AUDIT REPORT

Tennessee State Veterans' Homes Board

For the Year Ended
June 30, 2005

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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John G. Morgan
Comptroller

May 8, 2007

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, 2005. You will note from the independent auditor's report that a disclaimer was issued on the fairness of the presentation of the financial statements.

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

Sincerely,

John G. Morgan

John G. Morgan
Comptroller of the Treasury

JGM/th
06/056

State of Tennessee

A u d i t   H i g h l i g h t s

Comptroller of the Treasury   Division of State Audit

Financial and Compliance Audit
Tennessee State Veterans' Homes Board
For the Year Ended June 30, 2005

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, contracts, and grant agreements; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT COMMITTEE

On May 19, 2005, the Tennessee General Assembly 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. Entities, pursuant to the act, are required to appoint the audit committee and develop an audit committee charter in accordance with the legislation. The ongoing responsibilities of an audit committee include, but are not limited to:

1. overseeing the financial reporting and related disclosures, especially when financial statements are issued;
2. evaluating management's assessment of risk and the agency's system of internal controls;
3. formally reiterating, on a regular basis, to the board, agency management, and staff their responsibility for preventing, detecting, and reporting fraud, waste, and abuse;
4. serving as a facilitator of any audits or investigations of the agency, including advising auditors and investigators of any information it may receive pertinent to audit or investigative matters;

5. informing the Comptroller of the Treasury of the results of assessment and controls to reduce the risk of fraud; and
6. promptly notifying the Comptroller of the Treasury of any indications of fraud.

In the previous audit report, we recommended that the Tennessee State Veterans' Homes Board reexamine the activities of its existing audit committee. An audit committee charter has been adopted by the board and was approved by the Comptroller of the Treasury on May 22, 2006. At the end of audit fieldwork on June 30, 2006, the audit committee had received management's assessment of risk but had not reevaluated the entity's system of internal controls.

AUDIT FINDINGS

INTERNAL CONTROL FINDINGS

For the Second Consecutive Year, the Tennessee State Veterans' Homes Board Has Not Evaluated Fraud Risks and Does Not Have Adequate Policies and Procedures to Address Risks Which Auditors Have Previously Identified*

The board has not evaluated and mitigated fraud risks and still does not have comprehensive policies and procedures in place. The auditors previously identified fraud risks of misappropriation through theft of receipts, manipulation of accounts receivable records, inappropriate use of credit, unauthorized purchases, and overstated travel claims. These risks still have not been adequately addressed. There are also risks of fraud related to financial reporting in the areas of accounts receivable, revenue, and expenditures that have not been addressed. In addition to these long-standing risks, there are new risks identified in this audit that could lead to fraudulent checks, falsified documents, and underpaid pension liabilities. Furthermore, there are specific fraud risks because of a lack of segregation of duties in the business office, inadequate cash receipting practices, and noncompliance with conflict-of-interest procedures. The board does not have adequate policies and procedures to address the risks identified (page 11).

For the Second Consecutive Year, Management's Lack of Organization, Follow-Through, and Knowledge Has Increased Audit Risks and Is an Impediment to the Audit Process*

Management did not retain all documentation necessary for the audit process, and documentation that was provided was not always complete. Management made adjusting entries that had no supporting documentation and that could not be explained. The Finance Director and the Business Office staff often could not locate information, had not researched reconciliation differences, or could not explain information that Business Office personnel should be knowledgeable about (page 16).

For the Fourth Consecutive Year, Internal Controls for Information Systems Are Not Adequate, Leaving the Board's Records Susceptible to Fraud, Error, and Improper Alterations**

Management's manual reconciliations of accounts receivable information from the patient billing system with the general ledger were incomplete. Differences as much as $256,730 were found, but were not investigated and explained. Management was unable to provide the auditors with complete accounts receivable data for the entire audit period, and accounts receivable data provided from the patient billing system did not agree with the amounts in the general ledger. Differences were as large as $1,831,278. Control procedures have not been established for the identification and correction of errors in accounts receivable amounts. In addition, employee access to the information systems was not properly restricted, and there was no written disaster recovery plan (page 21).

As Noted Since 1997, Accounts Receivable Practices Are Not Adequate**

The Tennessee State Veterans' Homes Board 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. Management has not resolved the negative balances noted in prior years and the number of unresolved negative balances continues to increase. Also, changes in the way the facilities are recording revenues to avoid negative balances have been flawed and recording errors have gone unnoticed (page 26).

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

The accounts receivable 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. Research of balances that were still recorded in the boards' financial statements resulted in recommendations to write off more than $900,000 in accounts related to residents that had passed away and more than $800,000 in receivables that were too old to collect or for which posting errors appeared to have been made. Although the board stated that they would not tolerate practices of the past to continue, our review of more current balances still revealed numerous errors and unexplained adjustments (page 30).

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

The board does have written procedures in place to collect receivables, but the procedures are not followed and actions are not documented. At June 30, 2005, resident accounts receivable from private payor sources was $2,385,444. This was an increase from the prior year of over $651,436 (38%). Testwork revealed that adequate documentation of collection efforts did not exist for 15 of the 27 resident accounts reviewed (page 36).

Disbursement Information Included in the Check Register Is Unreliable, Increasing the Risk of Concealed Fraudulent Activity

The board did not maintain adequate accounting records of disbursements. The check registers contained numerous recording discrepancies including $1,102 in unsupported amounts, 66 checks totaling $113,785 that were not recorded in the register, and 72 checks with check amounts differing a total of over $97,000 from the actual amount of the checks written (page 39).

Management Has Not Exercised Proper Control Over Accounts Payable, Making the Board Susceptible to Fraud and Misstated Liability Account Balances, As Well As Encouraging an Environment Where Document Falsification Is Tolerated

Accounts payable at June 30, 2005, inappropriately included over $70,000 in invoices that had been paid prior to that date. Other recorded payables could not be supported. Also, the accounts payable subsidiary ledgers were not reconciled to the general ledger. Paid invoices were not always supported by adequate documentation, and expenditures were not always recorded in the correct fiscal year. In addition, signatures and dates on some purchase orders had been altered in an apparent attempt to falsify an approval and to misrepresent the dates of several approvals (page 41).

Management Has Not Established Internal Controls Over Cash, Allowing the Organization to Remain Unduly Susceptible to Fraud, Undetected Errors, Mismanagement of Funds, and Misstatement of Account Balances

Management has no written policies and procedures governing bank reconciliations. Reconciliation of bank records to accounting records is not always performed in a timely manner. Monitoring of bank accounts, the reconciliation process, and accounting for cash is not adequate. Reconciliation documents contained inaccurate information, including amounts carried forward for periods longer than two years, and were found to be erroneous or unsupported. The general ledger recordkeeping does not appear adequate to allow simplified reconciliations to the bank information. Additionally, staff members who perform accounting functions associated with cash did not always understand the accounting processes involved (page 43).

For the Sixth Consecutive Year, the Board Has Not Addressed the Risk of Illegal, Unauthorized, or Inappropriate Purchases**

The board's policies and procedures over purchasing were still not being followed, and service contract approvals required by state law were still not obtained. Also, contract payments were not always properly invoiced or reviewed. Travel claims were still not appropriately handled, and the former Executive Director again received duplicate payments totaling over $1,000 (page 46).

As Noted Since 2003, the Board Still Has Not Addressed the Risk of Fraud and Has Inadequate Controls Regarding Use of Credit Cards and Open Accounts**
Credit card transactions were not properly approved, and payments were made without proper support. Due to a lack of controls to prevent, deter, or detect fraud involving credit cards, a Humboldt department head was able to inappropriately use the facility's Fuelman card. Inadequate control over purchases resulted in duplicate payments as well as interest and penalty charges (page 52).

Management Did Not Accurately Report Contribution Information to the Tennessee Consolidated Retirement System (TCRS), Causing Contribution Underpayments of Over $27,000
The contribution worksheets required by TCRS were not completed accurately, and the correct amounts were not contributed to the pension program. The incorrect reporting caused the TCRS contribution amounts to be underpaid by at least $27,711 over the last two years (page 56).

COMPLIANCE FINDINGS

For the Third Consecutive Year, 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 58).

The Facilities Failed to Protect Funds Held in Trust for Nursing Home Residents With the Surety Bond Coverage Required by State Law
The Murfreesboro and Humboldt facilities allowed surety bond coverage to lapse for 27 days in September 2004, and the Murfreesboro facility allowed balances in the resident trust account to exceed amounts covered by surety bonds for an additional 81 days during the year (page 60).

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

- For the second consecutive year, the Tennessee State Veterans' Homes Board has not evaluated fraud risks and does not have adequate policies and procedures to address risks which auditors have previously identified
- For the second consecutive year, management's lack of organization, follow-through, and knowledge has increased audit risks and is an impediment to the audit process
- For the fourth consecutive year, internal controls for information systems are not adequate, leaving the board's records susceptible to fraud, error, and improper alterations
- As noted since 1997, accounts receivable practices are not adequate
- For the fourth consecutive year, accounting records do not portray a true picture of receivables, and the risk of theft of resident funds was not addressed

- Disbursement information included in the check register is unreliable, increasing the risk of concealed fraudulent activity
- Management has not exercised proper control over accounts payable, making the board susceptible to fraud and misstated liability account balances, as well as encouraging an environment where document falsification is tolerated
- Management has not established internal controls over cash, allowing the organization to remain unduly susceptible to fraud, undetected errors, mismanagement of funds, and misstatement of account balances

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.

DISCLAIMER ON THE FINANCIAL STATEMENTS

Certain records and documentation supporting transactions and account balances were not available for our audit. Questions regarding material differences between accounting records were unanswered. A cash flow statement in accordance with accounting principles generally accepted in the United States of America was not prepared, and one could not be prepared with the accounting information provided. Therefore, we were not able to satisfy ourselves about the amounts at which cash, accounts receivable, current liabilities, and net assets are recorded at June 30, 2005, and the amounts of revenues, expenses, and certain changes in asset values for the year ended June 30, 2005. Because of the significance of these matters, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements.

Audit Report
Tennessee State Veterans' Homes Board
For the Year Ended June 30, 2005

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Tennessee State Veterans' Homes Board
For the Year Ended June 30, 2005

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 a third facility in East Tennessee was opened after June 30, 2005. 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 governing board exercises its authority over operations through its executive staff. The executive staff consists of the Executive Director, Finance Director, Information Technology Director, and other executive staff. The Executive Director is responsible for the oversight of all the facilities. The Executive director hires and supervises the executive staff and employs the administrators to oversee the daily operations of each facility. The administrator then hires the managerial staff including the Director of Nursing, Business Office Manager, Director of Medical Records, Director of Social Services, Food Services Manager, Activities Coordinator, Housekeeping Superintendent, Maintenance Supervisor and all other facility employees.

The Finance Director was hired in April 2004, and the board purchased and implemented a new information system and became completely self-managed after many years of contracting with various management companies. The administrators continued to have responsibility for the business offices even though the Finance Director was ultimately responsible for the results and the output from the business offices. To correct this, the Finance Director was assigned the responsibility for the business offices in February 2006, and a director of patient financial services and a controller were subsequently hired.

An organization chart for the Tennessee State Veterans' Homes Board as it was on June 30, 2005, is on the following page.

AUDIT SCOPE

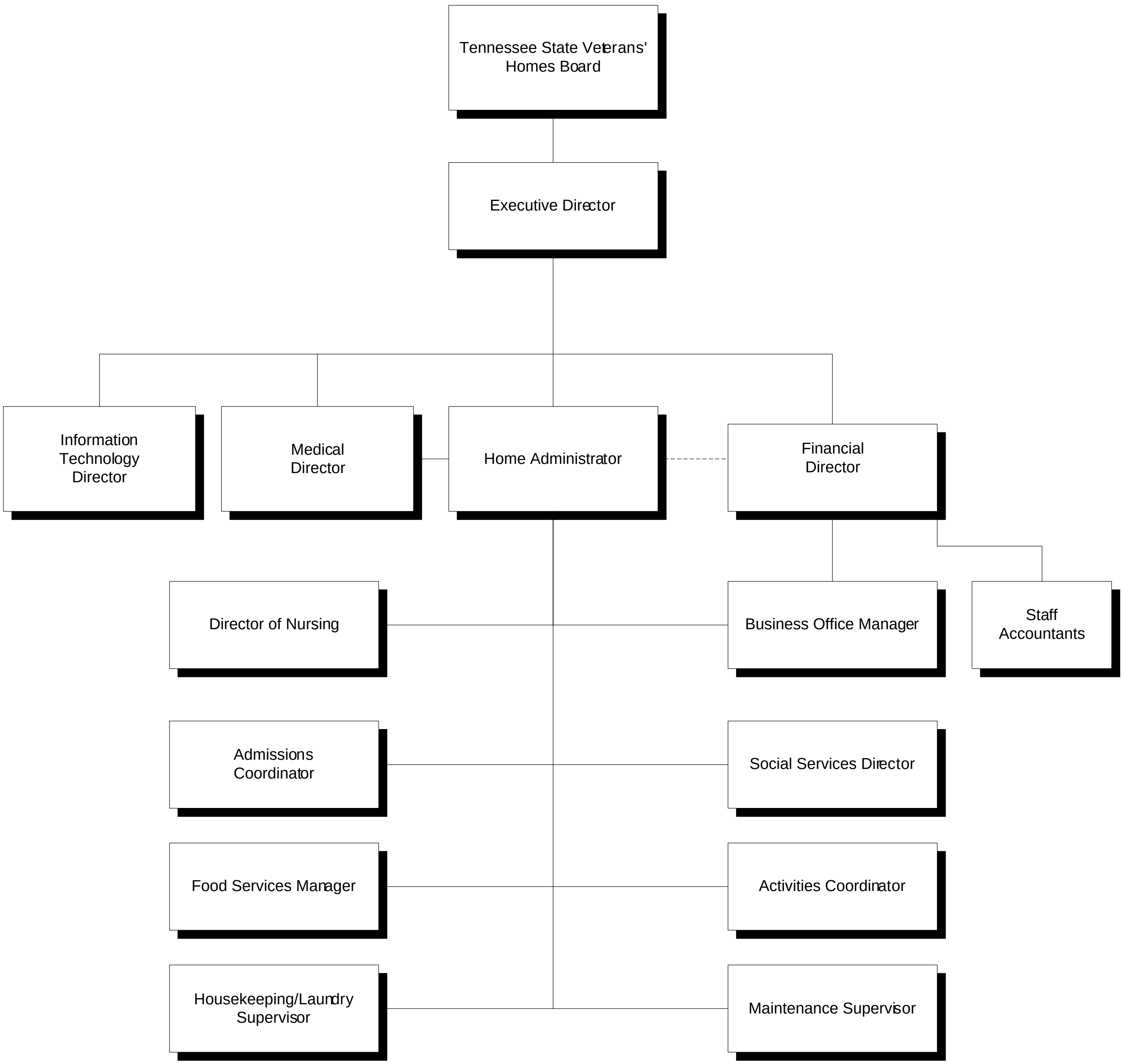
The audit was limited to the period July 1, 2004, through June 30, 2005. The Tennessee State Veterans' Homes Board has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report*.

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, contracts, and grant agreements;
3. to determine the fairness of the presentation of the financial statements; and

TENNESSEE STATE VETERANS' HOMES BOARD



4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The board filed its report with the Department of Audit on June 7, 2006. 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 capital assets, payroll segregation of duties, cellular phone payments, foundation accountability, excessive trust fund balances, recordkeeping for personal use of vehicles, bank account disclosures, and Title VI plan submission.

REPEATED AUDIT FINDINGS

The prior audit report also contained findings concerning the lack of an overall evaluation of fraud risks and the insufficiency of policies and procedures, lack of organization, inadequate accounts receivable practices, inaccurate recording of accounts receivable, inadequate collection efforts, overcharges to Medicaid residents, lack of control over the use of credit cards, failure to follow purchasing policies, failure to comply with travel regulations, failure to document receipt of goods, and inadequate controls over information systems. 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 also 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

On May 19, 2005, the Tennessee General Assembly 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. Entities, pursuant to the act, are required to appoint the audit committee and develop an audit committee charter in accordance with the legislation. The ongoing responsibilities of an audit committee include, but are not limited to:

1. overseeing the financial reporting and related disclosures, especially when financial statements are issued;
2. evaluating management's assessment of risk and the agency's system of internal controls;
3. formally reiterating, on a regular basis, to the board, agency management, and staff their responsibility for preventing, detecting, and reporting fraud, waste, and abuse;
4. serving as a facilitator of any audits or investigations of the agency, including advising auditors and investigators of any information it may receive pertinent to audit or investigative matters;
5. informing the Comptroller of the Treasury of the results of assessments and controls to reduce the risk of fraud; and
6. promptly notifying the Comptroller of the Treasury of any indications of fraud.

In the previous audit report, we recommended that the Tennessee State Veterans' Homes Board reexamine the activities of its existing audit committee. An audit committee charter has been adopted by the board and was approved by the Comptroller of the Treasury on May 22,

2006. At the end of audit fieldwork on June 30, 2006, the audit committee had received management's assessment of risk, but had not reevaluated the entity's system of internal controls.

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, 2005, 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 section of this report.

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 disclaimed an opinion on the Tennessee State Veterans' Homes Board's financial statements. Certain records and documentation supporting transactions and account balances were not available for our audit. Questions regarding material differences between accounting records were unanswered. A cash flow statement in accordance with accounting principles generally accepted in the United States of America was not prepared, and one could not be prepared with the accounting information provided. Therefore, we were not able to satisfy ourselves about the amounts at which cash, accounts receivable, current liabilities, and net assets are recorded at June 30, 2005, and the amounts of revenues, expenses, and certain changes in asset values for the year ended June 30, 2005. Because of the significance of these matters, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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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 30, 2006

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

Dear Mr. Morgan:

We were engaged to audit 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, 2005, and have issued our report thereon dated June 30, 2006. We did not express an opinion on the financial statements because certain records and documentation supporting transactions and account balances were not available for our audit, and questions regarding material differences between accounting records were unanswered. Also, the board declined to present a statement of cash flows for the year ended June 30, 2005. Presentation of such statement summarizing the board's operation, investing, and financing activities is required by accounting principles generally accepted in the United States of America.

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:

- For the second consecutive year, the Tennessee State Veterans' Homes Board has not evaluated fraud risks and does not have adequate policies and procedures to address risks which auditors have previously identified
- For the second consecutive year, management's lack of organization, follow-through, and knowledge has increased audit risks and is an impediment to the audit process
- For the fourth consecutive year, internal controls for information systems are not adequate, leaving the board's records susceptible to fraud, error, and improper alterations
- As noted since 1997, accounts receivable practices are not adequate
- For the fourth 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 fourth consecutive year, management has not mitigated the risks of lost revenues caused by the lack of collection efforts for accounts receivable
- Disbursement information included in the check register is unreliable, increasing the risk of concealed fraudulent activity
- Management has not exercised proper control over accounts payable, making the board susceptible to fraud and misstated liability account balances, as well as encouraging an environment where document falsification is tolerated
- Management has not established internal controls over cash, allowing the organization to remain unduly susceptible to fraud, undetected errors, mismanagement of funds, and misstatement of account balances
- For the sixth consecutive year, the board has not addressed the risk of illegal, unauthorized, or inappropriate purchases
- As noted since 2003, the board still has not addressed the risk of fraud and has inadequate controls regarding use of credit cards and open accounts
- Management did not accurately report contribution information to the Tennessee Consolidated Retirement System, causing contribution underpayments of over $27,000

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:

- For the second consecutive year, the Tennessee State Veterans' Homes Board has not evaluated fraud risks and does not have adequate policies and procedures to address risks which auditors have previously identified
- For the second consecutive year, management's lack of organization, follow-through, and knowledge has increased audit risks and is an impediment to the audit process
- For the fourth consecutive year, internal controls for information systems are not adequate, leaving the board's records susceptible to fraud, error, and improper alterations
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- Management had not established internal controls over cash, allowing the organization to remain unduly susceptible to fraud, undetected errors, mismanagement of funds, and misstatement of account balances

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.

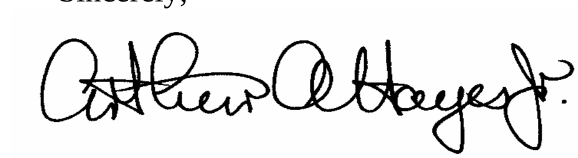
Compliance and Other Matters

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, contracts, and grant agreements, 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. 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/th

FINDINGS AND RECOMMENDATIONS

1. <u>For the second consecutive year, the Tennessee State Veterans' Homes Board has not evaluated fraud risks and does not have adequate policies and procedures to address risks which auditors have previously identified</u>

Finding

As stated in the prior audit report, the Tennessee State Veterans' Homes Board has not evaluated and mitigated fraud risks and still does not have comprehensive policies and procedures in place. Throughout the following findings, many fraud risks are identified. In addition to those risks, there are fraud risks identified in this finding because of a lack of segregation of duties, inadequate cash receipting, and noncompliance with conflict-of-interest procedures.

In response to the prior-year finding, management of the board concurred that the board did not have adequate policies and procedures during fiscal year 2004. Management stated they understood they were responsible for establishing effective internal controls and were in the process of developing policies and procedures that address the administrative and accounting functions of the facilities and board. The State Funding Board contracted with an accounting firm to assist the Tennessee State Veterans' Homes Board in the development of a comprehensive set of written policies and procedures to be completed by April 2006. Some of these policies and procedures were completed by April 2006; however, these policies and procedures were not in place for the audit period. Compliance with any policies written will have to be determined in subsequent audits.

In all organizations, auditors and management are required to assess the risk of fraud in the operations of the entity. The risk assessment is based on a critical review of operations considering what fraud could be perpetrated in the absence of adequate controls. The breadth and depth of those assessments are different; however, 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 must be 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 entity. 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.

Risk assessment

The former Executive Director submitted a risk assessment to the audit committee June 28, 2006, that identified the risks associated with each of the prior audit findings, the controls in place related to those risks, and an evaluation of the controls. The evaluation of the controls in place related to the 19 prior-year findings indicated for 7 of the findings, controls were ineffective or inadequate, 6 were effective except for certain areas of the findings, 5 needed strengthening, and one was deemed to be effective. So although certain risks have been identified, the board has a long way to go before a solid system of controls is in place. As demonstrated by the risk assessment evaluations and by the findings included in this report, management has not developed appropriate controls to offset those risks. Furthermore, 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 has not occurred. As demonstrated by the results of this audit; particularly findings numbered 2 through 6, and findings 10 and 11— all of which include fraud risks and all of which have been repeated for at least one to as many as nine 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 7, 8, 9, and 12 demonstrate that there are also additional risks unidentified in past audits and potentially unknown to the organization that have not been addressed.

It is essential that the governing 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 theft of receipts, manipulation of accounts receivable records, inappropriate use of credit, unauthorized purchases, and overstated travel claims. These risks still have not been adequately addressed. There are also risks of fraud related to financial reporting in the areas of accounts receivable, revenue, and expenditures that have not been addressed. In addition to these long-standing risks, there are new risks identified in this audit that could lead to fraudulent checks, falsified documents, and underpaid pension liabilities. 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

Based on discussion with personnel at the Humboldt facility, as of February 2006, they were still in the process of determining what policies they needed to develop or change since the departure of their management company in September 2004 (almost a year and a half). Management stated they were following the management company's policies and procedures from October 1, 2004, to January 22, 2006, but did not provide those policies. The facilities implemented some new policies and procedures on January 23, 2006. According to the Finance Director, the policies and procedures were approved internally by the Executive Office but not by the governing board. Section 58-7-103(3), *Tennessee Code Annotated,* states, "The Board has the duty to adopt written policies and procedures to govern its internal operations." Since a 2004 law change regarding the application of the Veterans Affairs subsidy, the governing board also must establish a policy on how to handle those funds now. However, the governing board has not yet established written procedures to ensure the consistent application of these funds.

The absence of board-approved policies and procedures is indicative of a larger problem with the internal control of the board. The ongoing control problems span the past six years, two management companies, and various Veterans' Homes Board administrations. For the years 1998 through 2005, the number of findings has been 3, 5, 11, 9, 14, 15, 19, and 15. The number of findings repeated from previous years in each year's report has been 2, 3, 4, 6, 9, 9, 13, and 10.

Deficient controls

When auditors find that internal controls are not operating as designed or as appropriate in a particular area or when documentation is not available (as noted in finding 2), 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 functioning properly, then the auditor has to consider the implications for the engagement. Simply stated, the weaker the internal controls, the greater the risk of fraud.

One of the ways that internal controls are not operating appropriately involves the lack of segregation of duties over key areas at both the Murfreesboro and Humboldt facilities. Business office personnel fill in for the receptionist when she is away from her desk. These business office personnel are responsible for posting cash receipts to patients' accounts and can make adjustments to patients' accounts. They also handle collection efforts. When the business office personnel fill in for the receptionist, they are also receiving resident funds and issuing money to residents. None of the functions performed are reviewed by someone outside the business office. Also, the Business Office manager handles both disputed items and preparation of the bank deposit. In addition, the Business Office manager initiates and processes certain adjustments with no review. These issues put residents' funds (trust funds) at risk of fraud.

Furthermore, internal control over cash receipting is deficient. The computerized accounting system does not automatically roll to the next number when a cash receipt is entered. Numbers can be skipped, and voided receipts do not have to be entered. Business Office personnel manually enter the receipt numbers into the system and no one ensures that all receipts are entered. Receipt books run sequentially from book to book; however, during the year ended June 30, 2005, the facility did not use the receipt books in sequential order for recording receipts into the patient trust funds. Department of Finance and Administration Policy 7, “Petty Cash and Departmental Bank Accounts”, Appendix A, states, “Receipts are to be used in sequence.” Using cash receipts out of sequence makes full accountings of cash receipts difficult, and misappropriated funds could go unnoticed.

Accountability has also not been established for construction projects. Several entries related to the construction of the additions to the facilities were not recorded for June 30, 2005. Amounts that should have been recorded for construction in progress, revenue, long-term debt, interest expense, and payables were not recorded. The construction assets must be recorded to maintain accountability and to allow for accurate recordkeeping.

Another area where accountability is lax involves the conflict-of-interest statements. For the Murfreesboro facility and Executive Office statements due in July 2004 and July 2005, 9 of 33 individuals reviewed (27%) did not have signed conflict-of-interest statements on file for one or both years. For statements prepared at the Humboldt facility around July of 2004 and March of 2005, 3 of 20 individuals reviewed (15%) did not have signed conflict of interest statements on file for one or both years. For governing board members, 5 of the 16 individuals reviewed (31%) did not have a completed conflict-of-interest statement provided for one or both years. Without disclosure of conflicts-of-interest, management could enter into a contract without knowledge of certain conflicts and could incur obligations or make expenditures that are not in the best interest of the board. Aside from compliance considerations, the failure of those in leadership positions to ensure they have met this basic obligation reflects negatively on their commitment to a strong ethical environment. Unfortunately, these actions are consistent with the overall weak control environment of the organization as a whole.

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 Executive Director should immediately coordinate the results of the risk assessment, the policies in place, and the policies recommended by the accounting firm to establish appropriate internal controls for the risks identified in the risk assessment. The Executive Director should also examine the organization to determine and address other risks for the board not identified in the audit report. Final policies and procedures should be carefully considered by the governing 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.

The Finance Director should ensure that business office personnel who handle cash receipting do not also have the ability to make adjustments to the resident accounts. Such individuals should not be involved with billing residents either. Also, the Finance Director should not allow the business office manager to initiate adjustments without approval and should not allow those individuals to handle cash as well as resolution of disputed items. These issues should receive immediate attention. Although formal policies and procedures should be developed and approved, the Finance Director should take steps to correct these conditions promptly through interim policies and procedures.

The Finance Director should also immediately require cash receipts to be issued in sequence and should account for all receipts. In addition, the Finance Director should review the activities at each facility and ensure that all financial activity related to the facility is accounted for, whether financed directly by the facility or donated by third parties.

The Executive Director should identify the individuals that do no have current conflict-of interest statements on file and should obtain new statements from those individuals immediately. The Executive Director should also ensure that conflict-of-interest forms are obtained timely and are retained for each individual required to fill out a conflict-of-interest statement.

The governing 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 that the Board had not evaluated fraud risks during the fiscal year ended June 30, 2005, and that the Board did not have policies and procedures to adequately address risks identified in previous audits.

Management performed a risk assessment based on the findings in the 2004 audit report and is in the process of addressing the seven reportable conditions identified in that report. An entity-wide risk assessment was recently completed that identified other risks, as well. Management is in the process of implementing controls and documenting procedures to mitigate the risks identified.

Recommendations already implemented include eliminating the ability to enter or post adjustments to resident accounts by any business office personnel. All adjustments are now initiated by the Director of Patient Financial Services and approved by the Controller. A new procedure was implemented requiring business office staff to enter the receipt number in the billing system, thus requiring staff to monitor the use of receipts and receipt books more closely.

Centralization of all billing activity to the home office will aid in the review and enforcement of policies and procedures and make compliance more manageable.

Implementation of recommendations arising from the risk assessment will continue with ongoing testing for compliance.

The process to obtain conflict of interest statements annually will be reviewed and modifications made to ensure future compliance.

This finding and many of the following findings relate to risk assessments and the obligations and responsibilities of the Audit Committee and management. The risk assessments and related recommendations conducted by management and Horne LLP will be reviewed, controls and procedures implemented and documented, and monitored for effectiveness and compliance. Exceptions to policy will result in disciplinary actions.

2. <u>For the second consecutive year, management's lack of organization, follow-through, and knowledge has increased audit risks and is an impediment to the audit process</u>

Finding

Management did not retain all documentation necessary for the audit process. In several instances, the documentation that was ultimately provided to the auditors was inaccurate. As this has been an issue in the past, we gave the board staff as much time as possible to locate the documentation. However, not all documentation was available, nor was the documentation always complete. For example, management made adjusting entries that had no supporting documentation and that could not be explained. The Finance Director and the Business Office staff often could not locate information, had not researched reconciliation differences, or could not explain information that Business Office personnel should be knowledgeable about. In response to the prior year audit, management stated that turnover had stabilized and reviews of the accounts payable and business office files were made with the goal of better organization. However, the extent of missing documents demonstrates that better organization has not been achieved.

The audit process is multifaceted, with auditors performing a series of tests over a period of months. These tests frequently involve confirming the legitimacy and accuracy of transactions by examining relevant supporting documentation. Missing and inaccurate documentation not only calls into question the facts and circumstances regarding tested transactions, but also raises questions about management's ability to properly manage an organization such as the Veterans'

Homes Board with assets exceeding $17 million and revenues exceeding $13 million. The lack of documentation and lack of information about questionable items contributed to a disclaimer of opinion on the financial statements of the Veterans' Homes Board for the year ended June 30, 2005.

Documentation that was not available for review at the Humboldt facility included 7 Remittance Advices; a personnel file; cancelled checks; 2 of 28 items (7%) in the expenses sample; 3 of 26 invoices (12%); physical therapy daily progress and weekly summary forms for November 7-20, 2004; support for 8 of 10 journal entries tested (80%); approvals for 28 of 28 disbursements tested (100%); and adjustments report (memo bills cleared) for September and October 2004. Also, for Humboldt, there were 21 of 25 invoices for nursing costs sampled (84%) that were not adequately supported because the supporting time sheets were missing.

Documentation that was not available for review at the Murfreesboro facility included payroll registers for the periods ended July 4, 2004, and July 18, 2004; support for a resident trust fund receipt; adjustment reports (memo bills cleared) for September and October 2004; support for one travel claim; support for 8 of 10 journal entries tested (80%); and approvals for 12 of 25 disbursements tested (48%). Also, supporting documentation could not be provided for the Murfreesboro, Humboldt, and Knoxville facilities for certain construction expenses.

In some instances, the documentation we received was incomplete. We requested a listing of all bank accounts used by the Murfreesboro facility, the Humboldt facility, and the foundation. This is very basic information. Any organization should have information gathered concerning where its funds are deposited. However, the listing that was provided for the Murfreesboro facility on January 30, 2006, was not complete. A revised listing was provided on February 17, 2006, after we made personnel aware of the error. This revised listing was also incomplete. A second revised listing was provided on February 22, 2006, after we again made personnel aware of the error. The electronic monthly Accounts Payable Aged Invoice Reports and Accounts Payable Trial Balance Reports provided were also incomplete at the Murfreesboro facility. The electronic and print versions of these reports were reviewed, and it was noted that in the electronic versions, vendors were missing from some reports, and some reports did not include totals at the end. The Accounts Payable Clerk stated that she did not understand the reports and did not use them, but simply printed them out and retained copies in a binder. Also, it took four times for the Accounts Payable personnel at the Murfreesboro facility to provide a usable electronic version of the check register. The payroll extracts provided by the IT Director for Murfreesboro and Humboldt were incomplete. The payroll extracts excluded the service department for both facilities. When auditors are unable to determine whether 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 are spent. As the board does not pay for its audit services provided by the Department of the Comptroller of the Treasury, ultimately the cost of this additional time and effort is borne by the Tennessee taxpayers.

Management has also had problems following through on issues. After BEP (the former management company) filed for bankruptcy in May 2001, the board attempted to collect funds from a surety bond after realizing that the BEP had not returned all of the board's documentation. The insurance company holding the bond has requested information from the board on several occasions, starting in October 2002. In September 2003, this company requested a settlement conference. However, as of February 28, 2006, this conference had not been scheduled. It appears that the board has placed no priority on pursuing this issue. Per the former Executive Director, he had been too busy to pursue the matter and did not feel that any funds would be awarded anyway because of the amount of time that had passed.

In addition, the Finance Director did not follow through on recommendations provided by a separate accounting firm concerning capital assets. The report on capital assets dated January 20, 2006, prepared by the firm, recommended that the board begin a monthly process to reconcile the corrected listing based on a physical inventory to the general ledger accounts to correct any differences. The report also recommended that the board enter the information from the listing into the new Accufund system. As of April 14, 2006, neither of these recommendations had been implemented. Also, based on a review of the restated June 30, 2005 general ledger, it appears that the Finance Director still had not made the entries to properly state accumulated depreciation for the Humboldt facility based on the work of the firm. We requested copies of the reconciliation of the Accounts Payable Control Account to the Trial Balance from the Finance Director and did not receive those reconciliations. The suggested adjustments to the accounting records were good as of a specific point in time. The longer the delay in making the corrections, the less valuable the work prepared by the firm and paid for by the board and the State Funding Board is.

Management could not provide adequate support or adequate explanations in many circumstances. The Finance Director made entries for the Murfreesboro and Humboldt facilities to the Cost Report Receivable account that could not be supported, and she could not explain how she calculated the amount. The amounts differed from the related information on the Remittance Advices by over $80,000. Discussions about the issues made us question if the Business Office staff even understands the content of the Remittance Advices and if the information is being recorded properly. For both facilities, the Finance Director could not provide adequate documentation to support the unposted Remittance Advice and cost report receivable accounts on the general ledger. Also, one $31,287 Remittance Advice was posted twice. In addition, certain contractual adjustments related to multiple therapy accounts actually exceeded the amount of revenue recorded. Contractual adjustments are made to reduce revenue to the amount actually received. It does not make sense that the adjustments would exceed revenues. The Finance Director could not explain why the adjustment would exceed related revenues.

Accounts receivable reconciliations for both facilities for June 30, 2005, had unreconciled differences between the general ledger and accounts receivable reports. Apparently arbitrary adjustments of $43,841 for Humboldt and $42,770 for Murfreesboro were made by staff to "correct" the differences at June 30, 2005. The Finance Director and Business Office staff could not provide an explanation or support for the adjustments. Other reconciliations of receivables and revenue had unexplained differences of $16,590 in Humboldt and $26,620 in Murfreesboro. Also, the board was operating dual accounting systems during August prior to converting to a new system in September. A comparison of August reports from each of the systems at both facilities was done to ensure there wasn't a difference between the agings and, if so, if the difference was explained. Differences were noted at both facilities with Humboldt having a difference of $5,812 and Murfreesboro a difference of $13,894. The Finance Director could not provide an adequate explanation for the differences. We also compared the amount recorded on the monthly journals in the new system to the amount recorded on the general ledger for September 2004 through June 30, 2005, and the comparison resulted in differences of $58,218 at Humboldt and $50,296 at Murfreesboro. Only three of the ten months reconciled at Humboldt, and none of the ten months reconciled at Murfreesboro.

Financial management and staff had difficulties explaining other financial information as well. The Finance Director could not provide a reconciliation of total checks to total expenses for either facility. When we tried to reconcile the two, large differences of over $200,000 were noted that could not be explained. One of 25 Murfreesboro disbursements sampled (4%) was recorded twice in the general ledger. Also, when comparing current-year expenses to prior-year expenses, large differences were noted that financial management and staff were unable to explain.

A Finance Director must have adequate knowledge of the board's operations and the way information is entered into the accounting system to attest to the accuracy of the financial reports provided to the governing board. Without reconciling information produced by the system and understanding the differences created, the Finance Director cannot know whether the information produced in the general ledger is correct. Also, when there are large increases or decreases in the financial reports, the Finance Director should make sure that she understands why those differences have occurred. The governing board needs accurate financial reports for decision making and must also be able to rely on financial personnel to understand the financial reports and be able to respond to questions that the governing board might have about those reports.

Recommendation

The governing board and, in particular, the audit committee, must take the responsibility to ensure all information related to the fiscal year under audit is complete, accurate, and available to auditors. The Executive Director should immediately adopt an effective file management system that allows Business Office personnel to prepare and maintain appropriate documentation to adequately support all transactions. This documentation should be readily available to management for purposes of ongoing monitoring of operations and to auditors, when requested. A document retention policy should be instituted that meets audit needs as well as the needs of the board. The governing board and audit committee should stress the importance of this to management and take administrative action as necessary if changes are not made.

The governing board and audit committee should require the Tennessee State Veterans' Homes Board's Finance Director at a minimum to: (1) ensure that all differences between reports are researched and proper explanations are provided; (2) ensure that all adjusting entries are properly supported, approved, and reviewed; (3) ensure that all documentation that is requested is provided to the appropriate persons; (4) have adequate knowledge of the board's operations and the way information is entered into the accounting system to attest to the accuracy of the financial reports provided to the governing board; and (5) have the technical and managerial ability to effectively address and promptly correct all audit conditions noted in this report related to the Finance Director's area of responsibility.

Documentation issues were identified in management's most recent risk assessment and the result of the evaluation was that controls were not effective. The audit committee should review the details of the risk assessment, determine what controls have been established as a result of the assessments, and monitor any actions taken by management to implement those controls.

Management's Comment

We concur that lack of organization and poor record keeping have been an impediment to the audit process.

A file management system and records retention policy shall be developed for business office, accounts payable, and accounting functions. The file management system will identify adequate filing space for the accounting functions. Centralization of the accounting functions will facilitate monitoring of the files.

Personnel who initiate and approve adjusting entries will be in-serviced on the appropriate documentation required to support the actions taken and will be held accountable should the documentation prove to be inadequate.

A review of the operations for fiscal year ended June 30, 2005, reveals that as the Board moved to self-management, it failed to adequately staff for the changes and assumption of responsibilities involved. The following systems were implemented in the fall of 2005 with the finance director position as the only person in the accounting department. In February 2005 a staff accountant was hired to assist the finance director.

- MAS 200 for general ledger and reporting
- FAS for fixed assets
- FRX for consolidated reporting
- ABRA for payroll (interface with MAS)
- BAS for payroll interface and month end accruals
- Unitime for time and attendance (interface with ABRA)
- ULTRACare for clinical and billing (interface with MAS)
- Resource for Windows for medical supplies (interface with ULTRACare)

Payroll, accounts payable, and the business office staff reported to the administrators during fiscal year 2005. It was in February 2006 that accounts payable and the business office staff were placed under Finance based on the recommendation of Horne LLP in its Report on the Review of the Accounting and Business Practices. The report stated in part:

> We noted during our review that the Finance Director does not have sufficient authority to direct the accounting activities at the facility level. The Finance Director's authority is less than what we typically see in other healthcare operations. The Finance Director is typically the primary party responsible for the financial operations of the healthcare entity. The current operations at each Nursing Home is such that the Administrator and Business Office Manager at each facility are responsible for the financial operations of their respective facility, with the Finance Director having little, if any, direct influence on the financial operations of the facility. Based upon the organizational chart obtained during our review, the financial operations of each facility have a reporting responsibility to the Administrator of the facility, as well as to the Finance Director. We concluded that the Finance Director's job duties are those normally performed by a Controller.
>
> ***We recommend that the reporting responsibility of the Nursing Homes' accounting departments, as set forth in the organizational chart approved by the TSVHB, be strictly adhered to and that the Finance Director be empowered with the authority and responsibility to direct the accounting and business office departments of each Nursing Home.***

Improvements in the business office and accounting functions have been made after placing these functions under Finance and providing appropriate staffing at the home office level.

Management's risk assessment will be incorporated with the entity-wide assessment and will be the basis for recommendations to improve controls and procedures.

3. <u>For the fourth consecutive year, internal controls for information systems are not adequate, leaving the board's records susceptible to fraud, error, and improper alterations</u>

Finding

As noted in the three previous audit reports, the Tennessee State Veterans' Homes Board did not have proper functioning controls over access to information systems and did not have a formal disaster recovery plan. As noted in the prior audit report, management's manual reconciliations of accounts receivable information from the patient billing system with the general ledger were incomplete. Large differences were found, but were not investigated and explained. We also found in the current audit that management was unable to provide us with complete accounts receivable data for the entire audit period; that the accounts receivable data that was provided from the patient billing system did not agree with the amounts in the general ledger; and that management had not established adequate control procedures for the identification and correction of errors in accounts receivable amounts.

The results of our audit procedures did determine that management had corrected previously reported deficiencies related to maintaining complete listings of system users, access to server rooms, and a lack of minutes of Information Technology Steering Committee meetings.

Management's comments regarding corrective action related to the repeated portions of this finding were included in the prior audit report and are addressed below. Management's comments from earlier years are included in the appendix on page 85.

Employee access not properly restricted

The management information 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. Also, the applications house financial and reporting data that should only be altered by authorized individuals.

In response to the prior finding management stated "All system access request forms are now reviewed by the IT Director prior to establishing access." However, access still has not been appropriately controlled. Eighteen of 34 employees tested (53%) did not have a written request from management granting them access. Also, four of the requests that were obtained did not indicate when the access was established. Improper access could compromise confidential information and accurate reporting, as well as enable fraudulent activity through the abuse of data.

No written disaster recovery plan

A written disaster recovery plan has still not been developed or approved. In response to the prior finding management stated "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." The board has entered into an agreement with Net Telcos, Inc. for disaster recovery data backup services and housing of a backup server and alternate processing site. However, no formal plan has been developed or approved.

Incomplete reconciliations

In response to the prior finding management stated "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." However, our examination of the monthly reconciliations for the period July 2005 through March 2006 found that each was out of balance with unexplained differences. Unexplained variances ranged from $770 to $166,530. Seven of the eight reconciliations reviewed for the year ended June 30, 2005, (88%) did not agree, with differences ranging from $4,197 to $256,730. For the reconciliations we reviewed, there were no sign-offs, no evidence of review by management, and management was unable to adequately explain the differences.

The reconciliation of accounts receivable activity from the billing system with the accounts receivable balances in the general ledger is essential. This reconciliation helps ensure that all accounts receivable transactions are properly recorded and is vital in determining the reliability of the accounts receivable reported in the financial statements.

Unable to provide accurate accounts receivable data

For the first two months of the fiscal year ended June 30, 2005, the Tennessee State Veterans' Homes Board used a patient billing and general ledger accounting system developed and maintained by National HealthCare Corporation (NHC), which had served the board in the capacity of management company and consultant. In September 2004, the board implemented a new patient billing system (UltraCare) and a new general ledger system (MAS 200).

Each month board staff import a file containing all patient transactions from UltraCare into MAS 200. We requested these import files beginning with UltraCare's implementation in September 2004 through June 30, 2005. Of these 20 months (10 months for Humboldt and 10 months for Murfreesboro), management was able to provide 17 months of the data. We examined the UltraCare accounts receivable transactions provided and compared them to the MAS 200 system and found that 9 of the 17 months (53%) did not agree. The differences observed ranged from $168,175 to $1,831,278. The Finance Director was asked to explain the omitted data and the amounts that did not agree but was unable to do so.

We were unable to obtain reasonable assurance that accounts receivable data were accurately and completely accumulated. The failure of management to provide complete accounts receivable data could obscure or conceal fraudulent accounting activity. Furthermore, the disparities observed between the patient billing system and the general ledger create uncertainty about the reliability of the accounts receivable balances reported in the financial statements. These uncertainties led to an audit disclaimer on the financial statements, meaning that the auditors could not determine whether or not the financial statements were correct.

Error correction procedures not in place

As a part of our audit procedures we asked for the board's control procedures regarding the correction of errors in accounts receivable in both the billing system and in the general ledger. According to the Finance Director, there were no formal error correction procedures in place over MAS 200, the general ledger system, during the audit period. The Finance Director also admitted that duplicate posting of error corrections had occurred on multiple occasions and that error corrections were not supported by appropriate documentation. We also found in our review at the Murfreesboro facility that error correction procedures were not in place over UltraCare, the patient billing system.

Adequate error correction procedures assist in identifying errors as they occur, facilitate the submission of corrected data, prevent error corrections from entering the system more than once, and provide documentation of management's monitoring and approval of changes to account balances.

Conclusion

A lack of controls over information systems has widespread fraud risk implications. When transactions can be altered or initiated 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 concealed by individuals with inappropriate access into systems that are not appropriately administered. Also, when transactions are not controlled and large deviations in data transferred from system to system are not examined, unusual transactions could easily occur and go unnoticed. The absence or failure of sufficient internal control, in combination with the other significant control issues noted throughout this report, could allow errors or intentional alterations of data to occur in large amounts and to go undetected by management.

Management's failure to institute error correction procedures and to follow through on reconciliations increases the probability of inaccurate accounts receivable balances. 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.

Recommendation

The risks identified in this finding should be immediately addressed. The security and controls over the system should become a priority for the governing board and audit committee. The board members 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 upper management and the governing board and audit committee. Since top management, the governing board, and the audit committee 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 suggested to mitigate those risks. Some of the issues identified in this finding were issues identified in management's most recent risk assessment. The result of that assessment was that controls were still inadequate. The audit committee should review the issues with the technical staff to determine why controls are still inadequate. The audit committee should monitor the steps taken by the Executive Director and the technical staff to address this material weakness.

In order to establish accurate accounts receivable balances, the Finance Director must ensure that the accounts receivable data from the UltraCare system are accurately and completely recorded in the MAS 200 general ledger system. Until these accounts receivable balances have been reviewed and verified as accurate and complete, management should maintain the import files used to transfer data from UltraCare to MAS 200. In addition, the Finance Director should ensure that manual accounts receivable reconciliations are performed every month between UltraCare and MAS 200, including the explanation and resolution of any amounts that did not agree, and also ensure that management's review is formally documented. The Finance Director should also implement error correction procedures over UltraCare and MAS 200, including controls that identify errors as they occur, facilitate the resubmission of corrected data, and prevent error corrections from entering the system more than once. Management's monitoring of error correction should also be formally documented.

Requests for access to the information systems should be documented and maintained by the Information Technology Director. Also, a written disaster recovery plan should be developed and approved for use in the event of an emergency. The Finance Director should thoroughly review HIPAA requirements and ensure compliance.

Management's Comment

We concur that internal controls for information systems were not adequate in fiscal year 2005.

Some of the recommendations of State Audit have already been implemented. A written disaster recovery plan has been developed and is in the process of being updated for fiscal year 2007. Requests for access to the information system are documented and maintained by the IT Director.

A systems review has recently been completed by MDI/Monette to determine how effectively facilities and staff are using the system, in clinical and financial operations as well as system set-up and security. A major focus of the systems review is on the interface of information and files from the billing system to the general ledger.

Risks and areas of weakness identified in systems review will be incorporated into the risk assessment performed by management to establish controls and procedures to mitigate the risks. Monitoring of controls and procedures shall be performed and documented by the IT Director.

4. <u>As noted since 1997, accounts receivable practices are not adequate</u>

Finding

As reported in the prior eight 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. Management has not resolved the negative (credit) balances noted in prior years and the number of unresolved negative balances continues to increase. Also, changes in the way the facilities are recording revenues to avoid negative balances have been flawed and recording errors have gone unnoticed.

Due to the long history of this finding and because the negative balances were becoming larger and larger over time, the State Funding Board assisted the home and contracted with an accounting firm to research and resolve the old negative balances. However, because of the amount of time that has passed since some of these balances were created and because of lost records, the underlying support for many of these balances was not available. Even so, the accounting firm researched the balances with the information provided and issued a draft report dated May 18, 2006. The firm identified $266,788 and $451,132 for Murfreesboro and Humboldt, respectively, as negative balances related to unprocessed void adjustments. The firm also recommended that the facilities write off $801,060 in receivables that were too old to collect or for which posting errors appeared to have been made, of which $1,305,791 were receivable balances and $504,731 were other old negative balances.

Many of the ongoing credit balances were created because the facilities were not regularly following a void adjustment process established in conjunction with the State of Tennessee's Medicaid Division. The void adjustment process was created because the residents were receiving third-party payments from the U.S. Department of Veterans Affairs, after the Medicaid funds were already requested, that would decrease the amount of Medicaid funds that the facility should receive. The void adjustment was a mechanism to return the funds owed back to Medicaid. When the facilities did not regularly process these void adjustments, the negative balances continued to grow. The Veterans Health Programs Improvement Act of 2004 nullified the agreement between the board and the state to continue these void adjustments.

Management's comments regarding corrective action were included in the prior audit report and are addressed below. Management's comments from earlier years are included in the appendix on pages 85-94.

Management concurred with the prior finding, agreeing that significant negative balances existed in accounts receivable. Management further stated that the board would request that the funds previously recouped through the void adjustment process be refunded to it, and that any claims to unprocessed void adjustments be relinquished by the Medicaid department as well. Yet, as of June 30, 2006, the board still had not contacted the Medicaid department to discuss the matter. The Finance Director stated that contacting the Medicaid department was not yet at the top of the board's list. Regarding the board's request that the department relinquish their claim, it should be noted that 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 payment 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 subsides are no longer considered a third-party resource. That effective date was expressly stated as November 30, 2004. Because of this, it is clear that the Medicaid department was entitled to those funds and has no obligation to relinquish its claim. Once again, because of inaction by management, large credit balances owed to Medicaid still remain.

In response to the prior finding, management also stated that certain other credit balances did exist and would be researched and addressed either by an accounting firm, if the date of service was prior to November 2004, or by board staff if the date of service was in or after November 2004. The board has always contended that although the credit balances are problematic, the facilities did not have time to do the research and were spending their time "keeping the current records current." The board has stated that the facilities are staying on top of the current recordkeeping and that the errors causing this finding to exist have been stopped. Therefore, in determining the extent and ongoing implications of this finding, we chose to examine only the time period from October 2004 through June 30, 2005, to determine if the facilities have corrected the problems that lead to unresolved negative balances. As noted below, the problem also involves more current records.

For the Murfreesboro facility for the period of October 1, 2004, through June 30, 2005, accounts receivable had new negative balances totaling $101,640 at June 30, 2005. For the Humboldt facility, accounts receivable had new negative balances totaling $84,456 at June 30, 2005. A lot of the negative balances resulted from the use of a new account called "unapplied cash." This account was to be used for situations such as when payments were received from an admission so new that there were no charges entered yet, a resident overpaid, a different payor paid than expected, or the facility billed and received payment in error. However, the Business Office Manager at Humboldt stated that it appeared that most of the negative balances in the unapplied cash account were from the facility billing Medicaid and Medicare for the same dates of service. It appears that the facilities still have not been recording the accounts receivable information appropriately, and the accounts have not been consistently reviewed or monitored to resolve issues such as negative balances, unapplied cash, or overbillings.

Additionally, in researching some of the negative balances, we noted that the facilities did not set up the information system to properly account for some transactions. Prior to the passage of the Veterans Health Programs Improvement Act of 2004, the facilities applied the subsidy from the U.S. Department of Veterans Affairs to each resident's accounts receivable balance. After passage of the act stating that the homes could use the subsidies from Veterans Affairs however they chose, as long as it was to benefit the residents, the facilities had the flexibility to apply the subsidy to the residents' account only if residents were designated as private-pay residents. The board has now been allowed to record the subsidy generated by Medicaid residents as a separate, additional revenue instead of applying the subsidy to the residents' account, and ultimately submitting the subsidy to Medicaid. Under this methodology, the revenue related to Medicaid residents should now include the room rate less any contractual adjustments, and a separate subsidy revenue not tied to room and board. However, the way the system is configured, the contractual adjustment is actually offsetting the subsidy account instead of the room and board account. In effect, this causes misstatements in the classifications of accounts receivable and overstatements of resident accounts receivable. The Finance Director was not aware that this was occurring. The revenue was still being recorded in this fashion as of May 31, 2006.

Without promptly refunding Medicaid overpayments recorded as payments on behalf of the residents and without making other appropriate adjustments to the residents' accounts, the residents' subsidiary accounts have inappropriate negative or "credit" balances incorrectly reflecting that refunds are due to those residents. In addition, errors recording contractual adjustments have caused misclassifications of revenue amounts. As the unidentified and unresolved credit balances grow in number and amount, the total accounts receivable, amounts due from the primary government, and amounts due to the primary government become more distorted, and financial decision making or monitoring may be affected. Negative balances are included in these accounts, causing the receivable balances on the board's monthly financial statements to appear to be lower than the amount the board actually must attempt to collect. Budgetary decision making may also be affected by the misclassified revenues.

Recommendation

The governing board and audit committee should determine why management has still failed to adequately address the negative balances. The governing board and audit committee should initiate conversations with the state's Medicaid Division so the two can agree on how to handle the old Medicaid credit balances. The write-off recommendation made in the accounting firm's report should be considered and submitted, as appropriate. Plans for corrective actions should be documented, and management should be held responsible for carrying out the corrective actions in a timely manner.

While this is occurring, the governing board should monitor the actions of management to ensure that the facilities are keeping the current accounts current. The governing board and audit committee should resolve not to let this continue. The governing board and audit committee cannot allow the facilities to again create the kinds of recording errors that have been made in the past and to allow balances to grow and become old and unmanageable. The governing board and audit committee should immediately assign the resources to individually research and resolve the negative balances before the balances increase. The governing board and audit committee should carefully review management's risk assessments and related controls for sufficiency.

Management should also 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 or she 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 accounts receivable practices were not adequate during fiscal year 2005.

Credit balances identified by Horne LLP as related to the VA subsidy and Medicaid-eligible residents have been removed from the resident accounts and established as a contingency on the balance sheet. A meeting was held with representatives of TNCare, the Department of Finance and Administration, and the Board. The consensus of the individuals present was that there is inconsistency in the interpretation of Public Law 108-422 by two federal agencies who provide direction to the states. Until those federal agencies reach an agreement on the effect of Public Law 108-422, TNCare and the State Veterans Homes Board have been given conflicting direction. The Board will pursue this topic at the national convention held in May 2007. The Audit Committee and Board have contacted Congressman Tanner and other legislators asking for resolution on the issue of language between the Federal Public Law and CMS. The board will continue to work toward formal resolution of this issue.

Based on the review of accounts with dates of service prior to November 1, 2004, by Horne LLP and an internal review of accounts with dates of service November 1, 2004, and later, a request for write-off of uncollectible accounts was submitted to the State for approval in January 2006. The total amount submitted and approved for write-off was $1.8 million. A second submission was approved by the Board in January 2007. This submission again included accounts from the Horne LLP report as well as accounts with dates of service after November 1, 2004. The amount submitted to the state totaled $598,628.69.

Taking into consideration the write off of accounts in the second submission, outstanding AR balances will be as follows:

Dates of Service	Murfreesboro	Humboldt	Total
Prior to Nov 1, 2004	$ 75,143.99	$ 157,978.09	$ 233,122.08
Nov 1, 2004 - Sep 30, 2005	35,498.53	74,982.04	110,480.57
Sep 30, 2005 - Jun 30, 2006	62,518.90	195,534.37	258,053.27
	$ 173,161.42	$ 428,494.50	$ 601,655.92

At the request of the State Funding Board in September 2006, Horne LLP did a follow-up to review the current position for accounts receivable and collections on accounts. The report from Horne LLP showed a positive trend with fluctuations in cash collections attributable to timing of receipts of the VA subsidy. A report that details revenues, receivables, and cash collections based on payor sources used by Horne LLP in its review is now a monthly report provided to the board.

The board receives two reports that help in monitoring the aging of accounts, including credit balances, and current monthly cash collections compared with current monthly revenues.

These two reports will be reviewed to determine if information is easily identified to the board members and modified as needed to provide accurate and concise information.

Management's risk assessments will be reviewed jointly with the assessment completed with Horne LLP to determine procedures and related controls needed for sufficiency.

5. For the fourth 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 three 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 prior to October 1, 2004, have been researched by an accounting firm hired by the State Funding Board, and recommendations were made concerning how to resolve the accounts. The firm recommended that the facilities write off more than $900,000 in accounts related to residents that had passed away. The report also recommended the write-off of over $800,000 in receivables that were too old to collect or for which posting errors appeared to have been made. The board stated that they would not tolerate practices of the past to continue for current and future billings.

In response to the prior-year finding, management concurred and stated that with the accounting firm handling the research on the old accounts receivable, the business office staff would be able to "focus on current residents and current claims." Management also stated in their comments that both facilities performed "an audit" of the accounts of all current residents and were able to produce accurate statements for all current residents. However, as of June 30, 2005, it appeared that the facilities were still not handling the current accounts appropriately. This could result in the loss of revenue and the loss of faith in the organization by the residents and the residents' families. When the account receivable records are not correct, theft of resident funds could occur and go unnoticed. Cash amounts paid by the residents' families could be stolen and not posted to the residents' accounts. If the stolen payment were discovered to have not been posted it could be argued by staff that it was just an accounting error and not fraud. Misstatements in the financial reports could occur and go unnoticed as well if errors in the accounting records are allowed to continue.

Management's comments for this recurring finding are exhibited for prior audits in the appendix on pages 94-95.

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, the U.S. Department of Veterans Affairs, private insurance companies, and the residents themselves are all major payor sources for the board. As noted in finding 4 of this report, the board has had problems for several years concerning a large amount of negative receivables on the books. (A negative 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.

Before receivables can be turned over to a 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 have not been turned over to a collection agency and remain on the books. Since the research of old accounts was performed by the accounting firm, the facilities should be able to stay current with their documentation and collection efforts to ensure that outstanding amounts can be collected or resolved promptly. This was the premise for paying the accounting firm for this work.

Receivable balances for the different payor sources (private, Medicaid, Medicare, Veterans Affairs, hospice, and private insurance) at June 30, 2005, may not be representative of actual amounts owed to the board. Along with the receivable accounts having old unresolved credit and debit balances, it was noted that once again certain charges have been set up incorrectly within the accounting system.

Similarly to the credit balance review in finding 4, we decided to examine the time period October 1, 2004, through June 30, 2005, to follow up on the findings in order to see if the facilities have made improvements they again agreed to make to their operations to keep similar problems from occurring again in the future. As in prior year, we again found numerous errors.

Murfreesboro:

- The Medicare rates changed on October 1, 2004. These rates were not changed in the system until May of 2005. After the rates were updated, any receivables set up for that period (after May 2005) would be billed at the proper rate; however, the rate change did not automatically adjust the receivables and revenues that were set up under the wrong rate. Medicare paid the appropriate, updated rates, but an erroneous receivable would still be in the accounting records for the earlier period. The Business Office manager stated that when payments are received, the receivables are adjusted, but any Medicare receivables for that time frame that had not been paid at June 30, 2005, would reflect an understated receivable balance. The same condition occurred with the Medicaid ICF and SNF rate increases effective July 1, 2004, that were not changed in the system until August 2004.
- Two of 13 contractual adjustment transactions tested (15%) were not recorded correctly. Contractual adjustments are reductions in the facility's room rate negotiated by third parties by contract. One adjustment was overstated $89 because of the use of the old Medicare rate, and one was overstated $264 because of the use of the wrong Medicaid ICF rate.
- Eight of 13 receivable transactions tested (62%) were not set up in the system properly. Six residents were overbilled $164, and two residents were underbilled $163. Two of

the 13 receivable transactions tested (15%) did not trace to the billing statement or remittance advice resulting in $1,050 in unbilled services.

- Six of 71 resident days per the November 2004 census report (8%) did not reconcile to the records submitted to the payor. The census report showed 7 less days than were billed, and in one case both Medicare and Medicaid were billed for the same dates of service.

- Revenue was not recorded properly for any of 21 therapy transactions tested for the month of April 2005. Nineteen of the same 21 transactions tested were established with the incorrect rate. Medicare therapy rates changed on January 1, 2005. However, based on discussion with the Business Office manager, the new rates were not updated in the system until May of 2005. Based on discussion with personnel, from January 1, 2005, to May 2005, when the appropriate payments were received from Medicare, Business Office staff would not necessarily adjust the receivable amounts to equal the amount paid. Instead, the last receivable to which the payment was applied would have a credit or debit balance depending on the amount of the payment. Also, the therapy revenue for 2 of the 21 transactions tested was reversed even though Medicare Part B would have paid for the charges. It does not appear that the therapy charges were ever billed to Medicare Part B.

- One revenue and related receivable tested was overstated by $48 because the resident type entered in the system was erroneous.

- Two residents were listed as “vets” and “non-vets” for different dates of service on the January 2005 census report. Veterans are eligible for the Veterans Affairs payments and non-veterans are not. Also, one resident was included on the Veterans Affairs billing statement but could not be located on the January 2005 census report.

- Two of 51 April cash receipts tested (4%) were not posted to the proper account.

- A payment received from Veterans Affairs for April 2005 dates of service exceeded the amount recorded in the cash journal by $297. However, the total payment was accounted for. After review of the cash journal, it appears the difference was posted to two residents’ accounts as unapplied cash instead of being applied to the residents’ outstanding Veterans Affairs receivables.

- One of 20 cash receipts tested (5%) was not posted to the correct dates of service.

- Nine of 20 resident bed-hold days tested (45%) could not be verified as correct. Bed-hold days should be recorded correctly to ensure that Veterans Affairs billings are correct. The bed-hold recorded on the census did not match the nurse’s notes because the nursing staff was not entering the discharge code correctly when a resident left the facility and returned. Veterans Affairs was not billed properly for 2 of 20 of the same bed hold days tested (10%). The Business Office manager did not reconcile the days recorded on the manual spreadsheet prepared to support the Veterans Affairs payment to the days recorded in the UltraCare system. This resulted in questioned costs of $4,427.

- According to the *Veteran's Health Affairs Services and Research Manual M-1,* Part 1, Chapter 3, "Each home will maintain a daily record showing the number of patients absent and the names of those who depart on or return from periods of absence of more than 96 hours." The records maintained at the facility to record these days did not reconcile to the census for 13 of 55 resident bed-hold days tested (24%).

- When a resident is transferred in or out of the facility, the day of transfer is not being counted on the census report using a consistent method. If the correct days are not entered under the correct payor source, this causes receivables and revenue to be over- or understated.

Humboldt:

- Two of 13 contractual adjustment transactions tested (15%) were not recorded correctly. One did not include a contractual adjustment or a receivable for a $4 medical supply, and the other was overstated $264 because of the use of the wrong Medicaid ICF rate.

- Two of 13 receivable transactions tested (15%) were not set up in the system properly due to incorrect census days. One of the 13 of the same receivable transactions tested (8%) was also overbilled for 1 day.

- During rate testwork, it was noted that one resident's information was not recorded properly for 10 private pay veteran days during November 2004. Several invoices and adjustments were established for these 10 days by the Business Office staff. The net effect of all the adjustments and invoices created to record revenue for these days was a $2,579 debit to room and board revenue, which is reducing revenue instead of increasing revenue, and a $594 debit to the Veterans Affairs subsidy, again reducing revenues. The facility should have recorded a $1,290 credit for room and board revenue. This same resident was in the facility for 23 days during November, which consisted of the 10 private-pay veteran days discussed above and 13 private-pay veteran bed-hold days. No receivables were established for these 23 days at June 30, 2005. It appears that the facility only received payment of $382 from the resident for November for these 23 days instead of the $2,373 due. The remaining balance of $1,991 was removed by an adjusting entry.

- Seven of 67 residents' days per the February 2005 Census report (10%) did not reconcile to the records submitted to the payor. The census report showed 35 less days than were billed to Medicaid and 4 less days than were billed to Medicare. Also, the facility billed both Medicaid and Medicare for two of the seven residents whose days did not reconcile.

- For 8 of 17 Medicare residents tested for the month of December (47%), documentation could not be provided to show that the Medicare scores that are used to identify applicable reimbursement rates were properly approved.

- Revenue was not recorded properly for three of 43 therapy revenue transactions tested for the month of November 2004 (7%). It appears the revenue recorded for occupational therapy was adjusted away when both residents had Medicare Part B, which would pay the Medicare rate for these services.

- Veterans Affairs was billed for one of 71 residents with bed-holds that exceeded 96 hours (1%). Per legislation, a resident on bed-hold status for more than 96 hours (4 days) is not eligible to receive the subsidy for those days. The facility must record the bed-hold days correctly to insure compliance with this requirement. Three of 20 bed-hold periods tested (15%) were not correct, resulting in incorrect Veterans Affairs' billings for 2 of the bed-holds.
- When a resident is transferred in or out of the facility, the day of transfer is not being counted on the census report using a consistent method. If the correct days are not entered under the correct payor source, this causes receivables and revenue to be over- or understated.

At both facilities, there is not a consistent method used to identify and document cash receipts. The employee that posts cash receipts is responsible for identifying and documenting cash receipts. Sometimes cash receipts were identified by receipt number, check number, remittance advice number, check amount, or was not identified at all. This inconsistent recording increases the risk of concealment of fraud as it is difficult to account for all receipts of a certain type. Also, there were numerous remittance advices that had a net payment of zero because large void adjustments at the end of the year offset any Medicaid funds that the facilities earned for current services. The adjustments used to record these zero-cash remittance advices were difficult to follow, and it could not be determined if the remittance advice transactions were posted properly. The inconsistent method of identifying and documenting cash receipts also made this process difficult.

The billing and recording problems are further aggravated by the use of unsupported or incorrect manual adjustments at both facilities to clear out certain credits in order to balance residents' accounts. Instances were noted at both facilities for several residents where the receivables set up in the system by payor source were different than the amounts 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. Due to these situations, the staff is not able to assess whether a certain payment has even been received or why an account was manually adjusted.

Due to the errors noted in almost every aspect of revenue or receivable testwork performed, it is very likely that the financial records are misstated, that some valid accounts receivables have not been billed, and that some inappropriate accounts receivable amounts have been billed. There also was not a sufficient audit trail to determine whether the revenues and receivables are fairly stated.

Although no actual instances of fraud were identified by the auditors, this is no assurance that fraud has not occurred. A risk of fraud is present, to some degree, in every audit engagement. In light of the pervasive, significant problems noted during this audit, which have existed year after year, a heightened risk of fraud exists at all the facilities.

Recommendation

The Executive Director should reassign staff specifically to take the necessary time to research each resident's account not addressed by the accounting firm that has any type of balance in the aging reports and make sure the amounts are correct. This should occur immediately before the balances increase further and become even more unmanageable. 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 Finance Director, and thorough documentation should be retained to support the adjustments made. The governing board and audit committee should review the recommendations of the accounting firm regarding the older receivables and ensure the Finance Director takes the actions necessary to correct erroneous receivables, to pursue the valid accounts, or to write off the uncollectible accounts.

The Finance Director should carefully review the billings each month to ensure each payor source is appropriately billed. The process regarding billing and the census taking should be reviewed and improved. Errors noted should be used to identify areas of weakness, and changes to procedures should be made so the errors will not recur. Accounts receivable policies concerning the periodic review of accounts for any errors should be followed by the homes. The resolution of these accounts should become a priority in order to restore accurate accounting records and to increase the chances of collection on past-due receivables. The Finance Director should establish a consistent method to identify and document cash receipts and research Remittance Advices that had a net payment of zero to determine if they were posted properly.

Special care should be taken during the review of these accounts, including enhanced skepticism related to the possibility of fraud. When resolving errors and inconsistencies between records, reviewers who are otherwise independent of the original transactions should keep in mind that transactions involving fraud also appear erroneous at first blush. In light of the heightened risk of fraud, reviewers should not accept evidence that is less than convincing in resolving errors and other problems. Transactions that cannot be adequately explained and other indicators of fraud should be promptly reported to the audit committee for their consideration. All instances of fraud should be immediately reported to the Division of State Audit as required by state law.

These issues were identified in management's most recent risk assessment and the result of the assessment was that controls need to be strengthened. The audit committee should review the details of the risk assessments and the policies developed to ensure that management does strengthen the controls to address the risks identified by management and by this and previous audits.

Management's Comment

We concur that during fiscal year ended June 2006 accounting records did not portray a true picture of receivables and that the risk of theft of resident funds was not addressed.

The review of system set-up by Monette has identified some set-up issues with mapping general ledger codes with billing and procedure codes. These have been identified and staff is working on making corrections to the set-up and in resolving any balances created by the errors.

Finance staff are working on the recommendations made by Horne LLP and either correcting account balances, submitting accounts for write-off or pursuing collections as appropriate. The balances that will remain on the aging for dates of service prior to Nov 1, 2004, is indicated in response to the previous finding and will be handled as appropriate.

A month end reconciliation shall be developed to compare billings for each payor source with the system census reports to prevent and detect any incorrect or double billings so that records are accurate. Errors noted in reconciliations shall be used to develop controls to prevent future errors.

Accounts receivable policies and procedures shall be reviewed to include monthly and month end procedures and processes and will include error resolution. The policies and procedures will establish a uniform method to identify cash receipts postings. Remittance Advices with zero payments will be reviewed to verify appropriate posting to resident accounts.

Centralization of the billing process to home office will aid in establishing controls and monitoring business office activities in a more timely manner.

All instances of fraud will be reported to the audit committee and to the Division of State Audit.

Management's risk assessment will be reviewed with the assessment performed with Horne LLP to determine controls necessary.

6. For the fourth consecutive year, management has not mitigated the risks of lost revenues caused by the lack of collection efforts for accounts receivable

Finding

As noted in the prior three audit reports, collection efforts for accounts receivable at the facilities are not adequate. The Tennessee State Veterans' Homes 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 made. At June 30, 2005, resident accounts receivable from private payor sources was $2,385,444. This was an increase from the prior year of over $651,436 (38%).

In response to the prior year finding, management concurred that collection efforts for the year ended June 30, 2004, were not adequate. They stated that "board policy on collections approved September 29, 2005, clearly establishes minimum requirements for the facilities' efforts in the collection of accounts receivable . . . . 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." These board policies did establish the minimum requirements; however, it is apparent based on the results of testwork that this policy is not being followed. Management also stated that the focus of the Business Office is placed on billing current claims properly and collections of those claims. Testwork results discussed below show that improvements have been made, but collection efforts are still lacking.

Management's responses to this finding from prior audits are exhibited in the appendix on pages 95-96.

As discussed in findings 4 and 5, the State Funding Board contracted with an accounting firm on behalf of the Tennessee State Veterans' Homes Board to research old accounts receivable balances to determine accuracy and proper dispositions for the Murfreesboro and Humboldt facilities. Specifically, Horne LLP researched balances aged in excess of one year as determined by the Accounts Receivable Aging Report dated October 31, 2005. Thus we only examined collection efforts on balances created October 1, 2004, through June 30, 2005.

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

At Murfreesboro we reviewed 13 receivable balances totaling $12,882 at June 30, 2005. As of May 1, 2006, the balance remaining was $4,123. Results from this testwork revealed that adequate documentation of collection efforts did not exist for any of the 13 residents' accounts. At Humboldt we reviewed 14 receivable balances totaling $78,265 at June 30, 2005. As of May 18, 2006, the remaining balances of these accounts was $11,971. Results from this testwork revealed that documentation of collection efforts such as phone calls and written correspondence did not exist for 2 of the 14 residents' accounts (14%).

If personnel do not document attempts 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.

Also, if personnel who are currently attempting to collect accounts receivable do not properly and conscientiously document those efforts in spite of the attention supposedly being focused on these more current efforts, other assertions that progress is at least being made in more current periods of operation are called into question.

Recommendation

The governing board should ensure collection effort policies are being communicated to the Finance Director and followed by Business Office personnel. The Finance Director should ensure that collection attempts are made in a timely manner and that the attempts are documented fully. Whenever the required collection attempts by board personnel have failed, the Finance Director should immediately submit the accounts to the collection agency and the Attorney General, as necessary. After collection agency efforts are exhausted, the Finance Director should take the necessary steps to write off the uncollectible accounts. The governing board should review the recommendations of the accounting firm regarding the older receivables and ensure the Finance Director takes the actions necessary to pursue the collectable accounts and to write off the uncollectible accounts.

Business Office personnel should recognize the importance of demonstrating they understand the collection policies, including documentation requirements, by complying fully with those policies. Each level of management, up to and including the governing board, should take effective steps to ensure that there is demonstrable improvement in the way officials and staff of the Tennessee State Veterans' Homes Board carry out their current responsibilities.

This issue was identified in management's most recent risk assessment and the results of the assessment were that controls must be strengthened since accounts were "not being worked as directed." The governing board should review the details of the risk assessments. The audit committee and the Executive Director should evaluate the policies and procedures in place to ensure proper internal control to prevent and detect exceptions timely. As departures from the policy are discovered, the Executive Director should take prompt disciplinary action.

Management's Comment

We concur that during the fiscal year 2005, the risks of lost revenues caused by the lack of collections efforts for accounts receivable.

Collection policies were documented by the Director of Patient Financial Services and the Controller and staff trained in September 2006 at Humboldt and October 2006 at Murfreesboro. Follow-up has shown the Humboldt business office was not following the established procedures, resulting in the BOM being reprimanded.

Centralization of the AR billing to home office will help management monitor work more closely and in a more timely fashion.

Management's risk assessment and that performed with Horne LLP shall be reviewed, procedures developed where necessary to ensure appropriate controls are in place.

7. <u>Disbursement information included in the check register is unreliable, increasing the risk of concealed fraudulent activity</u>

Finding

The Tennessee State Veterans' Home Board did not maintain adequate accounting records of disbursements. Without proper accounting records of disbursements, there is a serious risk of fraud. Details of fraudulent checks could be replaced with fictitious information. There are also risks regarding overpayments or underpayments to vendors, and the reporting of incorrect financial information.

When the board transitioned from a management company to self-management on October 1, 2004, management switched to a new accounting system, MAS 200, which is a part of the Monette Information System. Several problems occurred during the first few months with the check registers for both facilities and continued to occur throughout the fiscal year. It appears that the Accounts Payable staff have not been trained properly to use the system, and as a result, errors have been made. This has resulted in inaccurate disbursement records.

Both of the facilities' check registers were reviewed, and each contained numerous recording discrepancies.

- We discovered 66 checks totaling $113,785 that were not recorded in the check registers.
- Nineteen voided checks were reviewed that were not listed as void on the check register.
- The actual date for 52 of the checks reviewed did not match the date of the check on the check register.
- There were 72 checks with check amounts that did not match the actual check amounts. This created an approximate difference of over $97,000 between the amount of the checks on the check registers and the actual amount of checks written.
- There were many checks reviewed with check number errors. The number listed in the register did not match the number on the actual check. Several of the numbers used were out of sequence from the rest of the checks.
- On one check, the amount of "$40" was marked out by hand on the check and replaced with "$35.08."
- While looking through some accounting reports at the Murfreesboro facility, we found a blank check in with the reports that was not safeguarded and was not defaced in any way to indicate that it was voided.
- The Murfreesboro facility contacted a vendor with an outstanding check after we asked questions about the check, and the vendor stated that he did not get the check and that he was not owed any money anyway.

- Humboldt check numbers 0-5 were listed on the check register but were not actual checks. According to the Accounts Payable clerk in Humboldt, these items were adjustments to the check register to reduce selected check amounts on the check register, but the adjustments actually added $1,102 to the total of the checks on the check register. Also, there was not any support for these items.

While we did examine payees and endorsements on all the checks written to look for possible improper payments and found none, there is a heightened risk of fraudulent activity in this environment. Fraudulent activity may be occurring and may be easily concealed. The lack of an appropriate audit trail required much additional work on the audit and inevitably contributed to a disclaimer on the audit opinion. Until the board gains control over financial reporting, the governing board cannot be sure they are getting accurate financial information.

Recommendation

The Finance Director should immediately determine what controls are lacking in the cash disbursement system that are allowing these problems to occur. Check disbursement information should always match the checks generated by the computer, and employees should not have the ability to alter the information once the check has been produced. To the extent that the check numbering or data input problems are human error, the Finance Director should ensure that Accounts Payable staff are trained properly and adequate monitoring is established to ensure that the staff are not negligent in performance of their duties.

The Executive Director should include the risk of fraud related to any weaknesses in the cash disbursements system during the risk assessment process and should closely evaluate internal controls to ensure that exceptions are prevented or detected in a timely manner. 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 to internal controls occur.

Management's Comment

We concur that during fiscal year 2005, disbursement information included in the check register was unreliable.

During fiscal year 2005, accounts payable staff printed checks on-site. In July 2005, all check stock was removed from the facilities and held at the home office. Facilities no longer post to the general ledger without review of the entry by a staff accountant. Checks are not issued until the accounts payable package is reviewed by a staff accountant.

The accounts payable function will be consolidated at the home office in February 2007 to provide better controls, consistency, and monitoring. Procedures will be developed to ensure adequate controls are in place and functioning as designed.

8. <u>Management has not exercised proper control over accounts payable, making the board susceptible to fraud and misstated liability account balances, as well as encouraging an environment where document falsification is tolerated</u>

Finding

At both Murfreesboro and Humboldt, multiple problems were found during examination of accounts payable. Accounts payable at June 30, 2005, inappropriately included invoices that had been paid prior to that date. The accounts payable subsidiary ledgers were not reconciled to the general ledger. Also, paid invoices were not always supported by adequate documentation, and expenditures were not always recorded in the correct fiscal year. In addition, signatures and dates on some purchase orders had been altered.

<u>Paid invoices included in accounts payable</u>

The balance of accounts payable at the Humboldt facility at June 30, 2005, was $274,284. That amount erroneously included $70,283 that had been paid prior to that date. There is no evidence that accounting personnel at either Murfreesboro or Humboldt reconcile subsidiary ledgers to the general ledger, exposing both facilities' accounting records to undetected errors. At Humboldt, the balance also included $21,284, first listed in February of 2005 as payable to the Tennessee State Veterans' Homes Board for employee health premiums, for which no support or explanation was provided. The payroll manager explained that the accounting process for employee insurance would not allow an amount to remain payable from February to June; therefore, the $21,284 must be an erroneous listing.

<u>Unsupported payables</u>

At Murfreesboro, the accounts payable control account balance of $211,251 at June 30, 2005, included amounts totaling $1,577 for which staff could provide no documentation or explanation. The accounts payable clerk stated that she believed that the amounts were erroneously listed, but she did not know how to remove the amounts from accounts payable. Also at Murfreesboro, the trade payables account balance at June 30, 2005, included $29,295 that, according the Finance Director, had been transferred from the Payroll Clearing Account. However, the Finance Director could not provide documentation to support the amount nor provide a reason for the transfer. The Murfreesboro accrual account balance included $16,925 for which no documentation or satisfactory explanation was provided. For 5 of 31 invoices tested which were listed as accounts payable at Humboldt at June 30, 2005, (16%) facility personnel could provide no documentation or explanation. These five invoices totaled $76.

<u>Expenditures recorded in wrong fiscal year</u>

At Humboldt, amounts totaling $87,750, and at Murfreesboro, amounts totaling $73,800 were accrued at June 30, 2005, for Risk Management expenditures that are payable annually in January or February. The Finance Director could not explain why the liabilities were accrued at June 30, 2005, and after several inquires, agreed that the accrual was improper.

At Murfreesboro, 4 of 25 paid checks sampled from July 2005 (16%) included paid invoices which were recorded in the wrong fiscal year. Invoices totaling $524 and recorded as expenses in the year ended June 30, 2005, were for goods or services applicable to the year ended June 30, 2006. Invoices totaling $2,795 and recorded as expenses in the year ended June 30, 2006, were for goods or services applicable to the year ended June 30, 2005.

Inadequate or falsified documentation

As has been noted in prior audits, personnel at the Humboldt facility did not always comply with board purchasing policy that 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." Of 26 paid invoices tested, 21 (81%) were not supported by documentation containing the signature of two employees.

The Murfreesboro facility has not always complied with policy either. However, this year, that noncompliance appears to have been concealed by management. During testwork at Murfreesboro, the auditors noted seven purchase orders on which the signature or date had been altered. On five purchase orders, the "Received by" date had numbers written over other numbers, making it impossible to ascertain on which date the goods were received. In addition, the ink used for the signature and that used for the date of signature were in different colors and appear to have been written by different employees. Two purchase orders, written to authorize payment of invoices originally issued in November 2004, appear to have been backdated. These purchase orders were signed and dated November and December 2004 even though the purchase order numbers indicate that the purchase orders were processed in July of 2005. Further, the "Department Head" signature, indicating authorization for the order, was signed and dated twice by two different Facility Administrators. One signature was supposed to be that of the individual who was Acting Administrator in November of 2004. This signature was written over white-out. Clearly visible underneath the white-out, on the reverse side of the document, was the signature of the current Administrator. According to the accounts payable employees, the current Administrator does not date the purchase order approvals. It appears that employees attempted to falsify one approval and misrepresent the dates of several approvals.

Without accurate accounts payable information, the financial information will not be reliable. The board may not make adequate business decisions without reliable data. The tone set by the administration at the Murfreesboro facility appears to be that if you cannot follow policy, it is acceptable to cover it up. This tone is unacceptable in an ethical organization and could encourage further misdeeds.

Recommendation

The Executive Director should investigate any falsified documentation at the Murfreesboro facility and recommend disciplinary action to the governing board. The Finance Director should ensure that accounts payable subsidiary ledgers are reconciled to the general ledger at least monthly, and should ensure that the reconciliations are documented and independently reviewed by an appropriate person. Further, the Finance Director should instruct the accounts payable clerk to report to the appropriate staff accountant any errors found in the accounting records. When a balance is determined to be incorrect, appropriate actions should be taken to correct the error, especially where the facilities owe funds to vendors or individuals. Correcting accounting entries should be made, and complete explanatory documentation for all accounting records should be maintained. The Finance Director should ensure that year-end closing procedures in accounts payable are conducted so that all payments are recorded in the proper year. The Finance Director should also ensure that staff accountants or other appropriate personnel monitor payment documents for compliance with policies and procedures, and that staff accountants monitor balances in accounts payable to detect errors and old balances.

Management's Comment

We concur that controls over accounts payable for fiscal year 2005 were inadequate.

The executive director shall investigate the circumstances referred to in the audit finding and take appropriate action. All staff that deal with financial transactions shall be in-serviced on ethical conduct and expected standards from management.

Reconciliation of accounts payable subsidiary ledgers to general ledger is performed monthly and shall be reviewed by the controller and maintained on file.

The accounts payable clerks shall report to the staff accountant immediately any errors noted in processing of accounts payable so that accounting records do not become misstated. Any errors noted shall be researched and corrected. This process will be documented. Correcting or adjusting entries shall have sufficient backup to support the entries and shall be maintained with the journal entry form.

The staff accountants shall be instructed to notify the controller or finance director immediately should any non-compliance issues or out-of-balances be noted.

9. Management has not established internal controls over cash, allowing the organization to remain unduly susceptible to fraud, undetected errors, mismanagement of funds, and misstatement of account balances

Finding

Numerous problems were found during examination of both facilities' bank reconciliation processes and the associated general ledger cash accounts. Management has no written policies and procedures governing bank reconciliations. Reconciliation of bank records to accounting records is not always performed in a timely manner. Monitoring of bank accounts, the reconciliation process, and accounting for cash is not adequate. Reconciliation documents contained inaccurate information, including amounts carried forward for periods longer than two years and were found to be erroneous or unsupported. The general ledger recordkeeping does not appear adequate to allow simplified reconciliations to the bank information. Additionally, staff members who perform accounting functions associated with cash did not always understand the accounting processes involved.

Reconciliation process

At Murfreesboro, only 6 of 72 bank reconciliations (8%) were dated and signed by the preparer. The remaining reconciliations (92%) were initialed but not dated, and there was no indication of the nature of the functions performed by the individual who initialed the documents. The Patient Trust bank account was not reconciled at all during the entire year ended June 30, 2005. All 12 monthly reconciliations were dated the same date, August 22, 2005. At Humboldt, only three of eight reconciliations were signed and dated by the preparer and the reviewer.

General ledger account maintenance

At Humboldt, withdrawals from and deposits into the bank account used to process employee health insurance transactions were not posted to the general ledger regularly, which caused the general ledger cash balance to be chronically misstated. At June 30, 2005, the balance per the general ledger exceeded the bank balance by $29,891. Staff accountants at the Executive Office attributed this problem to two factors: the general ledger is not set up to accommodate all of the transactions involved in the payment of health insurance premiums, and the Humboldt Accounts Payable staff are habitually one month late in performing accounting functions related to insurance payments. No evidence was provided to explain the $29,891 difference.

Murfreesboro reconciliation problems

- Six checks totaling $1,519 were listed as outstanding for at least 12 months with no evidence that staff attempted to contact payees or identify reasons for failure of the checks to clear the bank.
- Two reconciling amounts were listed as bank errors, one dating from December 2001 and the other from August 2004. There was no evidence that facility personnel attempted to resolve the inconsistencies between bank and accounting records.
- Five checks listed as outstanding had cleared the bank. The total of these listed outstanding checks was $9,397. Checks with the same numbers, totaling $629, were listed as cleared on bank statements. Four of these checks were listed twice at different amounts in the facility's check register.
- For one reconciliation, the listed book balance did not trace to the general ledger. The difference was due to a check dated January 27, 2005, for $960 noted by the staff accountant on the reconciliation as having been "reversed" with the amount added back to the general ledger on January 27, 2005. However, this check was traced by the auditors as having actually cleared the bank on January 31, 2005.

- The accounts payable clerk was questioned concerning two checks on the outstanding checks listing at June 30, 2006. Based on this discussion, the accounts payable clerk called the two vendors. According to the clerk, she was told by the vendors that they had not received the checks and the facility did not have an outstanding balance for that amount. The accounts payable clerk requested that these two checks be voided. These checks were only researched because of questions raised during the audit by the auditors.

Humboldt reconciliation problems

- Twelve amounts totaling $4,563 were carried forward as outstanding with no resolution for at least 13 months, through June 30, 2005. There was no evidence that Humboldt facility staff had attempted to contact the payees, or to investigate the reasons for failure of the checks to clear the bank.
- When written explanations were included on the bank reconciliation, they sometimes misrepresented the underlying facts. One amount of $1,000, included as a reconciling item and noted as a "bank deposit error," was found to be a series of check writing and accounting errors by facility and Executive Office personnel. The Business Office manager stated that a check written for $24,034 had cleared the bank in the amount of $23,034, and that the bank had failed to correct its error. The check, payable to the depository bank account, was written from the patient trust bank account in payment of certain residents' room and board fees for June 2005. An examination of a copy of the check, which had been signed by both the receptionist and the payroll manager, revealed that the amount written in numerals was $23,034, while the amount written in text was "Twenty-four hundred thirty-four dollars." The Executive Office staff accountant in charge of Humboldt accounting could not identify the accounts involved or the accounting process for paying resident room and board charges, and therefore could not determine which amount was the correct amount for the check or identify and correct accounting records related to the questioned amount.
- Three large amounts listed as reconciling items for a bank account used for accounts payable were not supported or adequately explained. The sum of the accounts, a negative $750, was noted on the reconciliation as having been written off to "Administrative Adjustment." No documentation was available to explain the individual amounts, two of which (-$142,532 and $171,989) were very significant amounts. The staff accountant stated that when the facility changed banks in September of 2004, posting errors were made by facility staff that were still uncorrected as of June 2005.

The failure to articulate and implement policies and processes for reconciling bank records to accounting records, the failure of fiscal managers to monitor bank and cash accounts, and the failure of management to ensure that staff who perform accounting functions are properly trained resulted in serious deficiencies in internal controls over cash. Without accurate and reliable accounting records, management cannot make business decisions that facilitate effective and efficient use of cash, or detect and prevent errors in cash account balances. More importantly, however, the seriousness and pervasiveness of the weaknesses described above impair management's ability to prevent or detect fraud.

Recommendation

The Executive Director should assess the risk of fraud related to inadequate bank reconciliation practices and should evaluate the internal controls to ensure that errors or fraud is prevented or detected in a timely manner. This assessment should be included in the board's documented risk assessment activities and should include the identification of specific staff who will be responsible for monitoring for compliance. The Finance Director should review the current bank reconciliations and appropriately resolve all outstanding reconciling items.

The Finance Director should ensure that bank reconciliations are performed in a timely manner. The bank reconciliations should include timely resolution of general ledger errors, bank errors, and long-outstanding checks. The Finance Director should ensure that the reviews of bank reconciliations are thorough, including steps to ensure that the listing of outstanding checks is accurate and that the balances being reconciled are accurate. The review process should be well documented. The Finance Director should put the process in writing and submit it to the board for approval. The entire process should be monitored periodically to ensure that the preparation and review of the reconciliations are adequate.

Management's Comment

We concur that internal controls over cash were inadequate during fiscal year 2005.

The bank reconciliation process shall be reviewed to determine areas of risk and to identify controls that need to be implemented to ensure compliance with monthly and timely reconciliations. The assessment will identify the position given the responsibility to review and monitor for compliance.

The finance director will immediately review all bank account reconciliations to determine any unresolved items and initiate appropriate action to correct the situation. The finance director will develop with the controller and staff accountants a monthly and month-end checklist so that all processes are identified and completed timely.

10. For the sixth consecutive year, the board has not addressed the risk of illegal, unauthorized, or inappropriate purchases

Finding

As noted in the five prior audits, the Tennessee State Veterans' Homes Board's policies and procedures over purchasing were not being followed, and service contract approvals required by state law were not obtained. Also, as noted in the two prior audits, contract payments were not always properly invoiced or reviewed. In addition, as noted in the four prior audits, travel claims were not appropriately handled. Again, because of a lack of action by top management, the board has not mitigated the risks associated with disbursements, such as payments for personal items, duplicate payments, or payments for services that the board would not have otherwise been obligated to make. For this six-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.

In the prior audit, management concurred with the finding and stated that employees were trained on the purchasing policies and procedures during implementation of the new accounts payable software. In addition, management stated that a contract review process was being developed and contracts would be updated. As of the end of our audit fieldwork, positive results from this training and contract review process had not been observed. During the audit period, the purchasing policies were still not followed on a consistent basis, and the organization was still not in compliance with state law. Management also concurred with the previous finding regarding travel payments and stated that steps were taken to avoid future duplicate payments. However, the organization's process to reimburse the Executive Director involves the submission of a copy of the claim for payment and a separate original version that goes to the board chairman for approval. This process has caused some administrative problems, and additional duplicate payments were again noted during our audit. Management's responses to past findings are exhibited in the appendix on pages 96-97.

Purchasing policies and procedures not followed

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 at least three informal quotes will be obtained for purchase orders between $500 and $1,000. 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 consistent with good internal controls over purchasing. However, these policies were once again not consistently followed. Our review of certain disbursements revealed the following errors:

- Eight of 19 disbursements tested at the Humboldt facility (42%) and 7 of 20 disbursements tested at the Murfreesboro facility (35%) were not supported by a purchase order.
- Of the 11 disbursements tested at the Humboldt facility that were supported by purchase orders, 6 purchase orders (55%) were dated after the services were rendered, indicating that the purchase order was not approved prior to purchase, or the same day as the invoice. Purchase orders dated the same day as the invoice were noted because it is unlikely that this situation would occur based on the services provided. One Murfreesboro purchase order was not dated. Of the 12 disbursements tested at the Murfreesboro facility supported by a dated purchase order, 6 purchase orders (50%) were dated after the services were rendered or the same day as the invoice.
- Seven of the 11 purchase orders tested at the Humboldt facility (64%) were not completed properly. The purchase orders did not include a description of the item, quantity, approximate price, or the expense account charged. Twelve of the 13 purchase orders tested at the Murfreesboro facility (92%) were not completed properly. The purchase orders did not include a quantity, approximate price, or the expense account charged.
- One of the 11 purchase orders tested at the Humboldt facility (9%) was not properly approved. One of the 13 purchase orders tested at the Murfreesboro facility (8%) was not properly approved.
- All of the 7 disbursements tested at the Humboldt facility that were over $500 did not have documentation of quotes or formal written bids. All 6 disbursements tested at the Murfreesboro facility that were over $500 did not have documentation of quotes or formal written bids.

<u>Contract approvals required by state law not obtained</u>

Service contracts were still not 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 15 of 17 service vendors tested in Murfreesboro (88%) and 11 of 14 service vendors tested in Humboldt (79%), a service contract that covered the entire audit period could not be provided. Two of the five contracts that did cover the audit period were not approved by the Commissioner of the Tennessee Department of Finance and Administration as required by Section 12-4-109, *Tennessee Code Annotated*. 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.

<u>Contract payments for nurse staffing did not have contract approval, were not adequately supported, and were not mathematically accurate</u>

Adequate controls were not in place over nurse staffing. For the vendors tested for “nurse staffing,” there were no contracts covering the entire audit period. Further, there were no written policies and procedures for staffing for the Murfreesboro and Humboldt facilities to ensure that invoices were adequately supported and mathematically correct, and to ensure that the facilities were being charged the correct rate.

Testwork revealed that invoices for nurse staffing services were not properly supported. For Murfreesboro, there were four payments of invoices that had no support or inadequate support. For Humboldt, for 24 of 25 payments of invoices tested (96%) we were unable to determine if the rates charged were accurate due to contracts not being on file or rate schedules not being available for the audit period.

Due to improper controls over reconciling staffing invoices to timesheets, the Murfreesboro facility was charged holiday pay for a non-listed holiday. The amount of the overcharge was $323. There was also a duplicate charge of $229 on an invoice that showed two different service dates, but the support provided for each of the two dates was for the same day. The facility failed to notice or question the inadequate supporting documentation and paid the charges as invoiced.

Improper Travel Reimbursements

Because of issues noted with the then Executive Director's travel claims during the prior audit, all payments to the Executive Director were reviewed for the year ended June 30, 2005. (In August 2006, the Executive Director resigned. The Executive Director's resignation was not related to this issue.) Once again several problems were noted, including duplicate reimbursements. In prior years, the administrative assistants would often sign off on the Executive Director's travel claims on behalf of the Chairman of the Board. This was done to allow more timely payment of the travel claims. However, the board's policy is that all of the Executive Director's travel claims should be approved by the Chairman of the Board. Therefore, in response to the prior audit findings on this issue, the Chairman of the Board 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. A copy of the claim approved by the Executive Assistant or the Executive Secretary would then be sent to accounts payable so that the payment would still be timely. The original claim would be sent to the chairman for his approval and then would then be filed for documentation of the approval. This process was flawed, and duplicate payments continued to be made. Another finding was taken in the prior audit and management responded that the process was adjusted to clearly designate which version was for approvals and which version was to be paid. The Executive Secretary was also assigned the task of matching the check copies with the travel claims filed to look for duplicate payments. However, before these procedures were developed, there were still several problems with the Executive Director's travel claims:

- Two of the Executive Director's travel claims, which totaled $102 and $45, were paid with two different checks. Both of these overpayments were refunded by the Executive Director after a review was performed by the Finance Director on all of his travel reimbursements after duplicate payments had been noted for the Executive Director during the previous audit. The review resulted in a repayment of $1,150.

- The Executive Director claimed reimbursement on a Reimbursable Expense Statement for a meal that totaled $41, and on a travel claim, he claimed a per diem, which totaled $23, for the same date. At the time of testwork, management had not identified this overpayment, and the amount had not been refunded.

- The Executive Director claimed reimbursement on a Reimbursable Expense Statement for maintenance on the state car that totaled $960, and he received double reimbursement. The first check that was issued cleared the bank in January 2005. Subsequently, management placed a stop-payment on the check on March 15, 2005, and issued another check to the Executive Director. The second check cleared the bank in April 2005. The finance department personnel had not identified the overpayment before our testwork and had not requested reimbursement from the former Executive Director.

- The Executive Director received double reimbursement for the same travel claim that totaled $109. The Finance Director stated she was not aware of the overpayment, and the Executive Director had not paid back the improper reimbursement.

- Fifteen of the Executive Director's travel claims and Reimbursable Expense Statements were paid before they were approved by the Chairman of the Board. The board's travel policy states that the Executive Director's travel claims should be approved by the Chairman of the Board. According to the Financial Director, approvals for any Reimbursable Expense Statements should follow the same policies and procedures as travel claims. Another five of the Executive Director's travel claims were not dated by either the Executive Director or the Chairman of the Board. Because they were not dated, it was impossible to determine if the travel claims were properly approved before they were paid. Also, one of the Executive Director's travel claims was paid but was never approved.

- The purchasing policy and procedure states, "All purchases initiated on behalf of the facility require the completion of a purchase order, which will be processed through the Business Office." However, the Executive Director bypassed the purchasing policies and procedures on 11 occasions for 12 items—such as $960 of maintenance on the state car, and $697 for chairs, markers, books, a thumb drive, and an optical mouse—and claimed reimbursement on 9 Reimbursable Expense Statements. Because he bypassed the purchasing policies and procedures, $142 in tax was paid on the items.

In addition to the problems with the Executive Director's travel claims, there were problems with other travel claims as well. There was also a missing travel claim totaling $237, four travel claims that exceeded the allowable meals and incidentals per diem amount by $120, one travel claim that exceeded the allowable lodging amount by $41, one that exceeded allowable mileage by $24, and two that were not submitted timely. There were also other occurrences where employees bypassed the purchasing policies and procedures when purchasing a $30 gift card, for which no receipt was provided, and purchasing cleaning products on a reimbursable expense statement instead of going through the normal purchasing process.

As a result of not adhering to the travel regulations and the purchasing policies and procedures, and as a result of the flawed process for submission of the former Executive Director's travel claims, numerous travel claims and reimbursement claims were overpaid. The entity appears to have made undetected overpayments in the amount of at least $2,427.

Recommendation

The Finance Director should ensure that purchasing procedures 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 Finance Director should ensure that bids and price comparisons are performed as required by 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. The audit committee should approve a formal 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 for routine and recurring purchases should be available to business office personnel.

The Finance Director should ensure that all staff and board members are knowledgeable about the state travel regulations. The business office staff should only pay travel claims for which original documentation is attached, and should compare the dates on the travel claims with dates from previous claims to identify duplicate payments. The Finance Director should monitor the travel reimbursement process to ensure that overpayments do not continue, and individuals responsible for accounts payable should be held responsible for ensuring that all travel claims approved for payment comply with the travel regulations. Any overcharges and duplicate payments should be researched and recovered. The governing board should take action against those who attempt to submit duplicate claims, as well as against any staff who facilitate such payments.

The governing 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 audit committee should review and monitor the actions that result from the most recent risk assessment by management. Management's evaluation related to service contracts was that the controls in place were ineffective. For travel, management conceded further education was necessary for the staff. The audit committee should review the actions taken by the former Executive Director to ensure that risks related to unauthorized purchases and improper travel reimbursements are adequately mitigated by the policies and procedures currently in place. The Executive Director should recommend specific staff for the Board's approval 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 in fiscal year 2005 risks were not fully addressed and that procedures were not followed and that service contracts were not in compliance with State law.

Procedures have been put into place to strengthen controls over purchasing. Management made the decision to change to an accounting system that included an electronic requisitions module. The conversion was completed in November 2005. The electronic requisitions module provides a planned method for submitting and approving purchase requests. After a requisition is approved, it then results in a purchase order.

Electronic requisitions have streamlined the process and have eliminated blank paper purchase orders. Staff training on purchasing procedures has been held and purchasing activities monitored for compliance with Board policy. Disciplinary actions have been taken where necessary.

A Contract Officer has been appointed and given responsibility to bring service contracts into compliance with State law.

Written documentation is provided to staff that travel. This documentation includes the state travel regulations and instructions for the completion of a travel claim.

11. <u>As noted since 2003, the board still has not addressed the risk of fraud and has inadequate controls regarding use of credit cards and open accounts</u>

Finding

As noted in the two prior audits, the Tennessee State Veterans' Homes Board did not have adequate controls in place over the use of credit cards and open accounts. During the audit period, the board still did not adopt policies to address who is authorized to request credit with vendors during the audit period. The facilities still did not have written policies and procedures outlining safeguard measures for the physical possession of the cards, nor did the Murfreesboro facility maintain a complete list of individuals with authorization to make credit purchases on behalf of the facility. Management concurred with the prior-year finding and stated that "there was no board policy on the use of credit for fiscal year June 2004. The governing board approved such a policy at its September 29, 2005, board meeting." Management's response to this finding from the earlier audit is exhibited in the appendix on pages 97-98.

The governing board did approve credit card policies and procedures at its September 29, 2005, board meeting; however, these policies and procedures were not adequate. The policies did not indicate for which purchases the cards may be used, the procedures that must be followed in order to use the cards, or the procedures for cancellation of cards when personnel terminate employment. Also, it did not include any disciplinary action for misuse of the cards. Improvements were made to the September 29, 2005, policies and procedures effective February

8, 2006; however, testwork will have to be performed on future audits to see if the facilities have actually followed the revised policies and procedures. During the audit period, there were still no controls in place regarding advance approval for purchases on a credit card or an open account. When approvals were obtained, the approval was not always timely. There were also no controls yet in place to ensure timely or correct payments for credit purchases, and appropriate support was not always required.

The fraud risks associated with individuals with uncontrolled access to the board's credit are obvious under these circumstances. The board could easily pay for the personal purchases of cardholders in error. 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 management and the governing board in July 2004, and due to the implications, should have been addressed immediately. In fact, due to the failure to immediately address the risk of fraud resulting from a lack of control over credit cards, unauthorized charges occurred. The facility's former Administrator circumvented the purchasing procedures and allowed the maintenance director to put fuel in his personal vehicle. As detailed later in this finding, several unauthorized purchases followed and would have continued undetected by the facility if the service station where the fuel was being purchased had not questioned the purchases. If management and the governing board had mitigated these risks when they were first made aware of them, this situation may not have occurred.

During the year ended June 30, 2005, the Humboldt facility had credit cards or open accounts with 15 vendors. Of these accounts, five gave the facility a specific limit to the credit extended, and ten were open-ended accounts with no limits. The limited credit extended to the facility totaled $34,500. During the fiscal year, the facility made total purchases of $81,554 against these credit cards and open accounts. The Murfreesboro facility has had credit cards or open accounts with at least nine vendors. Of these accounts, three gave the facility a specific limit to the credit extended, and six were open-ended accounts with no limits. The limited credit extended to the facility totaled $19,500. During the fiscal year, the facility made purchases totaling $51,746 against these credit cards and open accounts.

Lack of proper approvals

Procedures in place for approval of credit card transactions were still not adequate. At Murfreesboro, approval was not even required prior to the purchase. Items could be purchased that would not have been approved, and when the approval was finally requested, the item would already have been purchased. During the testwork in Murfreesboro, 38 instances were noted in which the purchase orders were not completed until the day after the purchase or later. The time frames noted ranged from one day after the purchase to 52 days after the purchase. Five additional purchase orders were observed without a date. During the Humboldt testwork, 13 instances were noted in which the purchase orders were not completed until the day after the purchase or later. The time frames noted ranged from one day after the purchase to 36 days after the purchase.

Also, the purchase orders occasionally were not completed at all. In Murfreesboro, 21 purchases from an office supply store did not have purchase orders at all, and a standing purchase order was not retained for approved purchases on the gas card. In Humboldt, 25 transactions using the facilities credit at three vendors on behalf of the foundation did not have purchase orders, and a standing purchase order was not retained for approved purchases on the gas card.

Payments without adequate support

In addition to untimely or improper approval for purchases, certain purchases were still not supported adequately. There were 20 unsupported payments at the Humboldt facility. There were nine instances involving three vendors where only a copy of the invoice was used as support for the transaction. There were five instances where a receipt or an invoice was not attached to support the transaction. In one of these five instances, the purchase order failed to indicate what was being purchased. In addition, there were six instances where a faxed copy of the invoice from a grocery store was attached; however, the faxed invoices did not indicate what was being purchased. There was no grocery cash register tape attached to the purchase order as is required, and the purchase order did not state what was being purchased. There were 30 unsupported payments at the Murfreesboro facility. In two of the instances, involving two vendors, the receipt was not attached to the purchase order and check stub. In one instance, a purchase was not supported by an invoice and purchase order. The rest of the unsupported payments involved fuel card receipts for which the facility did not follow its procedure to attach the fuel card receipts to the monthly report as support for the payment.

Lack of consistency in payment

The facilities still 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. The facilities need to be consistent in the way payments are made through the system. Reconciliations between receipts submitted by employees and statements submitted by vendors were not performed to ensure that charges present on the statement were incurred by an authorized employee. Based on a review of the statements, the Humboldt facility incurred interest fees on seven occasions for a total of $123. Murfreesboro incurred $244 in interest and late fees.

Inappropriate use of credit card

Due to a lack of controls to prevent, deter, or detect fraud involving credit cards, a Humboldt department head was able to inappropriately use the facility's Fuelman card. The employee was using his personal vehicle to haul items to the landfill for the facility. According to the Executive Director at the time, the former Administrator acknowledged approving the use of the card for one instance; however, the employee used the card numerous times to put fuel in his personal vehicle. The approval by the Administrator was inappropriate as Fuelman is for state vehicle use only. Further, physical access to the card was not controlled as the card was stored in the individual's office. Neither the initial nor the additional uses of the card were questioned by the Administrator or the accounts payable clerks. The situation would have remained undetected if the purchases hadn't been questioned by an attendant at the service station where the employee was purchasing the fuel. The total amount of these charges identified by the facility was $456; however, based on our testwork, additional charges of $93 were determined to have resulted from the unauthorized use of the Fuelman card. Further, the department head had also filed a travel reimbursement claim for the hauling that resulted in a payment of $103 that would have included fuel costs. There were no written policies for card usage during the audit period. The employee and the Administrator involved are no longer employed at the facility.

Credit card transactions not controlled

Credit card procedures were still not clear during the audit period, and there were several additional internal control issues as a result.

The Murfreesboro facility had six instances where invoices were paid twice. The overpayments totaled $478. Humboldt had an instance where the facility paid twice the amount billed on the monthly statement for a total overpayment of $150. Sales tax of over $186 was erroneously paid by the facilities.

The Murfreesboro facility had two instances where credits were not used timely and one instance where the quantity purchased did not match the quantity listed on the purchase order on the purchase of a $120 item. For Humboldt, there were 92 instances for 5 different vendors where the purchase order did not have a description of the item being purchased. Several of these instances were related to the use of a standing purchase order. According to the purchasing policies and procedures, a standing purchase order is allowable but it must document the description and quantity of the items being purchased to help eliminate the risk of abuse or fraudulent transactions.

Conclusion

Due to management's continuing failure to address the lack of policies regarding authorized credit card users and the lack of advance approvals, the board became responsible for charges during the audit period that are not related to board activities. Inadequate control over purchases resulted in duplicate payments as well as interest and penalty charges. Without controls in place, credit cards can be used to avoid following existing purchasing policies. The lack of policies and the lack of monitoring of the credit cards were an invitation for fraud to occur and go undetected.

Recommendation

The governing board should promptly address and strengthen policies and procedures regarding the authorization and use of credit cards and lines of credit. Policies should be developed by the governing board to make clear what types of purchases are allowable by credit card, what types of approvals will be required, and what information is required on the purchase order. 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 nature and propriety of credit card purchases should be scrutinized by the authorized purchaser's supervisor. The Executive Director should ensure billing statements are properly reconciled to the receipts approved by the supervisors to eliminate duplicate payments and interest charges. Any charges without approved receipts should be investigated immediately. These reconciliations and investigations need to be done in a timely manner to ensure that late payment charges are avoided.

Physical access to the Fuelman card should be restricted to ensure who will be held accountable for the purchases on the card. The administrators should prohibit the use of the card for personal vehicles and should take immediate disciplinary action when that prohibition is violated. The Finance Director should ensure that the board is repaid for any funds used inappropriately.

This issue was identified as a risk in management's most recent risk assessment. Management's evaluation of the risks was that the process to create appropriate internal control in this area was incomplete, and the review recognized the need to strengthen certain controls. The audit committee should review the details of the risk assessments and the policies developed. The audit committee should monitor management's actions to complete the risk assessment and to strengthen the controls identified in the assessment.

Management's Comment

We concur that during fiscal year 2005, fraud risks had not been evaluated and that controls were inadequate for used of credit.

Procedures and controls for use of credit cards have been strengthened and additional training has been held. The number of credit cards has been reduced to three per facility. Access to credit cards is restricted and staff must be an approved user and have an approved purchase order prior to obtaining the credit card and making a purchase. Staff is aware of consequences of not following policy. This activity will continue to be monitored and reported to the Audit Committee.

12. Management did not accurately report contribution information to the Tennessee Consolidated Retirement System, causing contribution underpayments of over $27,000

Finding

The board does not have adequate controls to ensure that the Contribution Report worksheets are accurate and amounts reported to the Tennessee Consolidated Retirement System (TCRS) are proper. Each of the facilities is required to file Contribution Report worksheets with TCRS on a monthly basis. The worksheets include the gross salary of all pension-eligible employees multiplied by the employer rate, which is established by an actuarial evaluation. The amount calculated is the employer contribution amount due to TCRS to cover the pensions of the eligible employees. If the facilities do not complete the form correctly, the facilities will not contribute the correct amount to the pension program. The Tennessee State Veterans' Homes Board has reported the contribution amount incorrectly on several occasions and has caused the TCRS contribution amounts to be underpaid by at least $27,711 over the last two years.

During review of selected employees' salaries reported on Contribution Report worksheets for the current audit period, it appears that the Murfreesboro facility had certain errors when calculating gross salary. We reviewed 16% of the employee salaries reported. Contributions were underpaid due to underreported payroll for the months of November and December 2004 and March 2005. For the November 2004 worksheet, two of 19 employees' gross salaries tested (11%) were not reported, which caused an underpayment of $86. In December 2004, the Contribution Report worksheet included a pay period that had not been reported for September 2002. However, the gross salaries for these periods were still underreported by $9,498. Also when the gross salary amount was multiplied by the current rate, the current rate was used for both pay periods. The rate that was applicable for 2004 was 6.55%, and the rate that should have been used for 2002 was 8.09%. Due to the underreporting of gross payroll and the use of only the 6.55% employer rate, the December 2004 contributions were underpaid by $1,635. For March 2005, the gross salary was underreported for one of the 19 employees tested (5%) and caused an underpayment of $93. For the prior fiscal year at Murfreesboro, it appears that the March 28, 2004, pay period was not reported in the amounts remitted to TCRS, which resulted in an underpayment of $6,313. Therefore, the total error discovered for the audit periods was $8,127.

The Humboldt facility reports were underreported for the months of July, August, and October 2004. We reviewed 25% of the employee salaries reported. For July 2004, payroll was underreported for one of 24 employees (4%) which caused an underpayment of $14. In August, failure to report the payroll run for August 15, 2004, caused an estimated underpayment of $6,546. For October 2004, payroll was underreported for one employee of 24 employees (4%) resulting in an underpayment of $15. For the prior fiscal year at Humboldt, it appears that the August 17, 2003, and the September 14, 2003, payrolls were not reported on the Contribution Report worksheet for an underpayment of $13,009. Therefore, the total errors discovered for the audit periods were $19,584.

Although a pattern could not be established at either facility for these remittance errors, management should evaluate the procedures used to approve the Contribution Report worksheets. If these types of errors continue, employees could receive a smaller pension benefit than earned. Further, there is the risk that without adequate review from management, gross wages for employees could be overstated as well. These types of errors could allow employees to receive a greater benefit from the pension plan than earned and cause the facilities to pay a greater expense than necessary.

Recommendation

The Finance Director should immediately research the pay periods indicated in this finding as being underpaid and remit the appropriate amount of employer contribution to TCRS. The Finance Director should investigate the cause of the errors and then evaluate the procedures used to not only report but also to approve the Contribution Report worksheets. The Finance Director should ensure that future Contribution Report worksheets include gross pay amounts for all employees eligible to participate in the pension plan; that the gross pay amounts include any supplemental amounts paid, if applicable; and that the calculations used to determine the employer contribution amount are accurate. Management should not approve a Contribution Report worksheet unless the worksheet is verified as accurate to ensure that the pension plan is properly funded.

The Executive Director should ensure that risks related to employee benefits 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 contributions to the Tennessee Consolidated Retirement System were not always calculated accurately.

The pay periods indicated in this finding have been researched and contributions to TCRS will be made. Further, the contribution report worksheets are reviewed by someone other than payroll for each pay period to ensure payments are made accurately. This review is documented and kept on file.

13. <u>For the third consecutive year, Medicaid residents were charged more than private-paying residents</u>

Finding

As noted in the prior two audits, 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. The Division of TennCare of the Comptroller's Office uses the annual cost report that is submitted by the board to determine the Medicaid reimbursement per diem. 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 2004. Current-year testwork shows that the Medicaid rate exceeded the facility rates from July 1, 2004, through September 17, 2004, at the Humboldt facility.

Management's response to this finding from an earlier audit is exhibited in the appendix on page 98.

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 1 residents was lower than the established Medicaid reimbursement rate at the Humboldt Veterans' Home.

The level 1 Medicaid rate that was set for fiscal year 2004 was $128.97 per day, for both facilities. At the Humboldt facility, the level 1 private pay rate for the period July 1, 2004, through September 17, 2004, was $122.99 per day. This difference of $5.98 per day resulted in questionable payments from Medicaid in the amount of $18,670. 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.

Also, the board went from a management company to self-management on September 1, 2004, and implemented a new accounting system. The accounting system generates charges based on the resident type. There are numerous resident types established by the facilities based on a combination of the level of care, payor type, veteran status, and room type (private or semi-private). The board did not establish a resident type for a private pay level 2 resident. Therefore, private pay level 2 residents in the facility from September 1, 2004, through June 30, 2005, were charged the level 1 rate. Although Murfreesboro business office staff stated they did not have any private pay level 2 residents in the facility, physician's order forms indicated 45 days of private pay individuals with a level 2 level of care that were billed at the level 1 rate. The board lost $1,506 in revenue for these 45 days to which the facility would have been entitled to had the level 2 private pay resident type been established. Also, the level 2 Medicaid resident would be billed more than the private pay individual. In Humboldt, the same comparison could not be performed because the business office manager designated all private pay days as level 1 on the census, and the physician's order form did not state the level of care.

In addition to the costs that the homes may be responsible for repaying, the Tennessee State Veterans' Homes Board also lost revenue to which the facility would have been entitled had the level 1 private pay rates been established properly. As Medicaid was established to pay reasonable costs associated with long-term care for individuals with limited income, it would appear that the rates established for non-Medicaid residents should be, at a minimum, equal to, if not greater than, the rates established for Medicaid residents.

Recommendation

The Tennessee State Veterans' Homes Board should ensure that all rules and regulations established by the state and federal governments are followed. The board should evaluate its private pay rates annually when preparing data for cost reports in order to avoid any further questionable reimbursements which the board may ultimately be required to repay. The board should ensure that residents are charged the proper rate based on the level of care.

This issue was identified in management's most recent risk assessment and the result of the assessment was that controls were inadequate. The audit committee should review the actions taken by the Executive Director to address the inadequacy of controls over rate setting.

Management's Comment

We concur that at times during the 2005 fiscal year, Medicaid residents were charged more than private-paying residents.

It is the Board's goal to always be in compliance with state and federal rules and regulations. The Board reviews and evaluates its room rates during the budget process. A private pay level 2 resident type has been established in the billing system and procedures will be designed to ensure correct billing based on level of care.

14. <u>The facilities failed to protect funds held in trust for nursing home residents with the surety bond coverage required by state law</u>

Finding

The Humboldt and Murfreesboro facilities have not complied with Tennessee legal requirements for nursing homes that maintain accounts containing residents' funds, and have therefore failed to protect resident funds from loss. Regarding funds held in trust for nursing home residents, Section 68-11-906(f), *Tennessee Code Annotated*, states, "The nursing home shall maintain a surety bond on all funds held in trust for the facility residents. . . ."

The Murfreesboro and the Humboldt facilities allowed surety bond coverage to lapse for 27 days in September 2004, and the Murfreesboro facility allowed balances in the resident trust account to exceed amounts covered by surety bonds for an additional 81 days during the year. Funds held during these time periods that exceeded the available coverage ranged from $46 to $120,000 for the Murfreesboro facility and $91,000 to $120,000 for the Humboldt facility. The board was researching the code to determine if this particular law applied to the state facilities. However, before a conclusion is reached, if the funds were mishandled by the facilities, the residents' safety net may not be in place to replace the mishandled funds.

Recommendation

The board should maintain the adequate surety bond coverage until such time as a legal conclusion is reached that the surety coverage requirement does not apply. The Administrator at each facility should periodically monitor the balances of the resident trust funds to ensure that the surety coverage is adequate.

The Executive Director should ensure that risks related to resident trust funds 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 protect resident funds.

Management's Comment

We concur that there were days that coverage provided by the surety bond was less than the funds held for residents and that for a period of time there was no coverage at all.

When inquiries were made to add increased coverage for the Murfreesboro facility, the insurance carrier cancelled the two existing policies. The coverage was replaced as quickly as possible; however, there were few companies willing to offer coverage for just this part of the business. At the same time a new policy was obtained, the coverage limits were increased to provide ample insurance for the homes' resident trust funds.

Policy limits will be considered and documented each year as part of the budget process.

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COMPTROLLER OF THE TREASURY
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Independent Auditor's Report

June 30, 2006

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

Dear Mr. Morgan:

We were engaged to audit the accompanying statement of net assets of the Tennessee State Veterans' Homes Board, a component unit of the State of Tennessee, as of June 30, 2005, and the related statement of revenues, expenses, and changes in net assets for the year then ended. These financial statements are the responsibility of the board's management.

Certain records and documentation supporting transactions and account balances were not available for our audit. Questions regarding material differences between accounting records were unanswered. Therefore, we were not able to satisfy ourselves about the amounts at which cash, accounts receivable, current liabilities, and net assets are recorded at June 30, 2005, and the amounts of revenues, expenses, and certain changes in asset values for the year ended June 30, 2005. The board declined to present a statement of cash flows for the year ended June 30, 2005. Presentation of such statement summarizing the board's operating, investing, and financing activities is required by accounting principles generally accepted in the United States of America.

Because of the significance of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements referred to in the first paragraph.

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

The accompanying financial information on pages 81 through 84 is presented for purposes of additional analysis and is not a required part of the basic financial statements. We did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards,* we have also issued our report dated June 30, 2006, 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, contracts, and grant agreements 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/th

Exhibit A

UNAUDITED

Tennessee State Veterans' Homes Board
Statement of Net Assets
June 30, 2005

Assets:	
Current assets:	
Cash (Note 2)	$ 1,541,893.75
Investments (Note 2)	30,009.51
Resident accounts receivable, net of allowance for doubtful accounts of $2,731,376 (Note 3)	1,138,791.56
Medicare cost settlement receivable	6,731.02
Due from federal government	1,236,610.47
Inventories	78,341.33
Prepaid items	750.00
Restricted cash (Notes 2, 5)	329,486.86
Total current assets	4,362,614.50
Noncurrent assets:	
Restricted cash (Notes 2, 5)	1,178,557.44
Unamortized bond issuance costs	55,137.89
Capital assets (Note 6):	
Land and improvements	394,827.00
Infrastructure	676,063.00
Accumulated depreciation-infrastructure	(241,355.51)
Buildings and improvements	10,392,876.21
Accumulated depreciation - buildings and improvements	(2,951,355.43)
Furniture and equipment	1,993,192.42
Accumulated depreciation - furniture and equipment	(1,098,789.10)
Construction in progress	1,977,522.88
Total noncurrent assets	12,376,676.80
Total assets	16,739,291.30

UNAUDITED

Tennessee State Veterans' Homes Board
Statement of Net Assets
June 30, 2005

Liabilities:	
Current liabilities:	
Accounts payable and accruals (Note 7)	914,131.35
Due to primary government (Note 4)	970,658.72
Checks payable	103,341.66
Amounts held in custody for others	106,182.28
Medicaid current financing	302,034.66
Medicare cost settlement payable	45,818.77
Loans from the State of Tennessee (Note 8)	175,000.00
Compensated absences (Note 8)	158,389.45
Total current liabilities	2,775,556.89
Noncurrent liabilities:	
Loans from the State of Tennessee, net (Note 8)	3,762,890.86
Compensated absences (Note 8)	123,965.78
Total noncurrent liabilities	3,886,856.64
Total liabilities	6,662,413.53
Net Assets:	
Invested in capital assets, net of related debt	7,203,561.61
Restricted for:	
Debt service	144,591.40
Repairs and replacements	746,973.32
Other purposes	431,584.12
Foundation activities	21,005.11
Unrestricted	1,529,162.21
Total net assets	$ 10,076,877.77

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

UNAUDITED

Tennessee State Veterans' Homes Board
Statement of Revenues, Expenses, and Changes in Net Assets
For the Years Ended June 30, 2005

Operating revenue:	
Resident service revenue plus contractual adjustments of $1,269,051.70 and less provision for bad debts of $748,226.93	$ 13,876,021.91
Total operating revenue	13,876,021.91
Operating expenses:	
Administrative and general	2,505,219.11
Nursing services	5,555,997.67
Central services	583,670.25
Ancillary departments	1,274,136.74
Dietary	1,108,078.51
Activities	241,095.17
Social services	208,587.00
Environmental services	729,337.59
Plant operations and maintenance	736,651.33
Depreciation	465,514.89
Total operating expenses	13,408,288.26
Operating income	467,733.65
Nonoperating revenues (expenses):	
Grant revenue	1,154,508.55
Interest revenue	62,530.98
Miscellaneous revenue	671,390.78
Interest expense	(214,780.60)
Amortization of discounts and issuance costs	(3,263.54)
Loss on disposal of equipment	(33,676.50)
Miscellaneous expense	(37,766.39)
Total nonoperating revenues	1,598,943.28
Increase in net assets	2,066,676.93
Net assets, July 1	8,010,200.84
Net assets, June 30	$ 10,076,877.77

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

UNAUDITED
Tennessee State Veterans' Homes Board
Notes to the Financial Statements
June 30, 2005

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, 2005, 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. Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed to the extent that those standards do not conflict with or contradict guidance of the GASB. Governmental entities also have the option of following subsequent private-sector guidance subject to this same limitation. The Tennessee State Veterans' Homes Board has elected not to follow subsequent private-sector guidance.

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. 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 Premiums, Deferred Amounts on Refunding and Issuance Costs

Loan Premiums and issuance costs are deferred and amortized over the life of the loans. The deferred amount on refunding is amortized over the shorter of the life of the loans or bonds that were refunded. The straight-line method of amortization is used and the premium and deferred amortization amount is a component of interest expense. The results of using the straight-line method are not materially different from those of the effective interest method. Loans payable are reported net of unamortized premium and unamortized deferred amount on refunding.

NOTE 2. DEPOSITS AND INVESTMENTS

At June 30, 2005, the carrying amount of the board's deposits was $462,643.02, and the bank balance was $722,034.58. The entire bank balance and investment balance at June 30, 2005, 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.

The board also had $2,586,439.83 deposited in the Local Government Investment Pool (LGIP) administered by the State Treasurer and $855.20 of petty cash on hand. The LGIP is part of the Pooled Investment Fund. The fund's investment policy and required risk disclosures 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, 2005, consist of the following:

Receivables from patients and their insurance	$2,385,444.21
Receivable from Medicare	985,511.40
Receivable from U.S. Department of Veterans Affairs	499,212.88
Allowance for doubtful accounts	(2,731,376.93)
Net amount reported as resident accounts receivable	$ 1,138,791.56

The net receivable amount of $1,138,791.56 represents accounts receivable that are expected to be collected within one year.

NOTE 4. DUE TO PRIMARY GOVERNMENT

Due To:

Department of Finance and Administration–State Building Commission	$ 1,236,610.47
Department of Finance and Administration–Medicaid current services less void adjustments	(593,925.36)
Department of Finance and Administration–Medicaid overpayments occurring before 1994	282,062.42
Department of Health–bed tax	22,000.00
Department of the Treasury–retirement contributions	7,022.26
Department of Labor and Workforce Development–unemployment taxes	17,236.97
Department of Human Services–child support payments	(348.04)
Total due to primary government	$ 970,658.72

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, 2005, the receivable from Medicaid is $1,311,845.36, and the estimated payable to Medicaid for void adjustments is $717,920.

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

NOTE 5. RESTRICTED ASSETS

The balances of the board's restricted asset accounts at June 30, 2005, are as follows:

Resident trust fund accounts	$103,582.36
Debt service account	225,904.50
Bond savings account	431,584.12
Repair and replacement account	746,973.32
Total restricted assets	$1,508,044.30

NOTE 6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2005, was as follows:

	Beginning	Additions	Retirements	Ending
Capital assets, not being depreciated:				
Land and improvements	$251,827.00	$143,000.00	$ -	$394,827.00
Construction in progress	548,304.20	1,812,445.95	(383,227.27)	1,977,522.88
Total capital assets, not being depreciated	800,131.20	1,955,445.95	(383,227.27)	2,372,349.88
Capital assets, being depreciated:				
Infrastructure	676,338.00	-	(275.00)	676,063.00
Buildings and improvements	10,346,192.84	46,683.37	-	10,392,876.21
Furniture and equipment	1,627,128.00	636,271.54	(270,207.12)	1,993,192.42
Total depreciable capital assets	12,649,658.84	682,954.91	(270,482.12)	13,062,131.63
Less accumulated depreciation:				
Infrastructure	(252,814.79)	(27,217.32)	38,676.60	(241,355.51)
Buildings and improvements	(2,646,651.74)	(304,929.00)	225.31	(2,951,355.43)
Furniture and equipment	(1,052,975.97)	(267,156.97)	221,343.84	(1,098,789.10)
Total accumulated depreciation	(3,952,442.50)	(599,303.29)	260,245.75	(4,291,500.04)
Total depreciable capital assets, net	8,697,216.34	83,651.62	(10,236.37)	8,770,631.59
Net capital assets	$9,497,347.54	$2,039,097.57	($393,463.64)	$11,142,981.47

NOTE 7. ACCOUNTS PAYABLE AND ACCRUALS

Payables at June 30, 2005, consist of the following:

Payables to suppliers	$ 540,542.69
Accruals for salaries and benefits	290,288.41
Accrued interest	83,300.25
Amount reported as accounts payable and accruals	$ 914,131.35

NOTE 8. LONG TERM LIABILITIES

Long term debt activity for the year ended June 30, 2005, was as follows:

	Beginning	Additions	Reductions	Ending	Amount due within 1 year
Loans payable					
Murfreesboro-1989	$ 140,000.00	$	$ (10,000.00)	$ 130,000.00	$ 20,000.00
Murfreesboro-2003	1,392,760.70	-	(72,202.84)	1,320,557.86	72,300.00
Murfreesboro-2005	-	57,166.63	-	57,166.63	-
Humboldt-2003	2,380,320.89	-	(59,236.06)	2,321,084.83	82,700.00
Humboldt-2005	-	109,081.54	-	109,081.54	-
Total loans payable	3,913,081.59	166,248.17	(141,438.90)	3,937,890.86	175,000.00
Compensated absences	262,596.74	311,400.59	(291,642.10)	282,355.23	158,389.45
Total long term Liabilities	$4,175,678.33	$477,648.76	$(433,081.00)	$4,220,246.09	$333,389.45

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, 2005, was not paid until after June 30, 2005.

The State Funding Board, through the Division of Bond Finance, is currently issuing commercial paper to finance the construction of an additional wing for the Murfreesboro and Humboldt facilities. Once the projects are complete, the Division of Bond Finance will retire the commercial paper with general obligation bonds. The board will be responsible for the debt service of these bonds. Until then, no principal payments will be made on this loan. The board is responsible for the interest on the commercial paper. The amounts for the 2005 loans payable represent the commercial paper that has been expended on the construction projects through June 30, 2005.

The total loans payable at June 30, 2005, consisted of the following:

Loan from the State of Tennessee to the Murfreesboro facility, 0.0% due in yearly installments of $10,000	$ 130,000.00
Loan from the State of Tennessee to the Murfreesboro facility, 3.0% to 5.125%, due from 2005 to final maturity in 2019 (net of unamortized premium of $74,764.84 and unamortized deferred refunding of $33,106.98)	1,320,557.86
Loan from the State of Tennessee to the Murfreesboro facility, construction payments as of June 30, 2005	57,166.63
Loan from the State of Tennessee to the Humboldt facility, 3.0% to 5.125%, due from 2005 to final maturity in 2026 (net of unamortized premium of $72,053.35 and unamortized deferred refunding of $392,068.52)	2,321,084.83
Loan from the State of Tennessee to the Humboldt facility, construction payments as of June 30, 2005	109,081.54
Total loans payable	$3,937,890.86

Debt-service requirements to maturity of the loans payable at June 30, 2005, are as follows:

For the Year(s) Ended June 30	Principal	Interest	Total
2006	$ 175,000.00	$ 185,756.26	$ 360,756.26
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	185,000.00	156,831.26	341,831.26
2011 – 2015	1,035,000.00	641,281.27	1,676,281.27
2016 – 2020	1,125,000.00	368,115.67	1,493,115.67
2021 – 2025	805,000.00	144,993.75	949,993.75
2026	200,000.00	4,750.00	204,750.00
	$4,050,000.00	$2,018,021.99	$6,068,021.99

The above debt principal is more than that presented on the accompanying financial statements by $112,109.14 due to $(166,248.17) in loans for which debt service requirements have not been established and due to $(146,818.19) of unamortized premium and $425,175.50 representing the deferred amount on refunding.

NOTE 9. DEFINED BENEFIT PENSION PLAN

A. Plan Description

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

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

B. Funding Policy

The Tennessee State Veterans' Homes Board is required to contribute at an actuarially determined rate; the rate for the fiscal year ended June 30, 2005, was 6.55% 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, 2005, Tennessee State Veterans' Homes Board's annual pension cost of $313,015 to TCRS was equal to the board's required and actual contributions. The required contribution was determined as part of the July 1, 2003, actuarial valuation using the frozen entry age 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, 2005	$313,015	100.00%	-
June 30, 2004	$313,832	100.00%	-
June 30, 2003	$307,385	100.00%	-

NOTE 10. 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 11. 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) is paid only when an employee who has successfully completed one year of employment is absent due to illness or injury, there is no liability for these benefits at June 30, 2005.

NOTE 12. 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 buildings and contents are insured by the State of Tennessee. The board has scheduled coverage of $14,274,800 for the buildings and $2,223,200 for the contents.

   The state purchases commercial insurance for real property, flood, earthquake, and builder's risk losses and surety bond coverage on the state's officials and employees. The insurance policy deductibles vary from $25,000 per occurrence to an aggregate of $7.5 million.

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 13. SUBSEQUENT EVENTS

A third facility in East Tennessee has been opened.

UNAUDITED
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%
6/30/99	1,134	1,134	0	100%	2,022	0%

UNAUDITED

Tennessee State Veterans' Homes Board
Supplementary Information
Supplementary Schedule of Net Assets
June 30, 2005

	Murfreesboro	Humboldt	Knox County	Foundation	Totals
Assets:					
Current assets:					
Cash	$ 387,692.98	$ 1,111,114.24	$ -	$ 43,086.53	$ 1,541,893.75
Investments	-	-	-	30,009.51	30,009.51
Resident accounts receivable, net of allowance for doubtful accounts of $2,731,376	588,432.63	550,358.93	-	-	1,138,791.56
Medicare cost settlement receivable	6,731.02	-	-		6,731.02
Due from federal government	106,166.61	202,580.01	927,863.85		1,236,610.47
Due from other facilities	-	130,427.24	-	-	130,427.24
Inventories	34,558.68	43,782.65	-	-	78,341.33
Prepaid items	750.00	-	-	-	750.00
Restricted cash	149,776.20	179,710.66	-	-	329,486.86
Total current assets	1,274,108.12	2,217,973.73	927,863.85	73,096.04	4,493,041.74
Noncurrent assets:					
Restricted cash	602,175.57	576,381.87	-	-	1,178,557.44
Unamortized bond issuance costs	19,458.50	35,679.39	-	-	55,137.89
Capital assets:					
Land and improvements	51,700.00	200,127.00	143,000.00	-	394,827.00
Infrastructure	153,695.00	522,368.00	-	-	676,063.00
Accumulated depreciation-infrastructure	(118,173.13)	(123,182.38)	-	-	(241,355.51)
Buildings and improvements	3,966,433.12	6,426,443.09	-	-	10,392,876.21
Accumulated depreciation - buildings and improvements	(1,417,082.50)	(1,534,272.93)	-	-	(2,951,355.43)
Furniture and equipment	909,947.19	1,083,245.23	-	-	1,993,192.42
Accumulated depreciation - furniture and equipment	(507,620.44)	(591,168.66)	-	-	(1,098,789.10)
Construction in progress	203,786.44	344,724.59	1,429,011.85	-	1,977,522.88
Total noncurrent assets	3,864,319.75	6,940,345.20	1,572,011.85	-	12,376,676.80
Total assets	5,138,427.87	9,158,318.93	2,499,875.70	73,096.04	16,869,718.54

UNAUDITED
Tennessee State Veterans' Homes Board
Supplementary Information
Supplementary Schedule of Net Assets (Cont.)
June 30, 2005

	Murfreesboro	Humboldt	Knox County	Foundation	Totals
Liabilities:					
Current liabilities:					
Accounts payable and accruals	488,865.03	425,266.32	-	-	914,131.35
Due to primary government	85,027.92	(42,233.05)	927,863.85	-	970,658.72
Checks payable	32,461.21	70,880.45			103,341.66
Amounts held in custody for others	55,060.17	51,122.11	-	-	106,182.28
Medicaid current financing	130,339.04	171,695.62	-	-	302,034.66
Medicare cost settlement payable	-	45,818.77	-	-	45,818.77
Due to other facilities	128,898.24	-	1,529.00	-	130,427.24
Loans from the State of Tennessee	92,300.00	82,700.00	-	-	175,000.00
Compensated absences	72,345.02	86,044.43	-	-	158,389.45
Total current liabilities	1,085,296.63	891,294.65	929,392.85	-	2,905,984.13
Noncurrent liabilities:					
Loans from the State of Tennessee, net	1,415,424.49	2,347,466.37	-	-	3,762,890.86
Compensated absences	62,151.38	61,814.40	-	-	123,965.78
Total noncurrent liabilities	1,477,575.87	2,409,280.77	-	-	3,886,856.64
Total liabilities	2,562,872.50	3,300,575.42	929,392.85	-	6,792,840.77
Net Assets:					
Invested in capital assets, net of related debt	1,734,961.19	3,898,117.57	1,570,482.85	-	7,203,561.61
Restricted for:					
Debt service	67,948.12	76,643.28	-	-	144,591.40
Repairs and replacements	360,559.15	386,414.17	-	-	746,973.32
Other purposes	241,616.42	189,967.70	-	-	431,584.12
Foundation activities	-	-	-	21,005.11	21,005.11
Unrestricted	170,470.49	1,306,600.79	-	52,090.93	1,529,162.21
Total net assets	$ 2,575,555.37	$ 5,857,743.51	$ 1,570,482.85	$ 73,096.04	$ 10,076,877.77

UNAUDITED

Tennessee State Veterans' Homes Board

Supplementary Information

Supplementary Schedule of Revenues, Expenses, and Changes in Net Assets

For the Year Ended June 30, 2005

	Murfreesboro	Humboldt	Knox County	Foundation	Totals
Operating revenue:					
Resident service revenue plus contractual adjustments of $1,269,051.70 and less provision for bad debts of $748,226.93	$ 6,812,976.30	$ 7,063,045.61	$ -	$ -	$ 13,876,021.91
Total operating revenue	6,812,976.30	7,063,045.61	-	-	13,876,021.91
Operating expenses:					
Administrative and general	1,204,256.40	1,300,962.71	-	-	2,505,219.11
Nursing services	2,941,785.01	2,614,212.66	-	-	5,555,997.67
Central services	315,655.69	268,014.56	-	-	583,670.25
Ancillary departments	562,780.30	711,356.44	-	-	1,274,136.74
Dietary	523,667.20	584,411.31	-	-	1,108,078.51
Activities	112,253.29	128,841.88	-	-	241,095.17
Social services	91,226.08	117,360.92	-	-	208,587.00
Environmental services	368,704.70	360,632.89	-	-	729,337.59
Plant operations and maintenance	390,903.54	345,747.79	-	-	736,651.33
Depreciation	196,840.38	268,674.51	-	-	465,514.89
Total operating expenses	6,708,072.59	6,700,215.67	-	-	13,408,288.26
Operating income (loss)	104,903.71	362,829.94	-	-	467,733.65

UNAUDITED

Tennessee State Veterans' Homes Board

Supplementary Information

Supplementary Schedule of Revenues, Expenses, and Changes in Net Assets (Cont.)

For the Year Ended June 30, 2005

	Murfreesboro	Humboldt	Knox County	Foundation	Totals
Nonoperating revenue (expenses):					
Grant revenue	106,166.61	202,580.01	845,761.93	-	1,154,508.55
Interest revenue	24,172.33	37,810.14	-	548.51	62,530.98
Miscellaneous revenue	32,772.75	17,509.50	598,410.27	22,698.26	671,390.78
Interest expense	(63,205.39)	(151,575.21)	-	-	(214,780.60)
Amortization of discounts and issuance costs	(1,486.97)	(1,776.57)	-	-	(3,263.54)
Loss on disposal of equipment	(13,772.85)	(19,903.65)	-	-	(33,676.50)
Miscellaneous expense	-	-	-	(37,766.39)	(37,766.39)
Total nonoperating revenues (expenses)	84,646.48	84,644.22	1,444,172.20	(14,519.62)	1,598,943.28
Increase (decrease) in net assets	189,550.19	447,474.16	1,444,172.20	(14,519.62)	2,066,676.93
Net assets, July 1	2,386,005.18	5,410,269.35	126,310.65	87,615.66	8,010,200.84
Net assets, June 30	$ 2,575,555.37	$ 5,857,743.51	$ 1,570,482.85	$ 73,096.04	$ 10,076,877.77

APPENDIX

PREVIOUS RESPONSES FROM MANAGEMENT TO REPEATED AUDIT FINDINGS INCLUDED IN THIS REPORT

Current Finding

<u>For the fourth consecutive year, internal controls for information systems are not adequate, leaving the board's records susceptible to fraud, error, and improper alterations</u>

Management's Comments

For the Year Ended June 30, 2002

The information system referenced is owned by NHC. With the purchase of an information management system for the Board, the recommendations of the auditors will be used as a guide for development of controls.

For the Year Ended June 30, 2003

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

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

Current Finding

<u>As noted since 1997, accounts receivable practices are not adequate</u>

Management's Comments

For the Year Ended June 30, 1997

A. Processing void adjustments related to the VA per diem

The Board does not concur that the subsidy amounts should be refunded to the Medicaid program. The Board has requested, in writing, that the Governor review this issue. At this time, a response has not been received from the Governor's office.

C. Uncollectible accounts have not been written-off

We concur that there are uncollectible accounts on the aging that have not been submitted for bad debt write-off. A complete analysis of the Accounts Receivable aging will be completed by June 30, 1999. Accounts deemed uncollectible will be identified and submitted for write-off approval. Once approval is granted these accounts will be deleted from the general ledger.

A plan of action for timely Accounts Receivable review will be developed by June 30, 1999. This plan will include an analysis of existing facility staff and a plan for ongoing Business Office training as required.

We request that the procedure for obtaining approval to write off accounts be documented in writing, so that the Board and the Management Company have clear understanding of the process.

Auditor’s Comment

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

It appears that the only amount truly in contention is the $282,062.42 due to the Medicaid program for the overpayments occurring before the void adjustments process began. At the board’s request, the commissioner of the Department of Health researched the issues raised by the board and responded to the board on October 14, 1997, that the $282,062.42 was “due and payable to the TennCare [Medicaid] program.” If the Governor chooses to release the board from this obligation, the state will still be responsible for refunding the federal percentage to the U.S. Department of Health and Human Services.

For the Year Ended June 30, 1998

a. We concur. A considerable amount of time has been spent in training and supervising the facilities’ Business Office staff on the proper methods of the handling of overpayments. Although these procedures have been in place at the facilities, a written policy had not been established. A written policy and procedure will be presented to the Business Office Managers and a signed copy will be placed in the facilities’ records. In addition, the policy and procedure will be reviewed with the facilities’ Business Office Manager, Business Office Coordinator, and Administrator so that all are aware of their responsibility.

b. We do not concur. The Board has requested in writing that the Governor review this issue. We have not received a response.

d. We concur. During the last several monthly Board meetings, it has been the practice of the Tennessee State Veterans’ Homes Board to have the Management Company briefed on accounts receivable practices. The Board is satisfied that sufficient attention is being directed towards resolving these issues.

Auditor’s Comment

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

It appears that the only amount truly in contention is the $282,062.42 due to the Medicaid program for the overpayments occurring before the void adjustments process began. At the board’s request, the Commissioner of the Department of Health researched the issues raised by the board and responded to the board on October 14, 1997, that the $282,062.42 was “due and payable to the TennCare [Medicaid] program.” The board requested that the Governor reverse the Department of Health’s position on February 5, 1999. The Governor has not yet chosen to respond to the board’s request. If the Governor chooses to release the board from this obligation, the state will still be responsible for refunding the federal percentage to the U.S. Department of Health and Human Services.

For the Year Ended June 30, 1999

We concur with the finding for the period indicated in the report, except for the issue of repayment of $282,062.42. This finding is virtually identical to the 1998 audit report. We assert that our responses for the 1998 audit are still appropriate and accurate for the same problems detailed in this current audit. Our current policy regarding the repayment of Medicaid overpayments is in place and will prevent the same problem from recurring in the future. The repayment of overpayment occurring before 1994 has been completed in Murfreesboro, and it is proceeding on schedule at the Humboldt location. We are making all possible efforts to comply with the recommendations of the audit report concerning doubtful accounts. Uncollectible accounts are being analyzed and will be presented to the Executive Director for submission to the Department of Finance and Administration and the Comptroller’s office for approval for write-off. There are other pending actions, such as the assignment of accounts to an approved collection agency and the adoption of a collection procedure that will expedite the resolution of some of the bad debt issues. We have agreed with the recommendation of the audit team for an audit adjustment to better reflect the estimate of bad debts.

Auditor’s Comment

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

It appears that the only amount truly in contention is the $282,062.42 due to the Medicaid program for the overpayments occurring before the void adjustment process began. At the board’s request, the Commissioner of the Department of Health researched the issues raised by the board and responded to the board on October 14, 1997, that the $282,062.42 was “due and payable to the TennCare [Medicaid] program.” The board requested that the Governor reverse the Department of Health’s position on February 5, 1999. The Governor has not yet chosen to respond to the board’s request. If the Governor chooses to release the board from this obligation the state will still be responsible for refunding the federal percentage to the U.S. Department of Health and Human Services.

For the Year Ended June 30, 2000

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

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

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

Auditor’s Comment

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

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

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

For the Year Ended June 30, 2001

A. Medicaid overpayments are not refunded promptly

We do not concur. Void adjustments cannot be routinely processed to refund overpayments of Medicaid assistance within 60 days of receiving the VA Per Diem. The VA Subsidy payment (third party payment) is received the month following the month services are provided. However, the Medicaid payment is not received until approximately one month after the VA Subsidy is received. Third party payments for most facilities are received after Medicaid payments are received, allowing more time for processing. Additionally, most facilities process approximately twenty void adjustments per year. Each of the TSVH processes approximately forty void adjustments per month. The Tennessee State Veterans' Homes bill the Veterans Administration for per diem payments by the 10th of the month following dates of service. The Tennessee State Veterans' Homes bill Medicaid via the Turnaround Document for Level I Medicaid residents by the 5th day of the month following dates of service. The Veterans Administration payment is typically received in about two weeks after billing. Medicaid then processes payment via a Remittance Advice. For example, January dates of service are billed February 5th. The Remittance Advice showing the January claims being processed should be received from the Department of Human Services before the end of February. Next, the Tennessee State Veterans' Homes file Adjustment Request Forms (Void Adjustments) within sixty days after receipt of the Medicaid Remittance Advice for each veteran on Medicaid that received a per diem payment from the Veterans Administration. Compliance is measured by comparing the Medicaid Remittance Advice receipt date with the date on the Adjustment Request Form. In the absence of a receipt date on the Remittance Advice, the Remittance Advice date plus two days is used as the receipt date. For Level II, the Tennessee State Veterans' Homes indicate Veterans Administration per diem payment on the UB92 Form when it is filed. The old credit balances are processed concurrently with current credit balances. The Tennessee State Veterans' Homes process current Void Adjustments plus an amount of old credit balances up to the projected Medicaid payment for the following month.

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

B. Certain Medicaid rate adjustments have not been properly reduced

We concur. The accounting software described in our last audit response was only in place for six months before BEP was replaced by NHC. Since that time, credit balances have been processed manually and have not eliminated the "overpayments." When the patient's liability amount plus the subsidy amount is greater than the Medicaid per diem, the following is being instituted to correct the situation whereby an overpayment is being reflected incorrectly on a patient's accounts receivable card:

When the patient liability amount plus the subsidy amount is greater than the Medicaid per diem amount, the credit amount reflected is adjusted by means of a "Contractual Adjustment" on the patient's accounts receivable card. This adjustment will be done through the Medicaid Contractual Adjustment accounts on the Income Statement.

C. Numerous other credit balances exist for Medicaid eligible recipients

We do not concur. 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 were not recorded correctly. Taking into consideration the debits, which correspond to the credits, the credit balances would be substantially lower. Some balances were created as a result of various accounting systems during the tenure of BEP, and other credit balances at Murfreesboro existed before contracting with BEP. 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.

Auditor's Rebuttal

As management described, the VA per diem payment is received approximately two weeks after the billing, which would be the 24th of the month subsequent to the service received. Management also stated that the Remittance Advice is received before the end of the month subsequent to the service received, and that the void adjustment is processed within 60 days of receipt of that remittance advice. To say that void adjustments cannot be processed within 60 days of the receipt of the per diem payment which is so close to the date of the receipt of the remittance advice is contradictory. During the year ended June 30, 2002, numerous void adjustments were processed during the 60-day period, thus demonstrating that the time frame is reasonable.

Also, the evidence supporting the finding included over $500,000 in credit balances over 180 days old that were attributed to late void adjustments. These late void adjustments were not just related to old credits. Testwork on the processing of void adjustments during the audit period included void adjustments that were at least five months late. The management company should process void adjustments within the 60-day time frame and should complete the processing of the old void adjustments.

In addition, although the board does not concur that the Medicaid overpayments resulting from the VA per diem payments should be refunded to the Medicaid programs, as discussed in the finding, the board has implicitly recognized this liability since December 25, 1992, when the first funds were withheld from a Medicaid payment to the board. The board has continued to recognize this liability by reporting a payable each year in the financial statements and by routinely processing void adjustments. The request to the Governor to review the issue was made in February 1999. As stated in the finding, the Governor has taken no action to relieve the board of this liability.

Regarding the other credit balances, the board has acknowledged that there have been errors in the recording of the offsets of Medicaid receivables and that there are credit balances that are unknown. The board should proceed with researching, collecting, or adjusting these balances as appropriate.

For the Year Ended June 30, 2002

A. Medicaid overpayments are not refunded promptly

We still do not concur that void adjustments can be routinely processed to refund overpayments of Medicaid assistance within 60 days of receiving the VA Per Diem. The VA Subsidy payment (third party payment) is received the month following the month services are provided. However, the Medicaid payment is not received until approximately one month after the VA Subsidy is received. Third party payments for most facilities are received after Medicaid payments are received, allowing more time for processing. Additionally, most facilities process approximately twenty void adjustments per month. Each of the TSVH processes approximately forty void adjustments per month. The Tennessee State Veterans' Homes bill the Veterans Administration for per diem payments by the 10th of the month following dates of service. The Tennessee State Veterans' Homes bill Medicaid via the Turnaround Document for Level I Medicaid residents by the 5th day of the month following dates of service. The Veterans Administration payment is typically received in about two weeks after billing. Medicaid then processes payment via a Remittance Advice. For example, January dates of service are billed by February 5th. The Remittance Advice showing the January claims being processed should be received from the Department of Human Services before the end of February. Next, the Tennessee State Veterans' Homes file Adjustment Request Forms (Void Adjustments) within sixty days after receipt of the Medicaid Remittance Advice for each veteran on Medicaid that received a per diem payment from the Veterans Administration. Compliance is measured by comparing the Medicaid Remittance Advice receipt date with the date on the Adjustment Request Form. In the absence of a receipt date on the Remittance Advice, the Remittance Advice date plus two days is used as the receipt date. For Level II, the Tennessee State Veterans' Homes indicate Veterans Administration per diem payment on the UB92 Form when it is filed. The old credit balances are processed concurrently with current credit balances. The Tennessee State Veterans' Homes process current Void Adjustments plus an amount of old credits balances up to the projected Medicaid payment for the following month. The Board is in the process of finding a financial management system that will assist in the processing of the action.

We concur 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.

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

B. Certain Medicaid rate adjustments have not been properly reduced

We concur. The problem still exists for accounts from prior periods. Accounts from prior periods, is understood to refer to accounts managed by Service Master, Diversified Health Services, which later became BEP. This company went bankrupt and ceased being our management company in December, 2001. Up until that time much of the financial paper documents were maintained by the BEP. Records returned to the managed homes by the BEP were incomplete. Some records were sent to other homes and some were just lost. The TSVHB is currently seeking compensation for damages through a performance Bond carried by the management company as required by the management contract. As to the TSVHB efforts to reconcile these accounts from prior periods, the priority for both homes is to keep current, current. The existing staff is consumed with the day to day process of billing, collecting and recording accounts receivable. Both homes have hired temporary help to work on accounts which should have been kept up under BEP. The poor quality of record keeping plus the absence of many records complicates this process. Very little of the accounts from prior periods has been processed.

We concur that old accounts should be researched and adjusted. This will require the employment of additional staffing. These staff members will be hired as soon as possible and all efforts will be made to resolve these accounts before conversion to the new accounting system.

C. Numerous other credit balances exist for Medicaid-eligible recipients

We concur. Please see the response above.

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Auditor’s Rebuttal

The response to the lack of prompt refunding of Medicaid overpayments is the same response that management provided for the previous audit report. Our response, as in the prior report, is that as management described, the VA per diem payment is received approximately two weeks after the billing, which would be the 24th of the month subsequent to the service received. Management also stated that the Remittance Advice is received before the end of the month subsequent to the service received, and that the void adjustment is processed within 60 days of receipt of that remittance advice. To say that void adjustments cannot be processed within 60 days of the receipt of the per diem payment which is so close to the date of the receipt of the remittance advice is contradictory. Also, during current year testwork, each Murfreesboro void adjustment reviewed was processed in a timely manner, thus demonstrating that the time frame is reasonable. However, to take the board's comments into consideration, when errors were noted, we also reviewed the related remittance advice to determine if the adjustment was made 60 days after the remittance advice receipt date. For one of the five noted, the void adjustment was not processed timely regardless of the beginning date used. For the other four errors noted, staff could not locate the adjustment request form or the remittance advice showing that the void adjustment occurred. We examined every remittance advice from March 2002 through December 2002, and void adjustments never occurred for any of the four noted individuals.

In addition, although the board does not concur that the Medicaid overpayments resulting from the VA per diem payments should be refunded to the Medicaid programs, as discussed in the finding, the board has implicitly recognized this liability since December 25, 1992, when the first funds were withheld from a Medicaid payment to the board. The board has continued to recognize this liability by reporting a payable each year in the financial statements and by routinely processing void adjustments. Although a TennCare staff member has offered to help the board work to resolve the issue, the board has not chosen this option and continues to wait for a response to their request to the Governor's office, the first of which was made in February of 1999.

For the Year Ended June 30, 2003

A. Medicaid overpayments are not refunded promptly

We concur that not all Medicaid overpayments are refunded promptly.

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

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

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

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

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

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

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

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

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

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

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

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

B. Numerous other credit balances exist

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

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

Current Finding

<u>For the fourth consecutive year, accounting records do not portray a true picture of receivables, and the risk of theft of resident funds was not addressed</u>

Management's Comments

For the Year Ended June 30, 2002

Doubtful accounts will be turned over to the contracted collection agency. The new accounting system will have easily accessible information to answer billing questions. Accounts receivable policies and procedures were implemented in July 2003 implementing a periodic review of all credit balances as well as a review of all resident accounts to ensure receivables are properly stated. Adjustments are being submitted to the management company for correction.

For the Year Ended June 30, 2003

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

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

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

Part of the month end closing process includes a manual reconciliation to the revenues posted in the new software. This reconciliation shall be tied to the payor source and reviewed for reasonableness on a monthly basis.
We recognize the loss of faith involved when current residents are billed incorrectly or retain balances from prior periods which are incorrect. Each facility has reviewed the files of our current residents to resolve any incorrect postings and to obtain current insurance information and has made adjustments that are necessary to correct the accounts. On-going reviews are necessary to maintain accurate statements and accounts receivables balances.

Current Finding

<u>For the fourth consecutive year, management has not mitigated the risks of lost revenues caused by the lack of collection efforts for accounts receivable</u>

Management's Comments

For the Year Ended June 30, 2002

We concur. Policies and procedures will be reviewed for adequacy. Due to turnover of business office personnel at both facilities, collection procedures were not adequate at Murfreesboro until November 2003 and at Humboldt until December 2003 when the problems with accounts receivable were noted and the business office began to follow collection procedures.

For the Year Ended June 30, 2003

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

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

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

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

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

Current Finding

<u>For the sixth consecutive year, the board has not addressed the risk of illegal, unauthorized, or inappropriate purchases</u>

Management's Comments

For the Year Ended June 30, 2000

We will review and revise as necessary our policies and practices so that purchase requisitions and purchase orders are used as appropriate. We will review policies requiring informal and written bids for certain purchases so that our practices are consistent with board policy. Service contracts will be established and approved to the extent possible in accordance with state law.

For the Year Ended June 30, 2001

We concur that the deficiency existed during the audit period. Currently, Board policies and procedures over purchasing are being followed and have been modified to segregate purchasing duties.

While there are still service contracts that have not been updated, eight of thirty-five at Murfreesboro and fourteen of twenty-eight at Humboldt have been updated. For the remainder, we have existing agreements with providers to continue services at existing rates. We will continue to update contracts as time and staff constraints allow.

For the Year Ended June 30, 2002

We concur that for the period of the audit, adequate segregation for duties related to purchasing was not always available. The Board's policies and procedures over purchasing are being reviewed, and will be revised, if necessary. We are working with our liaison to the State Comptroller's office to insure proper segregation of duties or require a compensatory review by a superior staff person in the event that sufficient staffing is not available to allow for total segregation of duties.

We also concur that service contract approvals had not been properly obtained. Because of the number of services provided to our nursing homes, this has proven to be a somewhat overwhelming task. Board staff, with the advice and assistance of our liaison to the State

Comptroller's office has indeed begun the contract review process. As part of this process, services are to be clearly identified and organized into type of contract required, and again, because of the large number of services that are provided, we are looking at possible methods available to streamline the task of developing the required contracts. As this is completed, a timeline will be developed for bringing service contracts into compliance with state regulations and Board policy, so although it will take some time to accomplish this project, we anticipate measurable progress to be shown by the end of the current fiscal year.

For the Year Ended June 30, 2003

We concur that controls on purchases have been inadequate.

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

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

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

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

Current Finding

<u>As noted since 2003, the board still has not addressed the risk of fraud and has inadequate controls regarding use of credit cards and open accounts</u>

Management's Comment

For the Year Ended June 30, 2003

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

match the receipt with the statement from the credit card company. Discrepancies shall be investigated and resolved prior to payment.
Purchases by credit card shall require the same approval process and shall not be used in a manner that circumvents the purchasing policy established by the board.

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

Current Finding

<u>For the third consecutive year, Medicaid residents were charged more than private-paying residents</u>

Management's Comments

For the Year Ended June 30, 2003

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

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

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

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

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