

**Memphis and Shelby County
Community Services Agency**

**For the Year Ended
June 30, 2001**

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

State Capitol
Nashville, Tennessee 37243-0260
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John G. Morgan
Comptroller

December 19, 2002

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Board of Directors
Memphis and Shelby County Community Services Agency
1407 Union Avenue, Suite 1300
Memphis, Tennessee 38104

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Memphis and Shelby County Community Services Agency for the year ended June 30, 2001. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

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

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/th
02/068

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Memphis and Shelby County Community Services Agency
For the Year Ended June 30, 2001

AUDIT OBJECTIVES

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

AUDIT FINDINGS

INTERNAL CONTROL AND COMPLIANCE FINDING

A Fiscal Agent Relationship Was Created With the Department of Children's Services
The Memphis and Shelby County Community Services Agency paid for goods and services procured by the Department of Children's

Services without actively determining the necessity or reasonableness of the goods and services requested by the Department of Children's Services (page 7).

INTERNAL CONTROL FINDINGS

The Agency's Financial Activities Were Not Prudently Managed *
The financial statements prepared by the Chief Financial Officer for inclusion in the 2001 *Tennessee Comprehensive Annual Financial Report* (CAFR) were materially different from the audited financial statements. The CSA also held excessive funds in its non-interest-bearing operating and payroll accounts (page 11).

Bank Reconciliations Were Not Always Performed and Reviewed Timely, and Procedures Were Not Followed *
As noted in the prior audit, bank reconciliations were not performed timely, and procedures related to the preparation and review of the reconciliations and the signing of checks were not followed (page 14).

COMPLIANCE FINDING

The Agency Did Not Comply With Contract Terms*

Contract services were authorized, provided, and paid for prior to the approval of the contract (page 16).

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

- A Fiscal Agent Relationship Was Created With the Department of Children's Services
- The Agency's Financial Activities Were Not Prudently Managed
- Bank Reconciliations Were Not Always Performed and Reviewed Timely, and Procedures Were Not Followed

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 (page 5).

* This finding is repeated from the prior audit.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

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

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Audit Report
Memphis and Shelby County Community Services Agency
For the Year Ended June 30, 2001

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Memphis and Shelby County Community Services Agency For the Year Ended June 30, 2001

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Memphis and Shelby County Community Services Agency. The audit was conducted pursuant to Section 37-5-313, *Tennessee Code Annotated*, which authorizes the Comptroller of the Treasury to “make an annual audit of the program established by this part as part of the comptroller’s annual audit pursuant to Section 9-3-211.”

BACKGROUND

Tennessee’s 12 community health agencies were created by Chapter 567 of the Public Acts of 1989, known as the Community Health Agency Act of 1989. This legislation established a defined system of health services to make health care available to the indigent citizens of Tennessee. The community health agencies determined areas of need in their geographic areas and ensured that services were available to meet those needs.

In May 1996, the Community Services Agency Act of 1996 replaced the community health agencies with the community services agencies. The purpose of these agencies is to coordinate funds and programs designated for care of children and other citizens in the state.

The Memphis and Shelby County Community Services Agency’s administrative offices are in Memphis, Tennessee.

The governing body of the Memphis and Shelby County Community Services Agency is the board of directors. As of June 30, 2001, the board was composed of 11 members. (See Appendix.) An executive committee, consisting of four board members, has the authority to act on behalf of the board of directors in the management of the agency’s property, affairs, and funds in extraordinary circumstances when the governing board cannot convene.

The agency’s programs are carried out by staff under the supervision of the executive director, who is appointed by the Commissioner of the Department of Children’s Services, subject to the approval of the board.

AUDIT SCOPE

The audit was limited to the period July 1, 2000, through June 30, 2001, and was conducted in accordance with government auditing standards generally accepted in the United States of America. Financial statements are presented for the year ended June 30, 2001, and for comparative purposes, the year ended June 30, 2000. The Memphis and Shelby County Community Services Agency 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 agency's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
 2. to determine compliance with certain provisions of laws, regulations, and contracts;
 3. to determine the fairness of the presentation of the financial statements; and
 4. to recommend appropriate actions to correct any deficiencies.
-

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Memphis and Shelby County Community Services Agency filed its report with the Department of Audit on February 1, 2002. A follow-up of all prior audit findings was conducted as part of the current audit.

REPEATED AUDIT FINDINGS

The prior audit report contained findings concerning prudent financial management, proper performance of bank reconciliations, and compliance with contract terms. These findings have not been resolved and are repeated in this report.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Memphis and Shelby County Community Services Agency's financial statements for the year ended June 30, 2001, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by government auditing standards generally accepted in the United States of America. Reportable conditions, along with recommendations and management's responses, are detailed in the findings and recommendations. Consideration of internal control over financial reporting disclosed material weaknesses.

Compliance

The results of our audit tests disclosed no instances of noncompliance 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.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the Memphis and Shelby County Community Services Agency's financial statements.



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

May 2, 2002

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

Dear Mr. Morgan:

We have audited the financial statements of the Memphis and Shelby County Community Services Agency, a component unit of the State of Tennessee, as of and for the year ended June 30, 2001, and have issued our report thereon dated May 2, 2002. As discussed in Note 12 to the financial statements, the Memphis and Shelby County Community Services Agency changed its equipment capitalization policy. Also, as discussed in Note 13, the Memphis and Shelby County Community Services Agency did not correctly classify a capital lease, which resulted in a prior-period restatement. We conducted our audit in accordance with government auditing standards generally accepted in the United States of America.

Compliance

As part of obtaining reasonable assurance about whether the Memphis and Shelby County Community Services Agency's financial statements are free of material misstatement, we performed tests of the agency's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance 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 instances of noncompliance that we have reported to the agency's management in a separate letter.

Internal Control Over Financial Reporting

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

The following reportable conditions were noted:

- A fiscal agent relationship was created with the Department of Children's Services, and proper purchasing procedures were not followed
- Proper financial procedures were still not followed
- Bank reconciliations were not always performed timely, and procedures were not followed

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

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

The Honorable John G. Morgan
May 2, 2002
Page Three

We also noted other matters involving the internal control over financial reporting that we have reported to the Memphis and Shelby County Community Services Agency'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,

A handwritten signature in black ink that reads "Arthur A. Hayes, Jr." with a stylized flourish at the end.

Arthur A. Hayes, Jr., CPA,
Director

AAH/th

FINDINGS AND RECOMMENDATIONS

1. A fiscal agent relationship was created with the Department of Children's Services, and proper purchasing procedures were not followed

Finding

The Memphis and Shelby County Community Services Agency (CSA) paid for goods and services procured by the Department of Children's Services (DCS) without actively determining the necessity or reasonableness of the goods and services requested by DCS. These purchases were made primarily under the control, direction, and approval of DCS management and were for the purpose of facilitating the adoption of children in state custody (child specific services) or general expenditures for promoting adoption (non-child specific services). When DCS created a fiscal agent relationship with the CSA, the Department of Children's Services avoided compliance with the state's purchasing procedures, including bid requirements. Also, the CSA failed to comply with state law and its internal operations policies.

The Department of Children's Services contracts with the Memphis and Shelby County Community Services Agency, a separate legal entity, to promote adoption in Shelby County. The CSA expended over \$85,000 during the year ended June 30, 2001, and over \$138,000 during the year ended June 30, 2002, for purchases arranged for by DCS and paid for by the CSA. These goods and services included the following:

- Legal fees (i.e., attorney fees and court costs) were paid for handling the finalization of adoptions. The CSA also paid for divorces for foster parents whose spouses were not parties in the adoptions. DCS records state that this assistance would help the foster parents complete the adoption process, and in most cases, these fees were over \$1,000 per case.
- Entertainment was provided for the adoption/foster care parents' appreciation banquets. For the year ended June 30, 2001, DCS hired a band at a cost of \$600; for the year ended June 30, 2002, the same band was paid \$800 to play at these banquets.
- A local church was paid \$2,590 for use of the church's hall and preparation of dinner for a recruitment event. A gratuity of \$315 was included in the amount paid to the church.
- A local vendor printed adoption brochures for \$700.
- T-shirts were purchased from the former spouse of a DCS employee on at least three occasions. The cost charged to the CSA amounted to over \$2,500.
- Mouse pads, pens, license plate frames, keychains, and other similar items were purchased from a vendor in Jackson, Mississippi. One payment amounted to \$7,933,

of which \$496 was for freight and handling. For the year ended June 30, 2001, this vendor was paid \$13,500.

- Supplies were purchased for use in training provided to foster care and adoptive parents. A local vendor was paid more than \$12,000 during the year ended June 30, 2001. These supplies included such things as chairs and tables.

Instead of the CSA making the decisions regarding what goods and services were to be purchased and how these goods and services would be purchased, the DCS Shelby County regional office staff made the decisions concerning how the adoption funding would be spent. After the purchases were initiated, DCS personnel requested the CSA to pay for them by submitting an adoption service plan, a family service plan, or memorandum which in most cases was prepared by a DCS case manager and then approved by a DCS team leader and/or the DCS Shelby County Regional Administrator. Furthermore, certain purchases initiated by DCS resulted in contractual agreements between the vendor and the Department of Children's Services. These contracts were signed by the DCS Shelby County Regional Administrator, her secretary, or a DCS Team Coordinator and included a contract with a media company for the production of billboards to advertise adoption (\$7,700); a contract with a yacht club for an adoption and foster care appreciation banquet (\$5,750); and a contract with a minor league baseball team for tickets to a baseball game (\$787.50).

The CSA fiscal office personnel prepared checks based on requests from DCS. After these checks were signed, they were often picked up by a DCS employee and delivered to the vendor. In many cases, the CSA had no support as to whether the goods were received because all goods were delivered directly to the DCS Regional Office. Also, the CSA had no subsequent knowledge as to whether services such as an adoption took place or a divorce had been granted. The only support that the CSA fiscal office had was the initial documentation describing the goods or services to be provided. We asked the DCS Shelby County Regional Administrator to provide support for various goods and services; however, very minimal support was provided.

As a result of the manner in which these funds were expended, the CSA violated the following state law and CSA internal operations policies:

- Section 37-5-310(a)(2), *Tennessee Code Annotated*, states that the plan of operation shall include contracts for services. Expenditures for the billboard advertisement subsequently amounted to an additional \$58,700, and only at the request of the billboard company did the CSA execute a contract between the vendor and the CSA. The billboard contract between the vendor and the CSA was not included in the CSA's approved plan of operation or subsequent amendments.
- The CSA's internal operations policy entitled "Contract Approval Processes" states that in order for contracts to be valid, the board chair and the executive director must sign the contract. Most of the contracts for the goods and services for which the CSA paid were signed by the DCS Shelby County Regional Administrator. A contract was also signed by the secretary of the DCS Shelby County Regional Administrator and a

DCS Team Coordinator. The one contract that the CSA did sign, at the request of the billboard vendor, was not signed by the Executive Director.

- The CSA's internal operations policy entitled "Routine Purchasing" states that a minimum of three bids shall be secured for purchases over \$500, and documentation shall be maintained for these bids. The CSA paid for many purchases that were well in excess of \$500; however, neither the CSA nor DCS secured three bids.

In addition, the manner in which the DCS personnel initiated these procurements violated the state's purchasing procedures. Bids were not obtained and/or were not adequately documented. Receiving reports were not prepared, and contracts were signed by persons who were not authorized to obligate state funds. As a result of the way business was done between the CSA and the DCS Shelby County Regional Office, the CSA acted as a fiscal agent for DCS.

Furthermore, the DCS Shelby County Regional Administrator serves on the board of directors of the CSA and can vote on issues brought before the board. Since the Regional Administrator approved invoices for payment and served on the board, management may have been reluctant to question the transactions she approved. Also, serving on the governing board of the CSA, being employed by DCS, and approving invoices for payment by the CSA could be a conflict of interest.

Recommendation

The Executive Director of the Memphis and Shelby County Community Services Agency should ensure that the fiscal office only pays for goods and services when that agency is actively involved in determining the need for or the reasonableness of these good and services. The CSA should not act as a fiscal agent for the Department of Children's Services with regard to adoption funding or any other funding received from the department.

Also, the Executive Director should ensure that contracts are not entered into and signed by persons who are not authorized to obligate state funds. All contracts initiated by the CSA should be signed by both the Board Chair and the Executive Director in accordance with agency policy, and all applicable contracts should be included in the agency's plan of operation or subsequent amendments.

Prior to contracting with vendors and processing payments, the fiscal office should ensure that all required purchasing procedures have been followed and adequately documented. Purchases should not be made which avoid established purchasing procedures of the state or the CSA, and where applicable, bids should be secured and documented. All supporting documentation for goods and services should be secured and maintained by the CSA to ensure that the goods and services have been received.

In addition, the status of the DCS Shelby County Regional Director as a member of the board of directors of the CSA should be evaluated.

Management's Comments

Memphis and Shelby County Community Services Agency

We concur with the finding. This audit covers a period from July 2000 through June 2001. My tenure as Executive Director began March 2001; therefore, many of the findings cited for this audit period were the result of practices in place prior to my appointment. During the last year we have implemented several organizational changes which will address and correct the areas of concern. In addition, many of the issues identified were the result of ambiguity regarding lines of authority between the local Department of Children's Services (DCS) and the Memphis and Shelby County Community Services Agency (CSA). This issue has since been clarified by DCS Central Office, resulting in the development of improved systems and controls.

For the fiscal year ending June 30, 2003, a new system has been developed to process all purchase requests initiated from DCS to access funds from the CSA. All requests are reviewed for appropriateness by a CSA Funds Manager following receipt of a case service plan. The Funds Manager meets with DCS staff to discuss the request and approve it if appropriate. After the request is approved, the CSA staff person in charge of purchasing goods and services obtains the necessary bids and selects the service provider/vendor. The bids are properly documented and maintained with each request.

To ensure that only DCS/CSA clients receive services, all invoices are signed by the client, DCS/CSA case manager, and the service provider. The CSA enters into contracts with any vendor with expenditures which will exceed \$5,000. Contracts are signed by the vendor, the CSA Executive Director and the CSA Board Chair. Contracts exceeding \$25,000 are added to the Plan of Operation and subsequent plan changes. The CSA follows this procedure for all program purchases.

The issue of the Shelby County Regional Administrator's (RA) position as a voting member of the CSA board is a decision made by DCS central office staff and is consistent throughout CSAs across the state. In the event that this is determined to be a conflict of interest, we will ask that the DCS Commissioner replace the RA with another designee.

Department of Children's Services

We concur. The Memphis Shelby County Community Services Agency will review each request made by the Department of Children's Services to ensure the request is consistent with the terms of the CSA contract. The CSA will then follow its prescribed purchasing procedures to procure goods or services, noting that the activities listed are allowable activities per the federal guidelines.

The DCS Commissioner has issued a directive reminding Regional Administrators and other DCS staff that DCS employees are not authorized to sign contracts thereby obligating funds on behalf of the Department. The CSA Executive Director and Board Chair remain the only

parties authorized to sign CSA contracts. DCS Regional Administrators and Central Office Directors have received training provided in collaboration with the Department of General Services that reviewed appropriate purchasing and contracting procedures.

The Department of Children's Services will evaluate propriety of the DCS Regional Administrator's seat on the CSA Board of Directors.

Auditor's Comment

As noted in the CSA's comments, regional administrators do serve on CSA boards throughout the state as the commissioner's designee. However, it does not appear that other regional administrators control, direct, and approve transactions initiated by the Department of Children's Services for payment by the CSA. In essence, it does not appear that other CSAs are acting as fiscal agents for DCS as a result of the actions of the regional administrator.

2. Proper financial procedures were still not followed

Finding

As noted in the prior audit, the Memphis and Shelby County Community Services Agency did not prudently manage its financial activities. The following are examples in the current audit period:

- The financial statements that were provided to the Department of Finance and Administration on September 28, 2001, for inclusion in the 2001 *Tennessee Comprehensive Annual Financial Report* (CAFR) were materially different from the statements provided to the auditors on April 1, 2002. Management concurred with the prior audit finding and stated that the balance sheet as of June 30, 2001, and the related statements of revenues, expenditures, and changes in fund balance for the year ended June 20, 2001, given to the Department of Finance and Administration, did not contain material overstatements or understatements. However, from the time the financial statements were prepared for the CAFR until final unaudited financial statements were presented to the auditors, the balance in 11 balance sheet accounts, 3 revenue accounts, and 8 expenditure accounts had been changed. For example, cash increased by \$151,393.28, accounts payable increased by \$255,781.53, due to primary government decreased by \$152,318.69, fund balance decreased by \$100,276.03, and total expenditures increased \$104,713.58. As noted in the prior audit, the financial statements prepared for the CAFR did not accurately reflect the agency's financial position at June 30, 2001.
- The agency maintained excessive funds in its non-interest-bearing operating and payroll accounts. Management stated in response to the prior audit finding that during the year ended June 30, 2001, the agency did not maintain excessive amounts

in its bank accounts. However, from April 1, 2001, to May 31, 2001, the daily balance ranged from a low of \$259,692.12 to a high of \$554,965.29. There were also other months when the operating accounts' highest daily balance was well over \$300,000. The highest daily balance in the payroll account for July 2000 was \$632,552.35, and the lowest daily balance was \$566,862.58. State law requires the community services agencies (CSAs) to invest their funds into the state's Local Government Investment Pool (LGIP) so that these funds may earn interest. The CSA's Internal Operations Policy entitled "Departmental Bank Accounts" states that funds in excess of those required for normal, anticipated operating expenses will be deposited into the LGIP.

- Eighteen of 27 payables tested (67%) had a check issuance date of June 30, 2001, in the accounting records and were stamped paid June 30, 2001, on the invoice. Upon review of approval dates on the invoices, it appears that these checks were not written until after June 30, 2001. Also, per discussion with the Chief Financial Officer it appears that he failed to review the work of a Program Specialist in a timely manner and as a result, invoices and checks were erroneously dated as paid on June 30, 2001. An adjustment of \$151,393.28 to cash and accounts payable was made by the Chief Financial Officer to the statements provided to the auditors. This adjustment resulted in the audited financial statements being materially different from the financial statements that were presented in the 2001 *Tennessee Comprehensive Annual Financial Report*.
- The CSA's Internal Operations Policy entitled "Internal Control Review" requires that an internal control review be "conducted by no later than March 31, of each fiscal year." In addition, the policy also requires a report to be submitted to the Board of Directors and the Commissioner of the Department of Children's Services. However, the internal control review was not conducted until April 27, 2001, and no formal written report was submitted to the board or to the Commissioner of the Department of Children's Services.
- Accounts payable testwork revealed that 25 of 27 invoices (93%) were not date-stamped to indicate when the invoice was received by the agency. When invoices are not date-stamped, it is difficult to determine when the invoices were received and to handle disputes with vendors.
- A search for unrecorded liabilities revealed that 2 of a sample of 25 payments made in July 2001 (8%) should have been, but were not, recorded as accounts payable on June 30, 2001. As a result, accounts payable and expenditures were understated by \$5,614.89.
- A June 30, 2001, payable to St. Andrew AME Church was shown on the accounts payable listing in the amount of \$6,399.21. The invoice, check, and general ledger all show the amount as being \$6,933.21. It appears that invoice amount was incorrectly

keyed into the accounting records. This keying error resulted in a \$534 difference, understating accounts payable and expenditures.

- The CSA has three agreements for storage space. These agreements were effective on August 1, 1997; January 1, 1999; and February 15, 2000. No payments for storage space had been made by the CSA during this audit period or the prior audit period. The Chief Financial Officer could not explain why the agency had not paid for this storage space. The total amount that should have been paid for the year ended June 30, 2001, was \$7,140.
- Management also stated in the prior audit finding that “bank reconciliations are being performed on time and according to policy.” However, as noted in finding 3, bank reconciliations were still not always performed on time and were not always in accordance with the agency’s policy.

Recommendation

The Executive Director should ensure that the Chief Financial Officer manages the agency’s financial activities prudently and correctly. The Chief Financial Officer should prepare financial statements that completely and accurately reflect all of the agency’s financial activities during the fiscal year. Only funds sufficient to meet the agency’s obligations should be maintained in the operating and payroll account. Internal control reviews should be conducted in accordance with agency policy and reported to the board and the Commissioner of the Department of Children’s Services. All invoices received from vendors should be stamped with the date received, and all liabilities should be identified and correctly recorded in the accounting records and financial statements. In addition, the Chief Financial Officer should determine why the storage leases have not been paid and take appropriate action.

Management’s Comment

We concur with the finding. For the fiscal year ending June 30, 2002, the financial reports given to Finance and Administration will be consistent with those given to the Comptroller’s Office. The Chief Financial Officer has been strongly cautioned to exercise due care in the preparation of end of year financial statements. All payables have been reviewed to ensure that checks were dated properly.

For the fiscal year 2002/2003 the storage lease has been paid monthly. A system has been established to ensure that payments are made in a timely manner. All invoices received from vendors are properly documented as they are date-stamped when received by the agency.

The CSA maintains only needed funds in its bank accounts. The excessive amounts in the payroll account were the result of bank errors. Funds were mistakenly deposited by the bank into the payroll account instead of the operating account. The mistake was found and the bank

was immediately informed. In order to avoid maintaining excessive funds in the operating account, funds are now transferred into the operating account only after payables have been processed and checks are mailed.

The Internal Control Review was completed by the annual due date of March 31, 2002. It was submitted to both the Board of Directors and DCS.

3. Bank reconciliations were not always performed timely, and procedures were not followed

Finding

As noted in the prior audit, bank reconciliations were not performed timely, and procedures related to the preparation and review of the reconciliations and the signing of checks were not followed. Management concurred with the prior audit finding; however, these problems still exist.

The CSA's Internal Operations Policy entitled "Custodian of Accounts and Account Reconciliations" states that the agency's bank accounts and the Local Government Investment Pool (LGIP) account will be reconciled monthly to the accounting records. Also, "Upon completion of the reconciliation of the accounts, the Executive Director and the person performing the reconciliation will both sign and date the reconciliation." This policy further states that the banks statements will be mailed directly to the Executive Director and held by the Executive Director, unopened, until he or she delivers the statements to the person appointed to perform the reconciliation. However, as a result of testwork performed on the operating, payroll, and LGIP accounts, the following problems were noted:

- The reconciliations of the operating, payroll, and LGIP account statements to the accounting records for July 2000 through January 2001 were signed and dated by a Program Specialist, who prepared the reconciliation, and the Chief Financial Officer. The date shown on each reconciliation was the last day of the month, which was also the last day of statement activity for that month. This does not appear to be the actual date that the reconciliations were performed. The reconciliations for the remaining months of the year were signed and dated by the Program Specialist and the Chief Financial Officer, approximately one to two months after the close of the statement month. On February 22, 2002, the Executive Director signed and dated the July 2000 through November 2000 operating account reconciliations; the reconciliations for December 2000 through June 2001 were signed on March 4, 2002. All reconciliations for the payroll and LGIP accounts for the year ended June 30, 2001, were signed and dated by the Executive Director on February 22, 2002, and February 21, 2002, respectively. However, in the prior audit report, management stated, "The Executive Director has instructed the CFO to make sure that bank statements are reconciled within one month of receipt of the bank statement. For fiscal year 2000/2001 bank reconciliations were performed on time."

- Bank statements for the year ended June 30, 2001, were mailed to the attention of the Chief Financial Officer and not the Executive Director. In the prior audit report, management stated that “bank statements are mailed directly to the Executive Director, who then forwards the statements to the accounting department for reconciliation.” A review of select bank statements received in the subsequent year revealed that the bank statements are now being mailed to the attention of the Executive Director.

Also as noted in the prior audit report:

- The operating account and the payroll account reconciliations still contain many outstanding checks which date back as far as November 1999. In addition, there are other reconciling items which included checks or automatic transfers that cleared the bank in an amount that was different from what was recorded in the accounting records.
- The agency did not have the original bank statement or copies of the cancelled checks for the operating account for June 2001.
- The agency’s payroll bank reconciliation at June 30, 2001, does not appear to be accurate. The payroll bank balance was \$1,454.28, and the book balance was \$861.72, resulting in a difference of \$592.56. Management could not explain this difference.
- The agency did not follow its own policy concerning the signing of checks. According to the agency’s internal operations policy entitled “Signing of Checks,” checks are to be signed by the agency’s Executive Director or an authorized board member. In the prior audit report, management stated that “only the agency’s Board Chairperson and Executive Director are authorized to sign agency checks.” However, based on the signature authorization form dated May 16, 2001, the Executive Director, a board member, and the Deputy Director were authorized to sign checks. According to this policy, the Deputy Director should not be authorized to sign the agency’s checks.

Recommendation

The Executive Director should ensure that all bank reconciliations are performed and reviewed timely and that the reconciliations are dated with the actual date they are completed and reviewed. In conjunction with the reconciliation, any old or unusual outstanding checks as well as other outstanding items should be investigated, and appropriate action should be taken. Only persons authorized by agency policy should be allowed to sign checks.

Management's Comment

We concur with this finding. As of July 2002, bank reconciliations are completed each month. To ensure that this process is properly executed, forms have been developed that document each step in the reconciliation process. Each person in the process is responsible for signing and dating that his/her part has been completed. These forms are filed along with the bank statements. All old or unusual outstanding checks have been investigated and resolved.

Currently, only the Executive Director and the Board Chair are authorized to sign agency checks as required by the agency's policies and procedures.

4. The agency should comply with contract terms and include all contracts in its plan of operation

Finding

As noted in the prior audit, the Memphis and Shelby County Community Services Agency (CSA) did not comply with the terms of an emergency residential contract and did not include this contract in its annual plan of operation. For the year ended June 30, 2001, the CSA failed to comply not only with the terms of this same emergency residential contract but also with those of two home-based therapy contracts. These contracts were also not included in the CSA's plan of operation amendment until ten days prior to the end of the fiscal year.

The CSA contracted with the Exceptional Needs Care Management Agency (ENCMA) to provide "emergency residential/respite shelter for adolescents and youth" during the current as well as the prior audit period. It also contracted with Branches of Life, Inc., and Comprehensive Professional to provide "home-based, intensive, goal-oriented family therapy" during the current audit period. For the year ended June 30, 2001, all three contracts were not signed by the CSA board chair until September 21, 2000; September 15, 2000; and March 21, 2001, respectively. ENCMA began providing services on July 5, 2000; Branches of Life began providing services on August 1, 2000; and Comprehensive Professional began providing services on October 17, 2000. Also, prior to the signing of these contracts, the CSA made cash disbursements for services provided on two of the three contracts: \$10,356 to ENCMA and \$13,080 to Branches of Life, Inc. According to the agency's internal operations policy entitled "Contract Approval Processes," in order for contracts to be valid, the board chair and the Executive Director must sign the contract. All three contracts state that the CSA is not bound by the contract until it is signed by the appropriate officials. However, none of the contracts was signed by the Executive Director, and services were provided and payments were made prior to the signing by the board chair.

In addition, the contract with ENCMA states, "In no event shall the maximum liability to the agency under this contract exceed \$25,000.00." In November 2000, cash disbursements exceeded the contract maximum. The contract was not amended to increase the maximum liability to \$75,000 until June 4, 2001. The last check written to ENCMA for the year ended June 30, 2001, was dated April 24, 2001.

Also, none of these contracts were included in the CSA's plan of operation amendment until ten days prior to the end of the fiscal year. The CSA's board of directors approved the amendment on June 20, 2001. Section 37-5-310(a)(2), *Tennessee Code Annotated*, states that the plan of operation shall include contracts for services. Section 37-5-310(b) also states, "The plan of operation may be amended during the fiscal year with the written approval of the commissioners of children's services and finance and administration and the comptroller of the treasury." This approval was not granted until April 10, 2002. This was well after the CSA had paid \$64,794 to ENCMA; \$28,956 to Branches of Life, Inc.; and \$18,494 to Comprehensive Professional in the previous fiscal year. It appears that delays on the part of the CSA and the Department of Children's Services prevented the plan of operation amendment from being approved in a timely manner.

Management concurred with the prior audit finding and stated that contract expenditures were closely monitored and the agency contracts with all vendors who receive payments in excess of \$5,000. It also stated that all contracts were included in the plan of operation. If the contracts' expenditures had been closely monitored, the CSA would have obtained contracts from vendors and included the contracts in the CSA's plan of operation or subsequent amendment in a more timely manner.

Recommendation

The Executive Director and the Chief Financial Officer should ensure that contracts for services are signed in a timely manner, and services should not be authorized, provided, or paid for until a signed contract is in place. All applicable contracts should be signed by both the Board Chair and the Executive Director in accordance with agency policy. Also, contract limits should not be exceeded, and all applicable contracts should be included in the agency's plan of operation or subsequent amendments.

Management's Comment

We concur with this finding. Effective fiscal year 2002/2003, the agency has contracts with all vendors providing program services that exceed \$5,000. Expenditures exceeding \$25,000 are included in the plan of operation or subsequent amendments as required by state law. All contracts will reflect adequate amounts and be signed by the Executive Director and the Board Chair.



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT**

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JAMES K. POLK STATE OFFICE BUILDING
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Independent Auditor's Report

May 2, 2002

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

Dear Mr. Morgan:

We have audited the accompanying combined balance sheets of the Memphis and Shelby County Community Services Agency, a component unit of the State of Tennessee, as of June 30, 2001, and June 30, 2000, and the related statements of revenues, expenditures, and changes in fund balances for the years then ended. These financial statements are the responsibility of the agency's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Memphis and Shelby County Community Services Agency as of June 30, 2001, and June 30, 2000, and the results of its operations for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 12, the Memphis and Shelby County Community Services Agency changed its equipment capitalization policy. Also, as discussed in Note 13, the Memphis and Shelby County Community Services Agency did not correctly classify a capital lease, which resulted in a prior-period restatement.

The Honorable John G. Morgan
May 2, 2002
Page Two

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

In accordance with *Government Auditing Standards*, we have also issued our report dated May 2, 2002, on our consideration of Memphis and Shelby County Community Services Agency's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

A handwritten signature in black ink that reads "Arthur A. Hayes, Jr." with a stylized flourish at the end.

Arthur A. Hayes, Jr., CPA,
Director

AAH/th

MEMPHIS AND SHELBY COUNTY COMMUNITY SERVICES AGENCY
COMBINED BALANCE SHEETS
ALL FUND TYPES AND ACCOUNT GROUPS
JUNE 30, 2001, AND JUNE 30, 2000

	June 30, 2001				June 30, 2000			
	Governmental Fund Type	Account Groups		Totals (Memorandum Only)	Governmental Fund Type	Account Groups		Totals (Memorandum Only)
	General Fund	General Fixed Assets	General Long-Term Obligations		General Fund	General Fixed Assets	General Long-Term Obligations	
<u>Assets and other debit</u>								
Assets:								
Cash (Note 2)	\$ 346,500.53	\$ -	\$ -	\$ 346,500.53	\$ 576,964.87	\$ -	\$ -	\$ 576,964.87
Prepaid items	5,362.30	-	-	5,362.30	-	-	-	-
Accounts receivable	53,492.10	-	-	53,492.10	15,398.33	-	-	15,398.33
Due from primary government	1,013,177.54	-	-	1,013,177.54	505,362.41	-	-	505,362.41
Due from local government	-	-	-	-	78,596.00	-	-	78,596.00
Due from other CSA	14,356.13	-	-	14,356.13	-	-	-	-
General fixed assets (Note 3):								
Furniture and equipment	-	316,952.23	-	316,952.23	-	298,526.23	-	298,526.23
Leased equipment	-	53,478.26	-	53,478.26	-	53,478.26	-	53,478.26
Other debit:								
Amount to be provided for retirement of general long-term obligations (Note 4)	-	-	168,154.71	168,154.71	-	-	167,158.19	167,158.19
Total assets and other debit	\$ 1,432,888.60	\$ 370,430.49	\$ 168,154.71	\$ 1,971,473.80	\$ 1,176,321.61	\$ 352,004.49	\$ 167,158.19	\$ 1,695,484.29
<u>Liabilities, other credit, and fund balance</u>								
Liabilities:								
Accounts payable	\$ 254,984.75	\$ -	\$ -	\$ 254,984.75	\$ 229,536.65	\$ -	\$ -	\$ 229,536.65
Accrued payroll	103,778.69	-	-	103,778.69	73,980.76	-	-	73,980.76
Accrued payroll taxes and benefits	11,983.70	-	-	11,983.70	24,708.37	-	-	24,708.37
Accrued annual leave (Note 4)	-	-	132,561.93	132,561.93	-	-	121,581.30	121,581.30
Capital lease obligation (Note 4)	-	-	35,592.78	35,592.78	-	-	45,576.89	45,576.89
Due to primary government (Note 3)	242,776.07	-	-	242,776.07	53,267.05	-	-	53,267.05
Due to other CSA	-	-	-	-	1,140.00	-	-	1,140.00
Total liabilities	613,523.21	-	168,154.71	781,677.92	382,632.83	-	167,158.19	549,791.02
Other credit:								
Investment in general fixed assets (Note 3)	-	370,430.49	-	370,430.49	-	352,004.49	-	352,004.49
Fund balance:								
Reserved for prepaid items	5,362.30	-	-	5,362.30	-	-	-	-
Unreserved	814,003.09	-	-	814,003.09	793,688.78	-	-	793,688.78
Total other credit and fund balance	819,365.39	370,430.49	-	1,189,795.88	793,688.78	352,004.49	-	1,145,693.27
Total liabilities, other credit, and fund balance	\$ 1,432,888.60	\$ 370,430.49	\$ 168,154.71	\$ 1,971,473.80	\$ 1,176,321.61	\$ 352,004.49	\$ 167,158.19	\$ 1,695,484.29

The Notes to the Financial Statements are an integral part of this statement.

MEMPHIS AND SHELBY COUNTY COMMUNITY SERVICES AGENCY
 STATEMENTS OF REVENUES, EXPENDITURES,
 AND CHANGES IN FUND BALANCES
 FOR THE YEARS ENDED JUNE 30, 2001, AND JUNE 30, 2000

	General Fund	
	For the Year Ended June 30, 2001	For the Year Ended June 30, 2000
<u>Revenues</u>		
State grants	\$ 5,328,614.39	\$ 4,970,616.97
Local grants and contracts	146,637.23	83,358.13
TennCare Transportation contracts	805,058.35	650,460.69
Interest	25,707.59	39,493.58
Other	-	15,350.00
Total revenues	<u>6,306,017.56</u>	<u>5,759,279.37</u>
<u>Expenditures</u>		
Salaries and wages	2,730,657.50	2,584,803.73
Employee benefits and payroll taxes	766,797.42	664,285.83
Professional fees and grants and awards	1,713,332.21	1,483,350.90
Specific assistance to individuals	157,442.55	130,468.41
Travel and conferences and meetings	200,575.40	156,099.72
Supplies	172,586.56	191,613.31
Postage and shipping	11,973.23	12,677.58
Printing and publications	13,062.60	8,372.18
Telephone	94,469.59	78,310.58
Insurance	6,123.54	947.34
Occupancy	327,398.37	277,053.97
Equipment rental and maintenance	51,579.14	53,703.10
Capital purchases	18,426.00	77,772.51
Capital lease principal	9,984.11	7,901.37
Capital lease interest	2,315.89	2,348.63
Interest	-	35.54
Other nonpersonnel costs	<u>3,616.84</u>	<u>4,992.78</u>
Total expenditures	<u>6,280,340.95</u>	<u>5,734,737.48</u>
Excess of revenues over expenditures	<u>25,676.61</u>	<u>24,541.89</u>
<u>Other financing source</u>		
Capital lease	-	<u>53,478.26</u>
Total other financing source	-	<u>53,478.26</u>
Excess of revenues and other financing source over expenditures	<u>25,676.61</u>	<u>78,020.15</u>
Fund balance, July 1	<u>793,688.78</u>	<u>715,668.63</u>
Fund balance, June 30	<u>\$ 819,365.39</u>	<u>\$ 793,688.78</u>

The Notes to the Financial Statements are an integral part of this statement.

Memphis and Shelby County Community Services Agency
Notes to the Financial Statements
June 30, 2001, and June 30, 2000

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Title 37, Chapter 5, of *Tennessee Code Annotated*, established the CSA as “a political subdivision and instrumentality of the state.” The Memphis and Shelby County Community Services Agency is a component unit of the State of Tennessee and is discretely presented in the *Tennessee Comprehensive Annual Financial Report*. Although the CSA is a separate legal entity, the state is financially accountable for the CSA because the state appoints a majority of the CSA’s governing body and approves the CSA’s Plan of Operation (budget).

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).

Fund Structure, Basis of Accounting, and Measurement Focus

The financial records of the Memphis and Shelby County Community Services Agency are maintained on the modified accrual basis of accounting. Under this basis, revenues are recognized when they become measurable and available, and expenditures are recognized when the related fund liability is incurred.

The general fund is presented using the flow of current financial resources measurement focus.

The agency’s accounts are organized and operated on the basis of fund types and account groups. A fund is an independent fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds is maintained consistent with legal and managerial requirements. Account groups are a reporting device to account for certain assets and liabilities of the governmental fund not recorded directly in that fund.

The agency’s financial activities reported in the accompanying statements are classified into one fund type and two account groups:

Governmental Fund Type

General Fund—used to account for all resources not accounted for in other funds.

Memphis and Shelby County Community Services Agency
Notes to the Financial Statements (Cont.)
June 30, 2001, and June 30, 2000

Account Groups

General Fixed Assets Account Group (GFAAG)—used to account for all the agency’s fixed assets. The GFAAG is not a fund, but rather a management control and accountability listing of the agency’s general fixed assets.

General Long-Term Obligations Account Group—used to account for capital leases and annual leave obligations. The General Long-Term Obligations Account Group is not a fund, but rather a separate set of self-balancing accounts that provides certain information about the agency’s noncurrent liabilities.

Totals (Memorandum Only)

The total columns of the combined balance sheets are captioned “Memorandum Only” to indicate that they are presented only to facilitate financial analysis. Data in these columns do not present financial position in conformity with generally accepted accounting principles. Neither are such data comparable to a consolidation.

Budgetary Process

Legislation requires the CSA board to submit an annual plan of operation for review and approval to the Commissioner of Children’s Services, Commissioner of Finance and Administration, and the Comptroller of the Treasury. As part of this plan, the CSA is to submit a financial plan for operating and capital expenditures. This financial plan is prepared on the modified accrual basis of accounting. The Plan of Operation may be amended during the year with the written approval of the Commissioners and the Comptroller.

The agency does not have an annual appropriated budget. The Plan of Operation serves as an annual financial plan for budgetary purposes.

Prepaid Items

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items.

NOTE 2. DEPOSITS

The Memphis and Shelby County Community Services Agency’s bank accounts are in financial institutions that participate in the bank collateral pool administered by the Treasurer of the State of Tennessee. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account.

Memphis and Shelby County Community Services Agency
Notes to the Financial Statements (Cont.)
June 30, 2001, and June 30, 2000

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

NOTE 3. GENERAL FIXED ASSETS

General fixed assets are recorded at cost and are not depreciated.

The following changes in general fixed assets occurred during the year ended June 30, 2001:

	<u>Balance</u> <u>July 1, 2000</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2001</u>
Furniture and equipment	\$298,526.23	\$18,426.00	\$ -	\$316,952.23
Leased equipment	<u>53,478.26</u>	<u>-</u>	<u>-</u>	<u>53,478.26</u>
Total	<u>\$352,004.49</u>	<u>\$18,426.00</u>	<u>\$ -</u>	<u>\$370,430.49</u>

The following changes in general fixed assets occurred during the year ended June 30, 2000:

	<u>Balance</u> <u>July 1, 1999</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2000</u>
Furniture and equipment	\$455,499.33	\$102,648.18	\$259,621.28	\$298,526.23
Leased equipment	<u>78,353.93</u>	<u>53,478.26</u>	<u>78,353.93</u>	<u>53,478.26</u>
Total	<u>\$533,853.26</u>	<u>\$156,126.44</u>	<u>\$337,975.21</u>	<u>\$352,004.49</u>

Memphis and Shelby County Community Services Agency
Notes to the Financial Statements (Cont.)
June 30, 2001, and June 30, 2000

NOTE 4. GENERAL LONG-TERM OBLIGATIONS

The following changes in general long-term obligations occurred during the year ended June 30, 2001:

	<u>Balance</u> <u>July 1, 2000</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance</u> <u>June 30, 2001</u>
Amount to be provided for retirement of general long-term obligations	\$167,158.19	\$ 154,923.34	\$153,926.82	\$168,154.71
Accrued annual leave	\$121,581.30	\$ 154,923.34	\$143,942.71	\$132,561.93
Capital lease obligation	<u>45,576.89</u>	<u>-</u>	<u>9,984.11</u>	<u>35,592.78</u>
Total general long-term obligations	<u>\$167,158.19</u>	<u>\$ 154,923.34</u>	<u>\$153,926.82</u>	<u>\$168,154.71</u>

The following changes in general long-term obligations occurred during the year ended June 30, 2000:

	<u>Balance</u> <u>July 1, 1999</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance</u> <u>June 30, 2000</u>
Amount to be provided for retirement of general long-term obligations	\$116,267.24	\$196,669.46	\$145,778.51	\$167,158.19
Accrued annual leave	\$113,121.62	\$143,191.20	\$134,731.52	\$121,581.30
Capital lease obligations	<u>3,145.62</u>	<u>53,478.26</u>	<u>11,046.99</u>	<u>45,576.89</u>
Total general long-term obligations	<u>\$116,267.24</u>	<u>\$196,669.46</u>	<u>\$145,778.51</u>	<u>\$167,158.19</u>

**Memphis and Shelby County Community Services Agency
Notes to the Financial Statements (Cont.)
June 30, 2001, and June 30, 2000**

NOTE 5. OPERATING LEASES

The agency leases office space and equipment to carry out its activities and to administer the various programs. Total expenditures under operating leases for space and equipment were \$271,233.11 and \$10,270.44 for the year ended June 30, 2001, and were \$253,635.03 and \$11,335.03 for the year ended June 30, 2000. The leases were cancelable at the lessee's option.

NOTE 6. CAPITAL LEASE

The agency has a certain lease agreement in effect that is considered a capital lease. This agreement began on September 8, 1999, and ends on September 8, 2004, and has an imputed interest rate of 5.642%. The following is a schedule by years of future minimum lease payments under this capital lease together with the present value of the net minimum lease payments at June 30, 2001:

Year Ending <u>June 30</u>	
2002	\$ 12,300.00
2003	12,300.00
2004	12,300.00
2005	<u>2,050.00</u>
Total minimum payments required	<u>38,950.00</u>
Less amount representing interest	<u>3,357.21</u>
Present value of net minimum lease payments	<u>\$ 35,592.79</u>

The total value of equipment capitalized under this lease obligation was \$53,478.26 at June 30, 2001.

Memphis and Shelby County Community Services Agency
Notes to the Financial Statements (Cont.)
June 30, 2001, and June 30, 2000

NOTE 7. DEFINED BENEFIT PENSION PLAN

A. Plan Description

All full-time employees 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). The TCRS administers a defined benefit pension plan that provides retirement, disability, and death benefits, as well as annual cost-of-living adjustments, to plan members and beneficiaries. 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. Amendments to the TCRS are not applicable to a political subdivision unless approved by the political subdivision's 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 Department of the Treasury, 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

As authorized by the agency's board of directors, the agency pays the total pension contribution for its employees. The agency is required to contribute an actuarially determined rate; for the year ended June 30, 2001, the rate was 7.65% of annual covered payroll, and for the year ended June 30, 2000, the rate was 7.79% of annual covered payroll. The contribution requirements of plan members are set by state statutes and approved by the political subdivision's governing body. Contribution requirements for the agency are established and may be amended by the TCRS' Board of Trustees.

C. Annual Pension Cost

The agency's annual pension costs of \$206,799 for the year ended June 30, 2001, and \$205,761 for the year ended June 30, 2000, were equal to the agency's required and actual contributions.

The required contributions for the years ended June 30, 2001, and June 30, 2000, were determined as part of the July 1, 1999, and June 30, 1997, actuarial valuations using the frozen initial liability actuarial cost method, a projected-benefit cost method. Significant actuarial assumptions used include (a) rate of

**Memphis and Shelby County Community Services Agency
Notes to the Financial Statements (Cont.)
June 30, 2001, and June 30, 2000**

return on investment of present and future assets of 7.5% a year compounded annually, (b) projected salary increases of 5.5% a year (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries) compounded annually, (c) projected 4.5% annual increase in the social security wage base, and (d) projected post-retirement benefit increases of 3% of the retiree's most recent benefit. The actuarial value of the agency's assets was determined using techniques that smooth the effect of short-term volatility in the market value of both fixed income and equity securities over a five-year period. The agency's unfunded actuarial accrued liability is being amortized as a level-dollar amount of projected payroll on a closed basis. The remaining amortization period at July 1, 1999, was 24 years.

Three-Year Trend Information

<u>Fiscal Year</u> <u>Ended</u>	<u>Annual Pension</u> <u>Cost (APC)</u>	<u>Percentage of APC</u> <u>Contributed</u>	<u>Net Pension</u> <u>Obligation</u>
June 30, 2001	\$206,799	100%	\$ -
June 30, 2000	\$205,761	100%	\$ -
June 30, 1999	\$182,752	100%	\$ -

NOTE 8. CONTINGENCIES

Sick Leave—The agency records the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent because of illness, injury, or related family death, there is no liability for sick leave at June 30. The amount of unused sick leave was \$108,699.58 at June 30, 2001, and \$106,167.11 at June 30, 2000.

NOTE 9. DONATED VEHICLE

The Memphis and Shelby County Community Services Agency had the use of a van for one year ending February 28, 2000. The value of the donation is not recorded in the financial statements.

Memphis and Shelby County Community Services Agency
Notes to the Financial Statements (Cont.)
June 30, 2001, and June 30, 2000

NOTE 10. RISK MANAGEMENT

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

- A. The agency carries commercial insurance for risks of loss of its personal property and surety bond coverage for risks of employee dishonesty. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

- B. The agency participates in the State of Tennessee's Claims Award Fund, an internal service fund in which the state has set aside assets for claims settlement. This fund services all claims for risk of loss to which the state is exposed, including general liability, automobile liability, professional malpractice, and workers' compensation. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the participating agencies based on a percentage of each agency's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of each fiscal year-end to determine the fund liability and premium allocation. As a participant in the Claims Award Fund, the agency is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the agency for bodily injury and property damage is limited to \$300,000 per person and \$1,000,000 per occurrence. The limits under workers' compensation are set forth in *Tennessee Code Annotated*, Section 50-6-101 et seq.

- C. The agency 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

Memphis and Shelby County Community Services Agency
Notes to the Financial Statements (Cont.)
June 30, 2001, and June 30, 2000

administrative costs of the plan. The agency's obligation under the plan is limited to 80% of the total premiums. The employees are responsible for the remaining 20% of the total premiums. Employees have the option of obtaining insurance through either Blue Cross Blue Shield of Tennessee or Healthsource Tennessee, Inc. Claims are administered by these companies, which are currently under contract to provide these and other services to the state. Insurance premiums are adjusted at the end of the year based on the claims experience of the pool. Individual pool participants are not assessed additional premiums based on individual claims experience. Employees and providers have 13 months to file medical claims under Blue Cross Blue Shield of Tennessee and Healthsource Tennessee, Inc.

NOTE 11. RELATED-PARTY TRANSACTIONS

For the year ended June 30, 2001, and June 30, 2000:

- A board member was employed by Memphis City Schools, and a board member was employed by Shelby County Government, both of which contract with the agency.
- A board member was employed by the Juvenile Court of Memphis and Shelby County. The Juvenile Court of Memphis and Shelby County makes referrals to the agency.
- The Department of Children's Services (DCS) Shelby County Regional Administrator served on the board as the Commissioner's designee, as provided by state law. The Shelby County Regional Administrator not only can vote at board meetings, but also has authorized transactions to be paid by the CSA. The Department of Children's Services is the primary funding source of the CSA, and the Commissioner of DCS appoints the Executive Director of the Memphis and Shelby County Community Services Agency.

For the year ended June 30, 2001, a board member was on the Board of Directors at Access MedPlus, and a board member was a consultant with Memphis City Schools, which contracts with the agency.

For the year ended June 30, 2000, two board members were on the Board of Directors at Access MedPlus, which contracts with the agency.

Memphis and Shelby County Community Services Agency
Notes to the Financial Statements (Cont.)
June 30, 2001, and June 30, 2000

NOTE 12. CHANGE IN ACCOUNTING PRINCIPLE

During the year ended June 30, 2000, the threshold for capitalizing equipment was increased from \$1,000 to \$5,000. This change in accounting principle resulted in a decrease in equipment of \$240,833.08.

NOTE 13. PRIOR-PERIOD RESTATEMENT

The prior year's financial statements reported the capital lease reported in Note 6 as an operating lease. This lease agreement is considered in effect a capital lease instead of an operating lease. As a result, the following changes were made regarding amounts reported for June 30, 2000:

- The amount for equipment rental and maintenance has been reduced by the amount paid attributable to the capital lease in Note 4.
- The balance sheet for year ended June 30, 2000, now includes \$45,576.89 as a capital lease obligation as well as an addition of \$45,576.89 to the amount to be provided for retirement of general long-term obligations in the General Long-Term Obligations account group. Note 4 also reflects these changes.
- The prior year's balance sheet for the year ended June 30, 2000, now includes \$53,478.26 of leased equipment as well as an addition of \$53,478.26 to the investment in general fixed assets in the General Fixed Asset Account Group. Note 3 also reflects these changes.
- The Statements of Revenues, Expenditures, and Changes in Fund Balances now include \$7,901.37 of capital lease principal and \$2,348.63 of capital lease interest expenditure amounts. These amounts were deducted from the equipment rental and maintenance expenditure classification.

NOTE 14. NEW ACCOUNTING PRONOUNCEMENTS

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. This statement establishes new financial reporting requirements and restructures much of the information that governments have presented in the past. Comparability with reports issued in all

Memphis and Shelby County Community Services Agency
Notes to the Financial Statements (Cont.)
June 30, 2001, and June 30, 2000

prior years will be affected. The State of Tennessee will implement this statement, as required, for the year ending June 30, 2002. As a component unit of the state, the Memphis and Shelby County Community Services Agency will also implement the statement for the year ending June 30, 2002. Management has not yet determined the full impact that GASB Statement 34 will have on the agency's financial statements.

**Memphis and Shelby County Community Services Agency
Required Supplementary Information
Schedule of Pension Funding Progress**

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (Funding Excess) AAL (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	Unfunded (Funding Excess) AAL as a Percentage of Covered Payroll [(b-a)/c]
July 1, 1999	\$1,561,486	\$1,761,861	\$200,375	88.63%	\$2,396,860	8.36%
June 30, 1997	\$ 960,055	\$1,164,726	\$204,671	82.43%	\$2,316,785	8.83%

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

Actuarial Assumptions

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

APPENDIX

MEMPHIS AND SHELBY COUNTY COMMUNITY SERVICES AGENCY

Susan Adams, Executive Director

BOARD OF DIRECTORS

Board Officers

Nancy Lawhead, Chair
Betsy Black, Vice-Chair
J.W.Gibson, Secretary/Treasurer

Executive Committee Members

Betsy Black
J.W. Gibson
Nancy Lawhead
Malrie Shelton

Other Members of the Board of Directors

Gene Holcomb
Sara Lewis
Snowden Morgan
Rieta Selberg
William Terrell, Jr., MD
Juanita White
Jeune Wood