding should be immediately addressed. The security and controls over the system should become a priority for the board. The board and upper management must be particularly sensitive to the need for effective controls over information technology operations on a consistent basis. The responsibility for effectiveness of these controls rests with management and the board. Since top management and the board may not be familiar with the latest technological advances, it is important that they have competent, ethical technical staff to oversee these activities. This staff should be assigned to assess the risks related to the information systems, and top management should meet their overall responsibility to monitor the risk assessments and the internal controls in suggested to mitigate those risks.

The resident billing system should be reconciled to the general ledger immediately to examine whether fraud or unauthorized alterations have occurred. The board should make sure that the Financial Director accepts this as an immediate priority. Definite, inflexible deadlines for reconciliation of the systems should be established to make sure that the issue is resolved. The Financial Director should determine the cause for each reconciling item and develop a solution to resolve each reconciling item. Each correction that is not a routine adjustment should be reviewed and approved by the Executive Director.

Access to the rooms in which servers are housed should be restricted to only those whose jobs require such access. When employment is terminated, the Information Technology Manager should ensure that access to the system is removed immediately. Documentation requesting access as well as Steering Committee documentation should be maintained by 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 compliance.

Management's Comment

We concur that internal controls for information technology were not adequate for fiscal year June 2004. With the implementation of the new computer system, several parts of previous audit findings were addressed. We concur that errors and omissions were discovered on written system access request forms. A subsequent internal review of the access forms and corresponding computer system access indicated that, although all the forms were not completed correctly, those individual employees had indeed been granted the proper access. All system access request forms are now reviewed by the IT Director prior to establishing access.

We concur that the names of the employee workgroups did not always match the descriptions of the user access categories. Although the access was correct, the names of the user access categories have been revised to more directly coincide with the names of the employee workgroups.

Procedures have been developed to ensure that the IT Department is notified timely when an employee with computer access is terminated so their access rights can be immediately disabled. In the case of employees whose names change, we have developed a procedure for recording the date their access is disabled under their old name and the date that new access is established under their new name.

TSVHB entered into an agreement with Net Telcos, Inc. on July 22, 2005 for Disaster Recovery data backup services and housing of a backup server and alternate processing site for access to our computer data files in the event of a disaster.

TSVHB began using ULTRACare in September 2004 and encountered difficulties with the system for the first three months of operation. At the end of June 2005, the general ledger for each facility was out of balance by roughly $40,000 with the billing software and the out-of-balance amount closed out against revenues for year end. Since then, any out-of-balance issues have been investigated and resolved. There are still some minor issues with general ledger coding that need to be researched.

11. Management's lack of organization increases audit risks and is an impediment to the audit process

Finding

Management did not retain all documentation necessary for the audit process. In addition, documentation that should have been readily available for review by auditors was often not provided to the auditors until one month or more after the request was made to management. In several instances, the documentation that was ultimately provided to the auditors was inaccurate. As this has been an issue in the past, the audit team tried to give the board as much time as possible to locate the documentation. However, not all documentation was available or readily available, nor was the documentation always complete.

The audit process is multi-faceted, with an audit team performing a series of tests and samples over a period of months. While no test was completely unsuccessful in its objective, documentation that is missing or inaccurate raises questions about management's ability to truly manage an organization with assets exceeding $14 million and revenues exceeding $12 million.

The lack of organization appears to be a direct result of the excessive turnover of employees, particularly at the Murfreesboro facility. Since the end of the fiscal year under audit, the Murfreesboro facility has hired a new Administrator, a new business office manager, a new accounts payable clerk, and two new accounts receivable specialists. Both facilities have added personnel in efforts to correct the findings that have plagued the board for the past several years.

Documentation that was not available for review at the Murfreesboro facility included support for five payments to employees for either the reimbursement of travel expenses, payment of employee benefits, or the reimbursement of tuition payments. Documentation supporting three payments to vendors was also unavailable for review. These vendors included a staffing agency to whom the board had paid almost $15,000 during the fiscal year under audit and NHC, the former management company. In addition, as noted in finding 6, the petty cash reimbursement forms with related supporting documentation covering nine months of the fiscal year under audit could not be provided to the auditors.

The facilities' method during the audit period of approving invoices for payment includes the Administrator's reviewing the listing of payables, known as the Aged Trial Balance, and initialing those invoices that should be paid in the near future. These listings are the only documentation of approval for payment at the facilities. The Murfreesboro facility was unable to provide this documentation for the period July 1, 2003, through March 30, 2004.

Documentation that was not available for review at the Humboldt facility included a memo sent to an employee regarding a long-outstanding check and a UB92 for a particular resident for a period of time in March 2004. A UB92 is the form used to bill Medicare and one level of Medicaid.

Each facility also maintains a resident trust fund, which includes funds that are the property of the residents. These funds are held in an interest-bearing bank account, with the interest ultimately being allocated to the residents. During any time period, a report called the "Transaction for All Report" provides the documentation for all activity within the fund. At any point in time, a report called the "Patient Trust Fund Balances Report" provides the balance of the fund in total and each individual resident's balance within the fund. The Murfreesboro facility was not able to provide the Transaction for All Report for July 2003 or the Patient Trust Fund Balances report at June 30, 2004. Because the board implemented a new information system, the information was no longer available at the facility. Other information related to the resident trust fund was obtained by the facility from the former management company, but these two reports were not provided. As a result, the auditor performing testwork on the resident trust fund recalculated the balances for each resident at June 30, 2004. This task took a great deal of time and should not have been necessary.

As previously stated, documentation was not always readily available. The auditors were told on several occasions that documentation could not be located. Only after the Administrators were asked to sign a form indicating that the documentation could not be located was the documentation provided to the auditors. Documentation supporting 18 accounts payable and three disbursements at the Murfreesboro facility was requested on April 7, 2005. It was ultimately provided to auditors on May 20, 2005, more than six weeks later. Supporting documentation for the purchase of furniture exceeding $15,600 was requested on April 7, 2005; however, it was not provided to auditors until June 6, 2005, or 59 days later.

In some instances, the documentation received by the auditors was incomplete. The auditors requested a listing of all bank accounts used by the Murfreesboro facility, the Humboldt facility, and the foundation. The listing that was obtained on behalf of the Murfreesboro facility at the beginning of the audit process was not complete. A revised listing was obtained in May, after the auditor made personnel aware of errors. As noted in finding 3, multiple versions of the physical inventory records for each facility were received by the auditors. As noted in finding 10, an incomplete listing of information system users was provided to the auditors. When the auditors are unable to determine if they are testing a complete population or if they have been provided all necessary information, assurances can only be given after additional audit procedures are performed and after much additional time and effort is spent. As the board does not pay for its audit services provided by the Comptroller, ultimately, the cost of this additional time and effort is borne by Tennessee taxpayers.

When documentation is missing, the board will find that it will not be able to hold individuals accountable for the items paid, received, or approved. If documentation is not retained for audit purposes, the probability of an audit disclaimer increases.

Recommendation

The board must take the responsibility to ensure all financial information is complete, accurate, and available to auditors. The risk of fraud should be evaluated related to this condition, and appropriate controls should be developed to offset the risks. The Executive Director should immediately adopt an effective file management system that allows business office personnel to locate documents as requested. A document retention policy should be instituted that meets audit needs as well as the needs of the board. The board should stress the importance of this to management and take administrative action as necessary if changes are not made. The board should consider adding an internal auditor to the staff to help identify where management is failing and to ensure that the business office is managed appropriately.

Management's Comment

We concur with this finding and understand the frustrations expressed by the auditors. Records were not organized and in good order during the audit of fiscal year June 2004. Certain

documentation on the prior accounting system was not able to be reprinted. The current accounting system, which is run in-house, is able to reprint reports as needed.

Turnover in the Murfreesboro business office has stabilized over the past year and reviews of the accounts payable and business offices files were made with the goal of better organization.

12. The Tennessee State Veterans' Homes Board has not segregated duties related to payroll, leaving the board vulnerable to inappropriate payroll payments

The segregation of duties over the payroll function at both Tennessee Veterans' Homes facilities does not appear adequate to prevent the possibility of fictitious employees being added to payroll or to prevent other fraudulent payroll activities.

Prior to October 1, 2004, the board had procedures in place over the addition of employees to the payroll records, changes to personnel information in the system, and the processing of payroll that included the requirement that the facility Administrator approve such transactions. This would be documented by the Administrator entering a completion code into the payroll system. Furthermore, the records were then sent to the management company (NHC) to have the actual checks printed and sealed in envelopes, which were then returned to the facility for distribution by the receptionist.

On October 1, 2004, the management company participation ceased, and the board purchased its own systems for all functions including payroll. With these new systems, and because the management company was no longer handling its accounting, the board became responsible for adopting its own policies and procedures for operation. However, the board did not assess its risks in this area and did not develop adequate policies (see finding 11). There are no policies or procedures in place for the Administrator to approve new additions to payroll, personnel information changes in the system, or the final payroll before processing. The payroll officer is the last employee required to review any of the information. This payroll officer has full edit access to the payroll system, and prints and seals the checks in envelopes before the receptionist gets them to distribute. In fact, the payroll officer in Murfreesboro actually enters all payroll information for an employee into the system with no segregation of duties. The payroll officer also receives, retains, and investigates any returned W-2 forms.

This lack of segregation of duties and lack of upper-level review of payroll activities leaves the board open for fictitious employees to be added to the payroll and significant amounts to be paid for services that are not received by the board. Other risks include unapproved salary increases and terminated employees being left on the payroll and a change being made in the system to alter where the funds are sent or deposited. Combined with the fact that returned W-2 forms are kept and investigated by the payroll clerk, a fraud scheme by that individual would be easy to commit and easy to conceal.

Recommendation

The board should immediately segregate the duties over the payroll function to reduce the risk of fraud to a minimal level. Separate individuals should be responsible for adding new employees to the system and processing the payroll payments. The payroll clerk's access to the computer system should be altered to only permit the ability to accomplish one of the aforementioned tasks. A separate individual should be designated to approve all personnel changes and to approve all payroll payments. This individual should have knowledge of what changes are appropriate and his or her review should be mandatory in order to discourage any attempts or temptations to manipulate the payroll system. Returned W-2 forms should be investigated by a separate individual in the business office.

The Executive Director should ensure that risks related to fictitious employees and overpayments to employees are adequately identified and assessed in the entity's documented risk assessment activities. The Executive Director should identify specific staff to be responsible for the design and implementation of internal controls to prevent and detect exceptions timely. The Executive Director should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt action should exceptions occur.

Management's Comment

We concur. However, we feel controls are now in place to mitigate the risk of improper payments.

When an employee is hired, the direct department head signs a form listing all of that employee's information. This new-hire information is then sent to the administrator for approval and then to the payroll office for entry into the payroll system. After all information is entered into the payroll system, a change report is printed and the Administrator signs that as well to verify the information received earlier matches. It is then filed in the employees file.

The payroll data is also reviewed by the staff accountants prior to finalizing the pay run as part of the payroll process.

13. <u>The board paid $5,399 for an employee's board-issued cellular phone for nine months after the employee's resignation</u>

The board supplies cellular phones for its key employees and pays any fees related to these phones. These phones should be returned to the facility immediately upon the termination of an individual's employment. One individual at the Murfreesboro facility, however, continued to use her phone for nine months after her resignation on April 21, 2004, until the accounts payable clerk noticed the problem in February 2005.

Between the employee's resignation and the time that the phone's contract was canceled in February 2005, the former employee not only used the phone on a regular basis, but used the phone in excess of the phone's package plan of 1,700 minutes per month. In November 2004 alone, the phone was used for 5,082 minutes (or over 84 hours). Therefore, the facility was paying high overage fees as well as the monthly fee for the phone. A total of 37,177 minutes (or over 619 hours) were used during this time. This phone use averaged 2 hours per day. As a result, the board paid $5,399 in fees for a cellular phone that was no longer in its possession or its control.

Although the board has a checklist for use in determining if all board equipment and keys have been retrieved from the employees, the checklist is often not completed. Since the discovery of this issue, the Administrator of the Murfreesboro facility has gathered all of the cell phone bills and verbal statements from several employees. The board is in the process of determining whether to send this issue to the Attorney General's Office. While the board did eventually notice the problem and canceled the use of the phone thereafter, this incident underscores the problems that the board has with controls over the disbursement process in general. The board continued to pay the invoices for this phone for nine months without determining whether the charges were appropriate or allowable.

Recommendation

The Executive Director should ensure that risks of inappropriate payments are adequately identified and assessed in the entity's documented risk assessment activities. The Executive Director should identify specific staff to be responsible for the design and implementation of internal controls to prevent and detect exceptions timely. The Executive Director should ensure that policies and procedures are in place and are followed to ensure that any equipment belonging to the board is returned by all employees upon their resignation or release. Procedures should also be in place to ensure that all invoices are reviewed for propriety before disbursements are made. The Executive Director should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt action should exceptions occur.

Management's Comment

We concur with this finding. Working with the Attorney General's Office, certified letters were sent requesting repayment from the former employee. None of the certified letters were picked up from the post office. The administrator called and spoke with the individual about the amount owed to TSVHB and the need for immediate repayment. After no action by the former employee to make restitution, we are waiting for a TBI investigator to assist in the warrant process.

14. Duties for the Tennessee Veterans Home Foundation are not adequately segregated to deter receipting fraud, and as indicated in the prior audit, the improper accountability for restricted foundation accounts creates the risk that funds will not be used for their intended purpose

Finding

The 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. At June 30, 2004, the total of all restricted funds was $11,243, and the total of unrestricted funds was $76,373.

Segregation of Duties

Even though the foundation is separate from the board, foundation operations are performed primarily by board personnel. However, most of the financial functions are performed by one individual. The fact that one individual performs most functions represents a severe lack of segregation of duties and leaves the board exposed to thefts that could occur and go unnoticed.

Foundation donations are received in person by two or three individuals at each facility and through the mail at the Humboldt facility. The Murfreesboro facility and the Central Office share a post office box, which could also receive foundation donations. Regardless of the receipting location, the donations are ultimately given to the executive secretary, who works in the Central Office. At this point, the only log that is made of the donations is for those donations received at the Humboldt facility. When the executive secretary receives donations, she must return the donations to the Murfreesboro facility for a receipt to be written and the deposit to be prepared. The funds are deposited by the person from the Murfreesboro facility taking the facility's daily deposit to the bank. When the bank statement is received, the executive secretary reconciles the bank account and prepares the financial statements.

The above procedures create several internal control issues. The receipting function for donations is not centralized. At each facility, the activities director and the receptionist, as well as the assistant to the Executive Director in Humboldt, often receive donations for the foundation. Any donations received at the Humboldt facility and turned in to the assistant to the Executive Director are noted on a log. However, the log, after it is sent to the executive secretary at the end of the month, is only reviewed by the executive secretary. All donations are given to the executive secretary. While she does not prepare the deposit, there is no independent review of the log received from the Humboldt facility to ensure that all donations received are deposited, and there is no log of the donations received at the Murfreesboro facility until the receipt is written for all donations prior to preparing the deposit. One person should not have the responsibility of ultimately receiving all funds, reconciling the bank statements, and preparing financial statements. This process lacks the segregation of duties required in the cash receipting process and could result in thefts that could easily be concealed. The board did not adequately evaluate the risk of theft when setting up this process.

Accountability for Restricted Funds

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 was not analyzed by the foundation during the audit period.

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 executive secretary, 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 was allowing several of these restricted accounts to carry a negative balance during the audit period. In other words, the foundation 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.

During the audit period, the foundation board did not evaluate the restricted accounts appropriately to ensure that this situation was not occurring. However, at June 30, 2004, the foundation did close out all restricted fund accounts with a negative balance. This does provide a clearer picture, but throughout the audit period there were negative balances shown. As mentioned, all of the restricted accounts and some unrestricted money are accounted for in the checking account. Prior to June 30, 2004, the foundation board was even allowing some of the unrestricted accounts accounted for in the checking account to carry a negative balance. The disbursements in several accounts exceeded the donations related to that account, resulting in an even larger deficit for those accounts. In Murfreesboro at June 30, 2004, funds that still had restrictions totaled $5,803. In Humboldt, the total was $5,439, for a board total of $11,242. This means that the foundation board is required to spend $11,242 in the future for the purposes stated.

In response to the prior-year finding, the format of the report given to the foundation board was changed. However, the first month in which this new format was used was June 2004, the final month of the audit period. At that time, negative restricted funds received additional funding from the unrestricted funds to bring restricted balances to zero. Therefore, for the majority of the audit period, the report format was still not adequate in showing all negative balances. Also, it appears that the board still intends to allow the negative balances but will just close them out occasionally.

In addition, during the closing process as described above, two positive restricted fund balances were mistakenly closed out to the unrestricted fund balance. At that point, the funds were no longer identified as restricted. At the Murfreesboro facility, the East Patio restricted account had a balance at June 30, 2004, of $380. At the Humboldt facility, the popcorn

restrictive account had a balance at June 30, 2004, of $39. These two accounts should have remained restricted.

Because the foundation still has unrestricted funds in the checking account, 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, 2004. However, if the foundation continues to allow the accounts to become negative, it still risks a situation whereby the funds could be used for purposes for which they were not intended.

Recommendation

The foundation board should perform a comprehensive risk assessment to identify and mitigate the internal control weaknesses. The foundation board must immediately revise its procedures to ensure that financial duties related to the foundation are adequately segregated. It should revise any existing procedures to ensure that all conflicting duties related to the cash transactions are appropriately assigned to separate individuals. The person performing the bank reconciliation should not be the person who receives or records the cash receipts.

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. Restricted accounts that were erroneously closed should be reopened, and the donors' intentions related to the funds should be honored. The foundation board should identify specific staff to be responsible for ongoing monitoring for compliance with the policies in place and to be responsible for taking prompt action should exceptions occur.

Management's Comment

We concur that duties were not adequately segregated during fiscal year June 2004. A representative from the Executive Office now reviews Foundation bank statements and cross checks the deposit logs received from the facilities. Murfreesboro began keeping a log of donations forwarded to the Executive Office in June 2005.

A new financial format was presented to the Foundation Board in October 2004 and approved. In order to account for all restricted funds and also provide a starting point for the new method, several accounts with a negative balance were offset with general/unrestricted funds with the knowledge and understanding of the Foundation board. We concur that two restricted accounts with positive balances were closed in error. After researching each item, the accounts were reinstated and listed with other restricted funds.

A change was made in the procedures for accessing Foundation funds. Purchases made for functions approved for Foundation grants are now processed by the facility. The facility will then present a request to the Foundation for reimbursement. If funds are requested for which there are no specified funds or, if they exceed the approved amount, then the facility must make a formal request to the Foundation Board for reimbursement over the approved amount or absorb the cost. While there are restricted funds within the Foundation's net assets, the total net assets, restricted and unrestricted, equal cash and investments (less any payable). None of the pooled assets are in and of themselves restricted for use.

15. The Murfreesboro facility had Medicaid residents with excessive resident trust fund balances that jeopardized their Medicaid eligibility

Finding

The Murfreesboro facility housed four Medicaid residents with resident trust fund balances in excess of $2,000 at June 30, 2004. According to Chapter 1240-3-3.03 of the *Rules of Department of Human Services*, "(2) Applicants for medical assistance . . . are permitted to retain resources in an amount not to exceed SSI limits. . . . (a) Resources excluded from consideration in determination of eligibility for medical assistance are: (1)(iv) Personal effects and household goods of two thousand dollars or less . . . ." Personal effects would include a resident trust fund. Three Medicaid residents and one Hospice resident (formerly a Medicaid resident) at the Murfreesboro facility maintained resident trust fund balances in excess of $2,000 at June 30, 2004. The balances in excess of $2,000 ranged from $2,929 to $6,020.

According to the Medicare and Medicaid Regulations Title 42 CFR Part 483.10, Resident Rights, the facility must notify each resident that receives Medicaid benefits that, if the amount in the account, in addition to the value of the resident's other nonexempt resources, reaches the SSI resource limit for one person, the resident may lose eligibility for Medicaid or SSI. Per discussion with facility personnel, when a resident trust fund balance for a Medicaid resident exceeds $2,000, the resident and his or her family is contacted. The resident and family are encouraged to determine if the resident is in need of anything to try to lower the balance. If the balance remains over the limit, Medicaid is contacted in regards to the resident's continued eligibility.

However, a review of these four individuals showed that the board is not following this procedure. All four of the individuals exceeded the limit for a minimum of three months prior to June 30, 2004, and continued for several months after the fiscal year end or until the death of the resident.

Recommendation

The business office manager and the Administrator of each facility need to follow the procedure to ensure that proper steps are taken when the resident trust fund balances for

Medicaid residents exceed the limits established by that program. The residents' families should be encouraged to spend down the balances. If action is not taken, Medicaid should be contacted when amounts exceed $2,000 to determine if the resident is still eligible for Medicaid assistance.

Management's Comment

We concur that during fiscal year June 2004, resident trust funds for Medicaid eligible residents sometimes exceeded $2,000.

Resident trust fund balances are now monitored closely by the business offices and are reviewed as part of the month end process followed by staff accountants. Balances in excess of $2,000 are questioned to the business office manager.

Accounts that are close to the maximum are flagged and the Social Services department notified so that appropriate use of funds can be made.

16. The board and management have not assessed the risk of noncompliance with Internal Revenue Service regulations and as a result have not established adequate policies and procedures to report the personal use of the Executive Director's car

Finding

In September 2002, the board purchased a 2002 Ford Taurus for the Executive Director's use. At that time, the car had been driven approximately 23,000 miles. Even though the board provided the Executive Director with the car and a Fuelman account for gas and routine maintenance, there are no approved policies and procedures related to this vehicle. As a result, the board has not complied with certain Internal Revenue Service Regulations (IRS).

According to IRS Publication 463, Travel, Entertainment, Gift, and Car Expenses (2004 Edition), "If an employer-provided vehicle was available for your use, you received a fringe benefit. Generally, your employer must include the value of the use or availability as pay." According to various IRS publications, commuting is considered personal use of an employer-provided vehicle. Typically, the value of the personal benefit is added to one's wage base on an employee's W-2 form at the end of each calendar year. However, this benefit has never been included in the Executive Director's wages as it should have been for calendar years 2002, 2003, and 2004.

The monitoring of the car's usage is also inadequate. The Executive Director is required to submit the Fuelman receipts to the accounts payable clerk; however, he is not required to keep a log of mileage or other documentation. Per the Executive Director, a policy was submitted to the board prior to the purchase of the car. However, the policy was not approved.

As a result of the lack of policies surrounding the vehicle, there has never been a clear distinction between miles driven for business use and miles driven for personal use. The Executive Director resides in Clarksville and drives to the executive office in Murfreesboro to work. He also frequently visits both facilities in Murfreesboro and Humboldt, as well as the current building site in Knoxville. The Executive Director stated that he only uses the car for business use and for commuting, which he considers to be the drive between Clarksville and Murfreesboro.

IRS Publication 15-B, Employer's Tax Guide to Fringe Benefits, gives several methods of calculating the fringe benefits including use of the car and gas. Since there are no policies indicating what would be considered commuting and there are no mileage logs, the auditors used the Executive Director's statement that he considers commuting to be the drive between Clarksville and Murfreesboro. The auditors also estimated the number of times per year that drive is made. Based on these estimates and the Annual Lease Value rule as described in Publication 15-B, the total estimated taxable amount for the period September 2002 through December 2004 is approximately $9,800. This amount is not exact as it is based on several estimates and only uses the base numbers from the Employer's Tax Guide to Fringe Benefits for Benefits Provided in 2005. As this publication is revised for each calendar year, the base numbers would differ slightly each year.

Effective internal control would include written policies and procedures as well as maintaining adequate documentation of asset usage. Inadequate controls over the use of the car could result in undetected personal use of board assets in addition to potential tax liabilities for the board as well as for the Executive Director himself.

Recommendation

The board should ensure that risks related to unauthorized payments are adequately identified and assessed in the board's documented risk assessment activities. Policies and procedures should be written to adequately address the board's expectations regarding the vehicle provided to the Executive Director and to ensure compliance with IRS regulations. Adequate documentation should be maintained for mileage and maintenance costs and should be reviewed periodically by the Financial Director. The Financial Director and payroll officers should review Internal Revenue Service regulations to determine the amounts that should be included as additional taxable wages in the Executive Director's W-2 each calendar year. The wage base reported on the Executive Director's W-2s should be recalculated and resubmitted for each calendar year ended after September 2002.

The Executive Director should identify specific staff to be responsible for ongoing monitoring for compliance with the policies in place and to be responsible for taking prompt action should exceptions occur.

Management's Comment

We concur. The board will assess the risk involved in the use of the vehicle provided to the executive director, as well as other vehicles provided to the facilities. Policies and procedures have been developed for the safe and efficient operation and maintenance of TSVHB vehicles, and specifically for the vehicle authorized for use by the executive director. Included in the policy is a requirement for documentation of mileage and maintenance. TSVHB prohibits the use of vehicles from personal use, other than the executive director commuting to and from work.

IRS Publication 15-B, Employer's Tax Guide to Fringe Benefits, provides an alternative method of valuation if the vehicle is used for business, personal use is prohibited, and this restriction on personal use is followed. Under this method the taxable benefit of commuting is valued at $1.50 per one-way commute, or $3.00 for each working day.

Under this rule, the executive director will reimburse the board the appropriate amount that should have been included in the taxable earnings from each calendar year after September 2002. For calendar year 2005, the appropriate amount was added to the executive director's wages.

17. <u>Medicaid residents were charged more than private-paying residents</u>

Finding

As noted in the prior-year audit report, 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.

In response to the prior-year finding, management concurred that the Medicaid reimbursement rate was greater than the room rate for part of fiscal year 2003. The board went on to state that this situation can arise annually when the facilities receive notification from the Medicaid Department of a retroactive rate increase. Management must both obtain 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. Management also stated that a procedure would 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 equals or exceeds the reimbursement rate from Medicaid. However, as of June 30, 2005, this proposal has not been approved by the board. According to management, the 30-day notice to residents would still be a necessary step prior to the implementation of a room rate increase. Current-year testwork shows that the Medicaid rate

exceeded the facility rates for eight months at the Humboldt facility and for the full fiscal year at the Murfreesboro facility.

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 level 2 Medicaid rate that was set for fiscal year 2004 was $158.33 per day, for both facilities. At the Humboldt facility, the level 2 private pay rate for the period July 1, 2003, through February 29, 2004, was $156.00 per day. This difference of $2.33 per day resulted in questionable payments from Medicaid in the amount of $4,001.61. At the Murfreesboro facility, the level 2 private-pay rate for fiscal year 2004 was $158.00 per day. This difference of $.33 per day resulted in questionable payments from Medicaid in the amount of $1,363.23. 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. Based on the small differences between the rates, in the majority of instances, a resident's room and board plus ancillary charges exceeds the amount that Medicaid would reimburse. However, there are instances where the opposite is true at both facilities.

In addition to the costs that the homes may be responsible for repaying, the Tennessee State Veterans' Homes Board also lost revenue to which they 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 be proactive to resolve this issue. When Medicaid rate changes are received, the changes should be reviewed by management immediately to determine the effect on private-pay rates. The board should determine why management failed to address the prior-year finding, and the board should follow through on its prior-year comment that it would establish a policy for automatic increases.

Management's Comment

We concur that for a portion of the fiscal year June 2004, room rates charged during the year were less that the Medicaid ICF reimbursement rates. It is the goal of TSVHB to hold its room rates to the minimum while providing quality care for its residents.

In an effort to prevent this situation from recurring, TSVHB established a policy on room rates, approved September 29, 2005. The policy states that any increase to the room rates required by an increase in the Medicaid reimbursement rates has the approval of the board and requires only the mandatory 30-day notification to the residents and responsible parties prior to going into effect.

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

Finding

For the second year, the Tennessee State Veterans' Homes Board has 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 7 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. These bank accounts were tested for compliance with Section 9-4-302, *Tennessee Code Annotated*, and Department of Finance and Administration Policy 07.

For at least portions of the year ended June 30, 2004, the Humboldt facility maintained 17 bank accounts. Of those accounts, 12 (71%) do not appear to be authorized according to Section 9-4-302, *Tennessee Code Annotated*. In addition, changes to four bank accounts (24%) were not reported to the Department of Finance and Administration as required by Policy 07. In total, 16 of 17 accounts (94%) were not in compliance with Section 9-4-302, *Tennessee Code Annotated*, and/or Department of Finance and Administration Policy 07.

For at least portions of the year ended June 30, 2004, the Murfreesboro facility maintained 13 bank accounts. Of those accounts, seven (54%) were not authorized according to Section 9-4-302, *Tennessee Code Annotated*. In addition, changes to two of the bank accounts (15%) were not reported to the Department of Finance and Administration as required by Policy 07. In total, 10 of 13 accounts (77%) were not in compliance with Section 9-4-302, *Tennessee Code Annotated*, and/or Department of Finance and Administration Policy 07.

In response to the prior-audit finding, management concurred that the bank accounts had not been submitted to the Department of Finance and Administration for approval and stated that this particular problem was addressed in fiscal year 2005. Management also stated that any changes in bank accounts would be communicated in writing to the Department of Finance and Administration. Management was able to provide the auditors with paperwork that had been submitted to the Department of Finance and Administration in December 2004. However, upon discussions with the department, it appears that approval for these bank accounts is not forthcoming. According to the Department of Finance and Administration, it is their opinion, which has been communicated to the board several times, that the board has too many bank accounts. As a result, none of the accounts included in the finding in the prior year have been approved as of June 30, 2005, and the board has added new accounts and closed other accounts since June 30, 2004.

Recommendation

The Financial Director should immediately meet with representatives from the Department of Finance and Administration to reach an agreement on the number of accounts that are required for the Tennessee State Veterans' Homes Board. The Financial Director should immediately close any accounts not approved in accordance with state law and Finance and Administration policy. If the board determines that additional accounts are needed in the future, the Financial Director should obtain approval before opening the accounts. The Financial Director should also ensure that any changes to accounts are promptly communicated in writing to the Department of Finance and Administration.

The board should determine why this issue has not been resolved. The board should review the process that management is engaged in to gain approval for the accounts and monitor

the progress toward approvals. The board should see that any required changes are made immediately so that the board is in compliance with the law.

Management's Comment

We concur that not all bank accounts were in compliance with Section 9-4-302, *Tennessee Code Annotated*, and Department of Finance and Administration Policy 7 for fiscal year June 2004. Approval for all but three bank accounts was received in December 2005. The three accounts that still require approval are the three bank accounts for the construction projects. Applications for the bank accounts have been submitted to the Department of Finance and Administration.

19. <u>The board failed to submit in a timely manner a Title VI plan relating to compliance with the Civil Rights Act of 1964</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 current audit period, and as was noted for the prior audit period, the board was not in compliance with the state law.

The implementation plan did not specify an individual to be responsible for Title VI compliance until July 22, 2004. A written implementation plan was not approved by the board until September 30, 2004, and was not submitted to the Title VI Compliance Commission until October 2004. The Department of Audit did not receive an annual compliance report until June 29, 2005.

Management concurred with the prior audit finding and recommendation and stated that the issue had been addressed in the year ended June 30, 2005. The results of our examination indicated that the board was in compliance with the state law in the year ended June 30, 2005.

Recommendation

The board should ensure that all subsequent deadlines regarding Title VI compliance are met. The board should ensure that the annual compliance report is submitted on or before June 30 of each year to all required state departments.

Management's Comment

We concur there was no Title VI Plan in place for fiscal year June 2004. As noted in the finding, the board was in compliance with state law for the year ended June 2005. An initial Title VI Plan was developed and submitted October 2004. The plan was approved by the Comptroller of the Treasury June 29, 2005. An Annual Title VI Compliance Report was submitted along with an updated Implementation Plan on June 30, 2005 as required. To insure continued compliance, the board will develop and monitor a schedule of annual reports and submissions required by regulatory agencies.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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Independent Auditor's Report

June 27, 2005

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, 2004, and June 30, 2003, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years 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 audits.

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 audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrusts certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving plans of operation of the Tennessee State Veterans' Homes Board; approving certain state contracts; participating in the negotiation and procurement of services for the board; managing the bonds of the State of Tennessee; and serving as a member of the State Funding Board.

Management has not researched and corrected errors in accounts receivable resulting from manual and information system errors. 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 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, 2004, and June 30, 2003, and the changes in its financial position and cash flows for the years 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 96 is not a required part of the basic financial statements but is supplementary information 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 audits were conducted for the purpose of forming an opinion on the basic financial statements. The accompanying financial information on pages 97 through 108 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 27, 2005, on our consideration of the board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance.

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

AAH/cj

Exhibit A

Tennessee State Veterans' Homes Board
Statements of Net Assets
June 30, 2004, and June 30, 2003

	June 30, 2004	June 30, 2003
Assets:		
Current assets:		
Cash (Note 2)	$ 3,078,791.29	$ 2,536,905.14
Investments (Note 2)	28,696.06	28,591.79
Resident accounts receivable, net of allowance for doubtful accounts of $1,983,150 at June 30, 2004, and $1,701,233 at June 30, 2003 (Note 3)	322,617.13	417,891.92
Medicare cost settlement receivable	-	280,044.89
Inventories	61,600.38	63,101.00
Prepaid items	6,486.29	8,968.87
Restricted cash (Notes 2, 5)	352,322.39	335,693.45
Total current assets	3,850,513.54	3,671,197.06
Noncurrent assets:		
Restricted cash (Notes 2, 5)	880,601.50	1,150,700.14
Unamortized bond issuance costs	58,401.73	98,797.67
Capital assets (Note 7):		
Land and improvements	251,827.00	252,102.00
Infrastructure	676,338.00	676,338.00
Accumulated depreciation-infrastructure	(252,814.79)	(251,211.95)
Buildings and improvements	10,346,192.84	10,344,636.97
Accumulated depreciation - buildings and improvements	(2,646,651.74)	(2,377,226.52)
Furniture and equipment	1,627,128.00	1,882,346.60
Accumulated depreciation - furniture and equipment	(1,052,975.97)	(1,163,885.47)
Construction in progress	548,304.20	45,733.22
Total noncurrent assets	10,436,350.77	10,658,330.66
Total assets	14,286,864.31	14,329,527.72

Exhibit A (Cont.)

Tennessee State Veterans' Homes Board
Statements of Net Assets
June 30, 2004, and June 30, 2003

	June 30, 2004	June 30, 2003
Liabilities:		
Current liabilities:		
Accounts payable and accruals (Note 8)	585,770.37	608,676.28
Due to primary government (Note 4)	1,148,092.54	426,173.72
Checks payable	-	16,610.77
Amounts held in custody for others	132,887.91	109,571.87
Medicaid current financing	222,906.97	293,671.82
Medicare cost settlement payable	11,327.35	-
Bonds payable (Note 9)	-	180,000.00
Loans from the State of Tennessee (Note 9)	170,000.00	20,000.00
Total current liabilities	2,270,985.14	1,654,704.46
Noncurrent liabilities:		
Bonds payable, net of unamortized discount (Note 9)	-	4,219,934.16
Loans from the State of Tennessee, net (Note 9)	3,743,081.59	130,000.00
Compensated absences	262,596.74	197,605.66
Total noncurrent liabilities	4,005,678.33	4,547,539.82
Total liabilities	6,276,663.47	6,202,244.28
Net Assets:		
Invested in capital assets, net of related debt	5,584,265.95	4,858,898.69
Restricted for:		
Debt service	138,869.38	613,501.44
Repairs and replacements	620,819.98	635,775.72
Other purposes	259,781.52	-
Foundation activities	11,242.69	10,541.07
Unrestricted	1,395,221.32	2,008,566.52
Total net assets	$ 8,010,200.84	$ 8,127,283.44

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

Exhibit B

Tennessee State Veterans' Homes Board
Statements of Revenues, Expenses, and Changes in Net Assets
For the Years Ended June 30, 2004, and June 30, 2003

	For the year ended June 30, 2004	For the year ended June 30, 2003
Operating revenue:		
Resident service revenue plus contractual adjustments of $134,492.89 and less provision for bad debts of $281,917 for the year ended June 30, 2004, and less contractual adjustments of $53,213.24 and provision for bad debts of $238,580.33 for the year ended June 30, 2003	$ 12,158,601.68	$ 12,027,683.28
Total operating revenue	12,158,601.68	12,027,683.28
Operating expenses:		
Administrative and general	2,143,272.58	1,992,356.58
Nursing services	5,425,570.88	5,147,262.03
Central services	296,754.49	296,501.81
Ancillary departments	1,133,631.35	965,670.22
Dietary	1,074,711.76	1,009,384.14
Activities	190,031.77	175,659.83
Social services	185,759.29	155,071.56
Housekeeping services	469,732.11	487,198.76
Laundry and linens	169,028.65	179,274.09
Plant operations and maintenance	622,972.96	658,222.56
Depreciation	412,838.20	421,859.46
Total operating expenses	12,124,304.04	11,488,461.04
Operating income	34,297.64	539,222.24

Exhibit B (Cont.)

Tennessee State Veterans' Homes Board
Statements of Revenues, Expenses, and Changes in Net Assets
For the Years Ended June 30, 2004, and June 30, 2003

	For the year ended June 30, 2004	For the year ended June 30, 2003
Nonoperating revenues (expenses):		
Grant revenue	126,310.65	-
Interest revenue	45,536.61	61,151.00
Miscellaneous revenue	104,859.70	39,152.81
Interest expense	(225,618.12)	(318,208.86)
Amortization of discounts and issuance costs	(4,195.55)	(8,846.88)
Loss on disposal of equipment	(9,862.65)	(10,170.74)
Miscellaneous expense	(39,495.03)	(32,432.60)
Total nonoperating revenues (expenses)	(2,464.39)	(269,355.27)
Increase in net assets	31,833.25	269,866.97
Net assets, July 1	8,127,283.44	7,857,416.47
Change in accounting principle (Note 6)	(148,915.85)	-
Net assets (restated), July 1	7,978,367.59	7,857,416.47
Net assets, June 30	$ 8,010,200.84	$ 8,127,283.44

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

Exhibit C

Tennessee State Veterans' Homes Board
Statements of Cash Flows
For the Years Ended June 30, 2004, and June 30, 2003

	For the year ended June 30, 2004	For the year ended June 30, 2003
Cash flows from operating activities:		
Receipts from residents and third party payors	$ 13,413,445.86	$ 12,749,376.90
Other miscellaneous receipts	32,927.09	5,734.96
Payments to service providers and vendors	(4,719,145.10)	(4,608,677.30)
Payments to employees	(7,110,623.40)	(6,887,624.86)
Other miscellaneous payments	-	(20,361.55)
Net cash provided by operating activities	1,616,604.45	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)	(16,610.77)	4,052.50
Foundation donations	68,004.65	33,417.85
Expenses paid by the foundation	(39,512.99)	(32,632.75)
Net cash provided by (used for) noncapital financing activities	1,880.89	(5,162.40)
Cash flows from capital and capital-related financing activities:		
Capital grant received	126,310.65	-
Purchase of capital assets	(642,304.97)	(265,805.29)
Proceeds from refunding	51,169.60	-
Principal paid on debt	(681,578.67)	(170,000.00)
Interest paid on debt	(229,097.84)	(319,187.50)
Net cash used for capital and capital-related financing activities	(1,375,501.23)	(754,992.79)
Cash flows from investing activities:		
Interest received	45,432.34	60,345.28
Net cash provided by investing activities	45,432.34	60,345.28
Net increase in cash	288,416.45	538,638.24
Cash, July 1	4,023,298.73	3,484,660.49
Cash, June 30	$ 4,311,715.18	$ 4,023,298.73

Exhibit C (Cont.)

Tennessee State Veterans' Homes Board
Statements of Cash Flows
For the Years Ended June 30, 2004, and June 30, 2003

	For the year ended June 30, 2004	For the year ended June 30, 2003
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 34,297.64	$ 539,222.24
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	412,838.20	421,859.46
Miscellaneous receipts	9,611.05	5,734.96
Decrease in net resident accounts receivable	95,274.79	100,067.52
Decrease in due from primary government	-	87,163.63
(Increase) decrease in Medicare cost settlement receivable	280,044.89	(5,336.13)
(Increase) decrease in inventories	1,500.62	(12,924.50)
Decrease in prepaid items	2,482.58	72,148.90
Increase (decrease) in noncapital accounts payable and accruals	29,766.24	(174,486.72)
Increase in due to primary government	721,918.82	85,911.26
Increase (decrease) in amounts held in custody for others	23,316.04	(20,361.55)
Increase (decrease) in Medicaid current financing	(70,764.85)	124,072.18
Increase in Medicare cost settlement payable	11,327.35	-
Increase in compensated absences	64,991.08	15,376.90
Total adjustments	1,582,306.81	699,225.91
Net cash provided by operating activities:	$ 1,616,604.45	$ 1,238,448.15
Noncash capital activities		
Contributed capital assets	$ 27,244.00	$ -
Total noncash capital activities	$ 27,244.00	$ -

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

Tennessee State Veterans' Homes Board
Notes to the Financial Statements
June 30, 2004, and June 30, 2003

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, 2004, 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 accounting principles generally accepted in the United States of America 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 loan agreements. 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 1 year and with a single-item value of at least $1,000 or are part of a group of similar items with a cumulative value of $5,000. 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	4 to 20 years

I. Checks Payable

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

J. Loan Discounts and Issuance Costs

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

NOTE 2. DEPOSITS AND INVESTMENTS

At June 30, 2004, the carrying amount of the board's deposits was $600,868.92, and the bank balance was $639,220.71. 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 balances and investment balances at June 30, 2004, and 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 June 30, 2003, fiscal year, bank balances were neither insured nor collateralized. The amounts that were not insured or collateralized ranged from $30,000 to $69,414.

At June 30, 2004, the board also had $3,709,074.26 deposited in the Local Government Investment Pool (LGIP) administered by the State Treasurer and $1,772.00 of petty cash on hand. At June 30, 2003, the board had $3,665,942.06 deposited in the LGIP 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, 2004, consist of the following:

Receivables from patients and their insurance	$1,734,533.59
Receivable from Medicare	301,412.68
Receivable from U.S. Department of Veterans Affairs	269,820.86
Allowance for doubtful accounts	(1,983,150.00)
Net amount reported as resident accounts receivable	$ 322,617.13

The net receivable amount of $322,617.13 represents accounts receivable that are expected to be collected within one year.

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:	June 30, 2004
Department of Finance and Administration–Medicaid current services less void adjustments	$ 649,398.55
Department of Finance and Administration–Medicaid overpayments occurring before 1994	282,062.42
Department of Health – bed tax	44,500.00
Department of the Treasury–retirement contributions	27,617.75
Department of Labor and Workforce Development–unemployment taxes	6,749.86
Department of Human Services – child support payments	384.00
Department of Treasury – Risk Management Fund	137,355.00
Office of the Attorney General – litigation fees	24.96
Total due to primary government	$1,148,092.54

	June 30, 2003
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, 2004, the more recent receivables from Medicaid totaled $359,379.59, and older receivables for which research is required to determine the ultimate disposition is estimated to be $592,587.35. The payable to Medicaid for void adjustments is $846,218.12, and other unresolved credits for which research is required to determine the ultimate disposition is estimated to be $755,147.37. 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 are as follows:

	June 30, 2004	June 30, 2003
Resident trust fund accounts	$ 132,887.91	$ 109,571.87
Debt service account	219,434.48	226,121.58
Debt service reserve account	-	514,924.42
Bond savings account	259,781.52	-
Repair and replacement account	620,819.98	635,775.72
Total restricted assets	$1,232,923.89	$1,486,393.59

NOTE 6. CHANGE IN ACCOUNTING PRINCIPLE

The board revised its capitalization policy to increase the amount required to capitalize assets from $100 to $1,000 for a single item and $5,000 for purchases of similar items. As a result, the board reduced its capital assets and net assets by $148,915.85.

NOTE 7. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2004, was as follows:

	Beginning	Additions	Deletions	Change in accounting principle	Ending
Capital assets, not being depreciated:					
Land and improvements	$ 252,102.00	$ -	$ -	$ (275.00)	$ 251,827.00
Construction in progress	45,733.22	510,546.73	(7,975.75)	-	548,304.20
Total capital assets, not being depreciated	297,835.22	510,546.73	(7,975.75)	(275.00)	800,131.20

Capital assets, being depreciated:					
Infrastructure	676,338.00	-	-	-	676,338.00
Buildings and improvements	10,344,636.97	6,717.78	-	(5,161.91)	10,346,192.84
Furniture and equipment	1,882,346.60	150,842.68	(54,172.66)	(351,888.62)	1,627,128.00
Total depreciable capital assets	12,903,321.57	157,560.46	(54,172.66)	(357,050.53)	12,649,658.84
Less accumulated depreciation:					
Infrastructure	(251,211.95)	(1,602.84)	-	-	(252,814.79)
Buildings and improvements	(2,377,226.52)	(272,303.94)	-	2,878.72	(2,646,651.74)
Furniture and equipment	(1,163,885.47)	(138,931.42)	44,309.96	205,530.96	(1,052,975.97)
Total accumulated depreciation	(3,792,323.94)	(412,838.20)	44,309.96	208,409.68	(3,952,442.50)
Total depreciable capital assets, net	9,110,997.63	(255,277.74)	(9,862.70)	(148,640.85)	8,697,216.34
Net capital assets	$ 9,408,832.85	$ 255,268.99	$ (17,838.45)	$(148,915.85)	$ 9,497,347.54

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 8. ACCOUNTS PAYABLE AND ACCRUALS

Payables consist of the following:

	June 30, 2004	June 30, 2003
Payables to suppliers	$ 280,441.90	$ 308,133.74
Accruals for salaries and benefits	487,360.11	370,603.64
Accrued interest	80,565.10	127,544.56
Amount reported as accounts payables and accruals	$ 848,367.11	$ 806,281.94

NOTE 9. LONG TERM LIABILITIES

Long term debt activity for the year ended June 30, 2004, was as follows:

	Beginning	Additions	Reductions	Ending	Amount due within 1 year
Bonds payable:					
Series 1989	$1,658,197.35	$ -	$(1,658,197.35)	$ -	$ -
Series 1994	2,741,736.81	-	(2,741,736.81)	-	-
Total bonds	4,399,934.16	-	(4,399,934.16)	-	-
Loan payable:					
Murfreesboro	150,000.00	-	(10,000.00)	140,000.00	20,000.00
Murfreesboro	-	1,397,522.79	(4,762.09)	1,392,760.70	70,100.00
Humboldt	-	2,383,310.66	(2,989.77)	2,380,320.89	79,900.00
Total loans	150,000.00	3,780,833.45	(17,751.86)	3,913,081.59	170,000.00
Compensated absences:	197,605.66	244,265.92	(179,274.84)	262,596.74	152,566.89
Total long term liabilities	$4,747,539.82	$4,025,099.37	$(4,596,960.86)	$4,175,678.33	$ 322,566.89

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

	Beginning	Additions	Reductions	Ending	Amount due within 1 year
Bonds payable:					
Series 1989	$1,751,137.31	$ -	$ (92,939.96)	$1,658,197.35	$105,000.00
Series 1994	2,816,266.89	-	(74,530.08)	2,741,736.81	75,000.00
Total bonds	4,567,404.20	-	(167,470.04)	4,399,934.16	180,000.00
Loan payable:	160,000.00	-	(10,000.00)	150,000.00	20,000.00
Compensated absences:	182,228.76	230,021.78	(214,644.88)	197,605.66	118,155.04
Total long term liabilities	$4,909,632.96	$ 230,021.78	$ (392,114.92)	$4,747,539.82	$318,155.44

Certain amounts have been reclassified for comparative purposes.

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, 2004, was not paid until after June 30, 2004.

On September 11, 2003, the State of Tennessee issued $151,855,000 in General Obligation Bonds, 2003 Series A. A portion of this issuance was used to refund the Series 1989 bonds. As a result of this refunding, the board now is indebted to the State Funding Board, as opposed to individual bondholders. The refunding resulted in a difference of $39,728.41 between reacquisition price and the net carrying amount of the old debt. This difference, reported in the accompanying financial statements as a deduction from loans payable, is being charged to operations through the year 2014. The refunding decreased the board's debt service by $536,454.44, and the board recognized an economic gain (the difference between the present values of the old and new debt service payments) of $267,944.85.

A portion of the State of Tennessee General Obligation Bonds, 2003 Series A was also used to refund the Series 1994 bonds. As a result of this refunding, the board now is indebted to the State Funding Board, as opposed to individual bondholders. The refunding resulted in a difference of $436,529.93 between reacquisition price and the net carrying amount of the old debt. This difference, reported in the accompanying financial statements as a deduction from loans payable, is being charged to operations through the year 2021. The refunding decreased the board's debt service by $287,526.97, and the board recognized an economic gain (the difference between the present values of the old and new debt service payments) of $110,160.01.

The total loan payable for 2004 and the total bonds and loans payable for 2003 consisted of the following:

	June 30, 2004	June 30, 2003
Loan from the State of Tennessee to the Murfreesboro facility, 3.0% to 5.125%, due from 2004 to final maturity in 2019 (net of unamortized premium of $80,479.35 and unamortized deferred refunding of $36,718.65 for 2004)	$1,392,760.70	$ -

Loan from the State of Tennessee to the Humboldt facility, 3.0% to 5.125%, due from 2004 to final maturity in 2026 (net of unamortized premium of $75,641.10 and unamortized deferred refunding of $416,320.21 for 2004)	2,380,320.89	-
Loan from the State of Tennessee to the Murfreesboro facility, 0.0% due in yearly installments of $10,000	140,000.00	150,000.00
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 loan payable (includes bonds at June 30, 2003)	$3,913,081.59	$4,549,934.16

Debt-service requirements to maturity of the loan payable at June 30, 2004, are as follows:

For the Year(s) Ended June 30	Principal	Interest	Total
2005	$ 170,000.00	$ 191,106.26	$ 361,106.26
2006	165,000.00	185,756.26	350,756.26
2007	170,000.00	178,656.26	348,656.26
2008	175,000.00	172,181.26	347,181.26
2009	180,000.00	165,456.26	345,456.26
2010 – 2014	1,000,000.00	690,287.53	1,690,287.53
2015 – 2019	1,200,000.00	424,850.04	1,624,850.04
2020 – 2024	760,000.00	182,071.88	942,071.88
2025 – 2026	390,000.00	18,762.50	408,762.50
	$4,210,000.00	$2,209,128.25	$6,419,128.25

The above debt principal is more than that presented on the accompanying financial statements by $296,918.41 due to $(156,120.45) of unamortized premium and $453,038.86 representing the deferred amount on refunding.

NOTE 10. 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, 2004, 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, 2004, Tennessee State Veterans' Homes Board's annual pension cost of $313,832 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, 2004	$313,832	100.00%	-
June 30, 2003	$307,385	100.00%	-
June 30, 2002	$291,991	100.00%	-

NOTE 11. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee administers a group health insurance program which provides post-employment health insurance benefits to eligible board retirees. This benefit is provided by and administered by the State of Tennessee. The board assumes no liability for retiree health care programs. Information related to this plan is available at the statewide level 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, 312 Eighth Avenue North, 14th Floor, William R. Snodgrass Tennessee Tower, Nashville, TN 37243-0298 or by calling (615) 741-2140.

NOTE 12. EXTENDED DISABILITY BENEFITS

The board records the cost of extended disability benefits when paid. Generally, since these benefits (earned one day per month with unlimited accumulation) are paid only when an employee has successfully completed one year of employment and is absent due to illness or injury, there is no liability for these benefits at June 30, 2004, or at June 30, 2003.

NOTE 13. 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 $13,595,000 for the buildings and $1,843,300 for the contents.

B. The board participates in the State of Tennessee's Risk Management 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 14. SUBSEQUENT EVENTS

On February 28, 2005, Knox County donated land valued at approximately $143,000 to the board for the construction of a third facility. The board held a ground-breaking ceremony at this site on March 30, 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]
7/01/03	$2,569	$2,569	$0	100%	$2,902	0%
7/01/01	1,780	1,780	0	100%	3,048	0%
7/01/99	1,134	1,134	0	100%	2,022	0%

Changes in Actuarial Assumptions

An actuarial valuation was performed as of July 1, 2003, to establish contribution rates as of July 1, 2004. 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 Information
Supplementary Schedule of Net Assets
June 30, 2004

	Murfreesboro	Humboldt	Knox County	Foundation	Totals
Assets:					
Current assets:					
Cash	$ 1,218,756.37	$ 1,801,115.32	$ -	$ 58,919.60	$ 3,078,791.29
Investments	-	-	-	28,696.06	28,696.06
Resident accounts receivable, net of allowance for doubtful accounts of $1,983,150	99,624.96	222,992.17	-	-	322,617.13
Due from Humboldt facility	76,815.92	-	-	-	76,815.92
Inventories	21,175.68	40,424.70	-	-	61,600.38
Prepaid items	2,796.00	3,690.29	-	-	6,486.29
Restricted cash	129,448.14	222,874.25	-	-	352,322.39
Total current assets	1,548,617.07	2,291,096.73	-	87,615.66	3,927,329.46
Noncurrent assets:					
Restricted cash	463,327.47	417,274.03	-	-	880,601.50
Unamortized bond issuance costs	20,945.77	37,455.96	-	-	58,401.73
Capital assets:					
Land and improvements	51,700.00	200,127.00	-	-	251,827.00
Infrastructure	153,970.00	522,368.00	-	-	676,338.00
Accumulated depreciation-infrastructure	(109,887.73)	(142,927.06)	-	-	(252,814.79)
Buildings and improvements	3,964,055.75	6,382,137.09	-	-	10,346,192.84
Accumulated depreciation - buildings and improvements	(1,286,794.06)	(1,359,857.68)	-	-	(2,646,651.74)
Furniture and equipment	786,921.11	840,206.89	-	-	1,627,128.00
Accumulated depreciation - furniture and equipment	(578,643.23)	(474,332.74)	-	-	(1,052,975.97)
Construction in progress	212,130.89	209,862.66	126,310.65	-	548,304.20
Total noncurrent assets	3,677,725.97	6,632,314.15	126,310.65	-	10,436,350.77
Total assets	5,226,343.04	8,923,410.88	126,310.65	87,615.66	14,363,680.23

Tennessee State Veterans' Homes Board
Supplementary Information
Supplementary Schedule of Net Assets (Cont.)
June 30, 2004

	Murfreesboro	Humboldt	Knox County	Foundation	Totals
Liabilities:					
Current liabilities:					
Accounts payable and accruals	271,086.39	314,683.98	-	-	585,770.37
Due to primary government	754,083.44	394,009.10	-	-	1,148,092.54
Amounts held in custody for others	37,565.55	95,322.36	-	-	132,887.91
Medicaid current financing	117,294.21	105,612.76	-	-	222,906.97
Medicare cost settlement payable	2,639.49	8,687.86	-	-	11,327.35
Due to Murfreesboro facility	-	76,815.92	-	-	76,815.92
Loans from the State of Tennessee	90,100.00	79,900.00	-	-	170,000.00
Total current liabilities	1,272,769.08	1,075,031.98	-	-	2,347,801.06
Noncurrent liabilities:					
Loans from the State of Tennessee, net	1,442,660.70	2,300,420.89	-	-	3,743,081.59
Compensated absences	124,908.08	137,688.66	-	-	262,596.74
Total noncurrent liabilities	1,567,568.78	2,438,109.55	-	-	4,005,678.33
Total liabilities	2,840,337.86	3,513,141.53	-	-	6,353,479.39
Net Assets:					
Invested in capital assets, net of related debt	1,660,692.03	3,797,263.27	126,310.65	-	5,584,265.95
Restricted for:					
Debt service	65,156.14	73,713.24	-	-	138,869.38
Repairs and replacements	320,058.74	300,761.24	-	-	620,819.98
Other purposes	143,268.73	116,512.79	-	-	259,781.52
Foundation activities	-	-	-	11,242.69	11,242.69
Unrestricted	196,829.54	1,122,018.81	-	76,372.97	1,395,221.32
Total net assets	$ 2,386,005.18	$ 5,410,269.35	126,310.65	$ 87,615.66	$ 8,010,200.84

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

	Murfreesboro	Humboldt	Foundation	Totals
Liabilities:				
Current liabilities:				
Accounts payable and accruals	318,093.61	290,564.71	17.96	608,676.28
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	967,351.92	829,937.15	17.96	1,797,307.03
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
Compensated absences	96,468.32	101,137.34	-	197,605.66
Total noncurrent liabilities	1,779,665.67	2,767,874.15	-	4,547,539.82
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 debt	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 Information
Supplementary Schedule of Revenues, Expenses, and Changes in Net Assets
For the Year Ended June 30, 2004

	Murfreesboro	Humboldt	Knox County	Foundation	Totals
Operating revenue:					
Resident service revenue plus contractual adjustments of $134,492.89 and less provision for bad debts of $281,917	$ 6,012,481.46	$ 6,146,120.22	$ -	$ -	$ 12,158,601.68
Total operating revenue	6,012,481.46	6,146,120.22	-	-	12,158,601.68
Operating expenses:					
Administrative and general	1,084,311.89	1,058,960.69	-	-	2,143,272.58
Nursing services	2,898,597.21	2,526,973.67	-	-	5,425,570.88
Central services	173,212.92	123,541.57	-	-	296,754.49
Ancillary departments	538,314.53	595,316.82	-	-	1,133,631.35
Dietary	532,442.67	542,269.09	-	-	1,074,711.76
Activities	93,831.08	96,200.69	-	-	190,031.77
Social services	68,517.20	117,242.09	-	-	185,759.29
Housekeeping services	242,428.25	227,303.86	-	-	469,732.11
Laundry and linens	79,285.22	89,743.43	-	-	169,028.65
Plant operations and maintenance	312,460.09	310,512.87	-	-	622,972.96
Depreciation	160,331.20	252,507.00	-	-	412,838.20
Total operating expenses	6,183,732.26	5,940,571.78	-	-	12,124,304.04
Operating income (loss)	(171,250.80)	205,548.44	-	-	34,297.64

Tennessee State Veterans' Homes Board
Supplementary Information
Supplementary Schedule of Revenues, Expenses, and Changes in Net Assets (Cont.)
For the Year Ended June 30, 2004

	Murfreesboro	Humboldt	Knox County	Foundation	Totals
Nonoperating revenue (expenses):					
Grant revenue	-	-	126,310.65	-	126,310.65
Interest revenue	19,037.50	26,307.94	-	191.17	45,536.61
Miscellaneous revenue	2,312.00	34,543.05	-	68,004.65	104,859.70
Interest expense	(87,075.56)	(138,542.56)	-	-	(225,618.12)
Amortization of discounts and issuance costs	(1,875.93)	(2,319.62)	-	-	(4,195.55)
Loss on disposal of equipment	-	(9,862.65)	-	-	(9,862.65)
Miscellaneous expense	-	-	-	(39,495.03)	(39,495.03)
Total nonoperating revenues (expenses)	(67,601.99)	(89,873.84)	126,310.65	28,700.79	(2,464.39)
Increase (decrease) in net assets	(238,852.79)	115,674.60	126,310.65	28,700.79	31,833.25
Net assets, July 1	2,711,975.19	5,356,393.38	-	58,914.87	8,127,283.44
Change in accounting principle	(87,117.22)	(61,798.63)	-	-	(148,915.85)
Net assets (restated), July 1	2,624,857.97	5,294,594.75	-	58,914.87	7,978,367.59
Net assets, June 30	$ 2,386,005.18	$ 5,410,269.35	$ 126,310.65	$ 87,615.66	$ 8,010,200.84

Tennessee State Veterans' Homes Board
Supplementary Information
Supplementary Schedule 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 Information
Supplementary Schedule 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 Information
Supplementary Schedule of Cash Flows
For the Year Ended June 30, 2004

	Murfreesboro	Humboldt	Knox County	Foundation	Totals
Cash flows from operating activities:					
Receipts from residents and third party payors	$ 6,571,789.20	$ 6,841,656.66	$ -	$ -	$ 13,413,445.86
Other miscellaneous receipts	16,607.77	16,319.32	-	-	32,927.09
Payments to service providers and vendors	(2,256,576.64)	(2,462,568.46)	-	-	(4,719,145.10)
Payments to employees	(3,740,982.33)	(3,369,641.07)	-	-	(7,110,623.40)
Net cash provided by operating activities	590,838.00	1,025,766.45	-	-	1,616,604.45
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 repaid	-	(16,610.77)	-	-	(16,610.77)
Foundation donations	-	-	-	68,004.65	68,004.65
Expenses paid by the foundation	-	-	-	(39,512.99)	(39,512.99)
Net cash provided by (used for) noncapital financing activities	(10,000.00)	(16,610.77)	-	28,491.66	1,880.89
Cash flows from capital and capital-related financing activities:					
Capital grant received	-	-	126,310.65	-	126,310.65
Purchase of capital assets	(266,456.61)	(249,537.71)	(126,310.65)	-	(642,304.97)
Proceeds from refunding	51,169.60	-	-	-	51,169.60
Principal paid on debt	(343,402.57)	(338,176.10)	-	-	(681,578.67)
Interest paid on debt	(87,567.19)	(141,530.65)	-	-	(229,097.84)
Net cash used for capital and capital-related financing activities	(646,256.77)	(729,244.46)	-	-	(1,375,501.23)
Cash flows from investing activities:					
Interest received	19,037.50	26,307.94	-	86.90	45,432.34
Net cash provided by investing activities	19,037.50	26,307.94	-	86.90	45,432.34
Net increase (decrease) in cash	(46,381.27)	306,219.16	-	28,578.56	288,416.45
Cash, July 1	1,857,913.25	2,135,044.44	-	30,341.04	4,023,298.73
Cash, June 30	$ 1,811,531.98	$ 2,441,263.60	$ -	$ 58,919.60	$ 4,311,715.18

Tennessee State Veterans' Homes Board
Supplementary Information
Supplementary Schedule of Cash Flows (Cont.)
For the Year Ended June 30, 2004

-	Murfreesboro	Humboldt	Knox County	Foundation	Totals
Reconciliation of operating income to net cash provided by operating activities:					
Operating income (loss)	$ (171,250.80)	$ 205,548.44	$ -	$ -	$ 34,297.64
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:					
Depreciation	160,331.20	252,507.00	-	-	412,838.20
Miscellaneous receipts	2,312.00	7,299.05	-	-	9,611.05
Decrease in net resident accounts receivable	90,744.43	4,530.36	-	-	95,274.79
Decrease in Medicare cost settlement receivable	36,051.77	243,993.12	-	-	280,044.89
Decrease in due from Humboldt	65,786.65	-	-	-	65,786.65
Decrease in inventories	3.52	1,497.10	-	-	1,500.62
Decrease in prepaid items	1,861.40	621.18	-	-	2,482.58
Increase (decrease) in noncapital accounts payable and accruals	(10,766.31)	40,532.55	-	-	29,766.24
Increase in due to primary government	447,783.92	274,134.90	-	-	721,918.82
Increase in amounts held in custody for others	14,295.77	9,020.27	-	-	23,316.04
Increase (decrease) in Medicaid current financing	(77,394.80)	6,629.95	-	-	(70,764.85)
Increase in Medicare cost settlement payable	2,639.49	8,687.86	-	-	11,327.35
Decrease in due to Murfreesboro	-	(65,786.65)	-	-	(65,786.65)
Increase in compensated absences	28,439.76	36,551.32	-	-	64,991.08
Total adjustments	762,088.80	820,218.01	-	-	1,582,306.81
Net cash provided by operating activities:	$ 590,838.00	$ 1,025,766.45	$ -	$ -	$ 1,616,604.45
Noncash capital activities					
Contributed capital assets	$ -	$ 27,244.00	$ -	$ -	$ 27,244.00
Total noncash capital activities	$ -	$ 27,244.00	$ -	$ -	$ 27,244.00

Tennessee State Veterans' Homes Board
Supplementary Information
Supplementary Schedule 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 Information
Supplementary Schedule 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	(69,294.66)	(105,192.06)	-	(174,486.72)
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)
Increase in compensated absences	14,736.69	640.21	-	15,376.90
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