East Tennessee Community Services Agency

For the Year Ended
June 30, 2003

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

Edward Burr, CPA
Assistant Director

Kandi B. Thomas, CPA
Audit Manager

Sam Alzoubi
In-Charge Auditor

LaToya Hampton
Jonathan Smallwood
Staff Auditors

Gerry C. Boaz, CPA
Technical Analyst

Amy Brack
Editor

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

Financial/compliance audits of community services agencies are available on-line at
www.comptroller.state.tn.us/sa/reports/index.html.
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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

June 30, 2004

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Board of Directors
East Tennessee Community Services Agency
P. O. Box 630
Clinton, Tennessee 37717-0630

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the East Tennessee Community Services Agency for the year ended June 30, 2003. 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 resulted in no audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/th
04/037

State of Tennessee

Audit Highlights

Comptroller of the Treasury Division of State Audit

Financial and Compliance Audit
East Tennessee Community Services Agency
For the Year Ended June 30, 2003

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

This report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

Audit Report
East Tennessee Community Services Agency
For the Year Ended June 30, 2003

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East Tennessee Community Services Agency
For the Year Ended June 30, 2003

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the East Tennessee 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

The Community Services Agency Act of 1996 created 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 East Tennessee Community Services Agency serves the following counties: Anderson, Blount, Campbell, Claiborne, Cocke, Grainger, Hamblen, Jefferson, Loudon, Monroe, Morgan, Roane, Scott, Sevier, and Union. The agency's administrative offices are in Clinton, Tennessee.

The governing body of the East Tennessee Community Services Agency is the board of directors. As of June 30, 2003, the board was composed of 16 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, 2002, through June 30, 2003, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the year ended June 30, 2003, and for comparative purposes, the year ended June 30, 2002. The East Tennessee 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 East Tennessee Community Services Agency filed its report with the Department of Audit on August 2, 2003. A follow-up of the prior audit finding was conducted as part of the current audit. The current audit disclosed that the agency has corrected the previous audit finding concerning the donation of assets to a related party without proper approval.

OBSERVATIONS AND COMMENTS

Appropriateness of Expenditures

The current audit revealed that East Tennessee Community Services Agency spent administrative funds for purposes that may not be reasonable and necessary for the provision of services to children and other citizens in need. According to state law, the board of the community services agency shall submit a plan of operation for review and approval to the commissioners of the Departments of Children's Services and Finance and Administration and to the Comptroller of the Treasury. However, because the agency's plan of operation does not detail specific expenditures, the parties responsible for review and approval of the agency's budget cannot determine the appropriateness of all specific expenditures.

During the audit period, the board approved the agency to pay $8,000 in bonuses to six employees for appreciation of hard work done for the agency. Four administrative employees received one-time bonuses of $1,500 each, and two fiscal employees received one-time bonuses of $1,000 each. The board also approved service bonuses for full-time employees with a minimum of one-year service. The agency paid these service bonuses, a net amount, after deductions for federal withholding and FICA taxes, of $100 per year of service, to 74 employees totaling $59,428. It should be noted that the board specified that each eligible employee would receive a net of $100 for each year of service. As a result, employees received varying amounts per year of service depending on each employee's payroll deduction authorization.

In addition to the payroll costs, the board approved a board and staff member retreat that was held in Pigeon Forge, Tennessee, during November 2002. The agency incurred costs of $2,015 associated with the retreat. In December 2002, the agency also incurred $1,825 of expenditures for a Christmas luncheon for board members, their spouses, and the CSA staff held at a restaurant. The agency also purchased gift certificates to local restaurants totaling $302 that were given as gifts at the luncheon. The auditors also noted that the agency spent approximately $3,600 for food and gratuities at other agency functions during June 2002 and June 2003. It appears questionable whether the costs described above were reasonable and necessary costs in carrying out the agency's purpose to provide services to children and other citizens of Tennessee.

The Role of the Commissioner on the Board of Directors Appears to Violate State Law

Section 37-5-305, *Tennessee Code Annotated*, defines the membership of the Community Services Agency's (CSA) Board of Directors. Included on each rural CSA's board is the Commissioner of the Department of Children's Services (DCS) or the commissioner's designee.

The duties of the Commissioner as either a CSA board member or the chief executive of DCS are frequently interrelated. As a board member, the Commissioner can vote on all CSA business including: the adoption of written policies, procedures, or rules and regulations to govern the CSA's internal operations; the making and executing of contracts; or the receiving, administering, allocating, and disbursing of funds made available under any federal or state assistance program.

As the chief executive of DCS, the Commissioner appoints the CSA's Executive Director with the approval of the CSA's board of directors. The Commissioner also approves any CSA policies, procedures or rules and regulations proposed by the board of directors, as well as all contracts for the purchase of services or the acquisition or improvement of real property. Furthermore, the Commissioner is responsible for the review and approval of the CSA's plan of operation submitted in accordance with Section 37-5-310, *Tennessee Code Annotated*.

Because DCS is the primary funding source of the East Tennessee Community Services Agency, providing over $4.9 million in revenue, many of the issues and decisions brought to the CSA board of directors relate to DCS. It appears that the Commissioner's participation in these discussions or voting on matters relating to DCS violates Section 37-5-305(j), *Tennessee Code Annotated*, which states:

> If any matter before the board involves a project, transaction or relationship in which a member or the member's associated institution, business or board has a direct or a conflicting interest, the member shall make known to the board that interest and shall be prohibited from participating in discussions and voting on that matter.

The appointment of the Commissioner to the board of directors through Section 37-5-305(c), *Tennessee Code Annotated*, appears to be inconsistent with Section 37-5-305(j) which in effect limits the Commissioner's participation in the majority of the CSA's business. The Commissioner of the Department of Children's Services and the Community Services Agencies should seek the advice of the Attorney General regarding the Commissioner's role on the board of directors. If that role is in fact limited, the Commissioner and the Community Services Agencies may want to seek legislative changes to the statute to redefine the Commissioner's role on the board.

Audit Committee Recommended

The East Tennessee Community Services Agency's board of directors should establish an audit committee as a standing committee. The audit committee should be composed of at least three members. The chair of the audit committee should preferably have some accounting or financial management background, and each member of the committee should have an adequate background and education to allow a reasonable understanding of the information presented in the financial statements of the agency and the comments of auditors with regard to internal control and compliance findings.

The audit committee should have a written charter that addresses the committee's purpose, which should, at a minimum, be to assist the board in its oversight of the integrity of the agency's management and staff, the integrity of the agency's financial statements and other financial reports, establishment and maintenance of strong internal control, and compliance with legal requirements and applicable rules. The charter should include guidelines and policies on how the board will identify risks of fraud and financial reporting irregularities and monitor and control those risks.

The audit committee should meet regularly. These meetings may take place during dates for other board meetings, but the committee should meet separately from those other meetings. At one of the meetings each year the audit committee should review the financial audit of the agency by the Comptroller's office and consider what actions are necessary in response to any findings of the audit.

The audit committee should also meet, as appropriate, to review any other audit or investigative reports issued by the Comptroller's Office relative to the agency. The audit committee should serve to facilitate the audit.

The audit committee should reiterate in its charter that the Executive Director and senior management are primarily responsible for assessing the agency's exposure to risks of fraud and financial reporting irregularities, and those responsibilities should be regularly restated to top management of the agency.

The audit committee should establish policies and procedures for encouraging management and staff of the agency who have knowledge of questionable actions of any employee of the agency or board member, relating to fraud or abuse of agency assets or funds or financial reporting irregularities, to report that information to the audit committee. The audit committee should immediately inform the Comptroller's Office of any such information it receives.

The audit committee should develop a written code of conduct to recommend to the full board for communication to management and staff which reminds all employees of the public nature of the agency and the need to protect agency assets from waste, abuse, and fraud and to avoid engaging in activities which bring dishonor to the agency.

Employee/Employer Relationship

As noted in prior audits, the East Tennessee Community Services Agency has entered into a contract with the Department of Health, specifying that the community services agency (CSA) would assist in implementing various state programs. However, the Department of Health's participation in this contract was greater than indicated in the contract. Through the Department of Health contract, state officials directly supervised CSA employees. And although these CSA employees' salaries, travel costs, and other program costs were paid by the CSA, the Department of Health reimbursed the CSA for these costs, including the CSA's administrative costs for serving as a fiscal agent. The contract with the Department of Health appears to create "employer-employee" relationships between the Department of Health and these individuals.

Programs under the supervision of the Department of Health included Children's Special Services Care Coordination and Local Health Services. The programs were operated from the county or regional health offices with CSA staff. Department of Health employees supervised the CSA staff, and new CSA employees were either selected or approved by the Department of Health supervisors. In some instances, the regional health director was responsible for operating the program.

The practice of allowing employees of non-state entities such as the community services agencies to report directly to officials or employees of the Department of Health, in carrying out what can be construed as state programs, raises policy and legal issues. We do not believe these situations should be accepted as a matter of policy. Section 37-5-314, *Tennessee Code Annotated*, considers CSA employees "state employees" for the purposes of negligent acts or omissions within the scope of their authority. However, Section 37-5-315(2), *Tennessee Code Annotated*, states: "This part shall not be construed as creating an employer-employee relationship between the department, the community services agencies, or their contractors." This legal concern arises from the legislative intent that the department not create an employer-employee relationship with community services agencies and a review of the factors commonly used in determining the existence of an employer-employee relationship. These factors include the Department of Health's ability to direct and control the work of CSA employees it supervises. These relationships also create inherent problems for the Department of Health's supervisory personnel in that they have less direct control over the performance of CSA case managers.

In addition, the state apparently has additional cost by contracting with non-state entities to operate programs. Over the years, the CSAs have operated programs for various departments of the state. In addition to direct program cost, the CSAs have received funding from each state department to defray the costs of administration. These costs included the salaries and benefits of the executive director and fiscal officer and costs of travel, supplies, and equipment used by the administrative staff.

The most recent audit of the Department of Health includes an audit finding on this inappropriate contract with the East Tennessee Community Services Agency and other CSAs serving the department.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the East Tennessee Community Services Agency's financial statements for the year ended June 30, 2003, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

The results of our audit tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the East Tennessee Community Services Agency's financial statements.

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

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

December 18, 2003

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 East Tennessee Community Services Agency, a component unit of the State of Tennessee, as of and for the year ended June 30, 2003, and have issued our report thereon dated December 18, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the East Tennessee 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 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 East Tennessee Community Services Agency's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control financial reporting that might be a material weakness. 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted other matters involving the internal control over financial reporting that we have reported to the East Tennessee 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,

Arthur A. Hayes, Jr., CPA,
Director

AAH/th

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

Independent Auditor's Report

December 18, 2003

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

Dear Mr. Morgan:

We have audited the accompanying financial statements of the governmental activities and the general fund of the East Tennessee Community Services Agency, a component unit of the State of Tennessee, as of and for the years ended June 30, 2003, and 2002, which collectively comprise the agency's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the agency's management. Our responsibility is to express opinions on these financial statements, based on our audits.

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

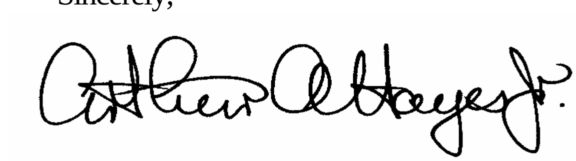
In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the general fund of the East Tennessee Community Services Agency as of June 30, 2003, and 2002, and the respective changes in financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and the Schedule of Pension Funding Progress for East Tennessee Community Services Agency are not a required part of the basic financial statements but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the agency's basic financial statements. The accompanying financial information on page 35 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 18, 2003, on our consideration of East Tennessee 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,



Arthur A. Hayes, Jr., CPA,
Director

AAH/th

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of East Tennessee Community Services Agency provides this *Management's Discussion and Analysis* as an integral part of the East Tennessee Community Services Agency's Annual Financial Report to further inform readers about the financial statements presented herein. This narrative overview and analysis of the financial activities of the East Tennessee Community Services Agency provides financial and other information for the fiscal years ended June 30, 2003, and 2002. East Tennessee Community Services Agency implemented GASB 34 for the year ended June 30, 2002. We did not restate the financial statements for June 30, 2001, for comparative purposes. Complete comparative information will be presented in future years.

FINANCIAL HIGHLIGHTS

Government-Wide Highlights:

Net Assets - The assets of the agency exceeded its liabilities (presented as "net assets") at June 30, 2003, by $1,488,805.71, and at June 30, 2002, by $1,334,705.94. Of these amounts, $1,438,070.45 and $1,263,547.41 were reported as "unrestricted net assets" at June 30, 2003, and 2002, respectively. Unrestricted net assets represent amounts available to fund the agency's ongoing obligations.

Changes in Net Assets - The agency's total net assets increased by $154,099.77 during the fiscal year ended 2003 and by $234,012.65 during the fiscal year ended 2002.

Fund Highlights:

Governmental Funds - Fund Balances - At the close of fiscal years 2003 and 2002, the agency reported for its only governmental fund, the general fund, ending fund balances of $1,564,463.00 and $1,406,157.79, respectively, an increase of $158,305.21and $253,498.35, respectively, over the prior year. The agency's TennCare Transportation Program, net of unreimbursed expenditures in other programs, provided these increases. The "unreserved fund balance" portion of the fund balance amount was $1,557,331.73 and $1,401,687.21 at each respective year-end.

OVERVIEW OF THE FINANCIAL STATEMENTS

This following discussion and analysis overview introduces three components of the East Tennessee Community Services Agency's basic financial statements: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report also contains required supplementary information, the Schedule of Pension Funding Progress; and non-required supplementary information, the Budgetary Comparison Schedule.

BASIC FINANCIAL STATEMENTS

The two basic financial statements, ***Government-Wide Financial Statements*** and ***Fund Financial Statements,*** present financial information about the agency from different perspectives**.** The ***Notes to the Financial Statements*** further explain certain financial statement information and provide more financial detail.

Government-Wide Financial Statements

The *government-wide financial statements* provide a broad view of agency operations, using accounting methods similar to a private-sector business. The short-term and long-term financial information provided by these statements allows the reader to assess the agency's economic condition. Management prepares these statements using an economic resources measurement focus and the accrual basis of accounting. These statements present all earned revenues and incurred expenses for each fiscal year whether or not the resulting cash has been received or paid. The *government-wide financial statements* include two statements:

The *statement of net assets* presents all agency assets and liabilities, reporting the difference between the two as "net assets." Over time, increases or decreases in the agency's net assets indicate whether the financial position of the agency is improving or deteriorating.

The *statement of activities* provides financial information that shows the change in the agency's net assets during the fiscal year being presented. All changes in net assets are reported when the event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses presented in this statement, such as earned but unused vacation leave, may not result in cash flows until future fiscal periods. This statement also compares direct expenses and revenues for each agency program. All of the agency's services are classified as *Governmental Activities*.

Governmental Activities - The financial activity of all agency services are presented in the statement of activities as governmental activities. The agency's core services provide assistance to children and their families and coordinate medical transportation needs for TennCare enrollees. These activities are supported primarily by governmental revenues (state grants) and revenue from Managed Care Organizations (MCOs) and Behavioral Health Organizations (BHOs) serving the region's TennCare population.

The *government-wide financial statements* can be found immediately following this discussion and analysis.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The agency, like other agencies and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The fund financial statements focus on individual segments of the agency, reporting its operations in more detail than the government-wide statements. The agency has only one category of funds: Governmental Funds.

Governmental Funds Financial Statements - The basic services provided by the agency are financed with government funding. Governmental funds account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, the governmental fund financial statements focus on near-term inflows and outflows of liquid resources and the amount of liquid resources available at fiscal year-end. This information helps to evaluate near-term agency financing requirements and resources. Prepared using a current financial resources measurement focus and the modified accrual basis of accounting, these statements provide a detailed short-term view of agency finances, thus allowing the reader to project the adequacy of financial resources to meet current financial needs. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of agency near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate a comparison between governmental funds and governmental activities. These reconciliations are presented on the same pages as the governmental fund financial statements. The agency has only one governmental fund, the General Fund, which is presented in the governmental fund financial statements immediately following the government-wide statements.

Notes to the Financial Statements

Notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and the fund financial statements. The notes to the financial statements immediately follow the fund financial statements.

Required Supplementary Information

Required supplementary information, the Schedule of Pension Funding Progress, follows the basic financial statements and notes.

Supplementary Information

The Budgetary Comparison Schedules, although not required, are presented as supplementary information, immediately following the required supplementary information.

FINANCIAL ANALYSIS

Net Assets

As noted earlier, net assets serve over time as a useful indicator of an agency's financial position. The agency's net assets (governmental activities) totaled $1,488,805.71 at the end of fiscal year 2003 and $1,334,705.94 at the end of fiscal year 2002.

ETCSA'S NET ASSETS
Governmental Activities

	2003	**2002**
Current and other assets	$2,230,280.93	$1,940,938.78
Capital assets	50,735.26	71,158.53
Total Assets	**2,281,016.19**	**2,012,097.31**
Current and other liabilities	665,817.93	537,780.99
Long-term liabilities	126,392.55	142,610.38
Total Liabilities	**792,210.48**	**677,391.37**
Net Assets		
Invested in capital assets	50,735.26	71,158.53
Unrestricted	1,438,070.45	1,263,547.41
Total net assets	**$1,488,805.71**	**$1,334,705.94**

Changes in Net Assets

Increases in the agency's net assets occurred as its TennCare Transportation Unit revenues from Managed Care Organizations and Behavior Health Organizations exceeded unit expenses by $245,222 and $371,988 during the fiscal years ended June 30, 2003, and 2002, respectively. The decline in that excess during 2003 reflects the reduction in fees imposed by a major customer and an increase in operating costs to handle higher telephone call volume. Also increasing net assets, investments earned interest income in the amount of $22,897.68 and $31,320.76, respectively, during the aforesaid fiscal years, reflecting the macro-trend of significantly declining interest rates throughout the two-year period. These increases in net assets were offset primarily by fund balance expenditures for community development initiatives and employee incentive programs. Case Management expenditures declined in fiscal year 2003 because approximately 35 agency employees engaged in Custodial Case Management activities were transferred to the Department of Children's Services in October 2001 and at the end of fiscal year 2002. Support Services expenditures increased in fiscal year 2003 due to case managers' heightened awareness and utilization of available flexible funding programs for custodial and non-custodial children. Also, during fiscal year 2003, the Department of Children's Services allocated incremental funding to the agency for two new programs, Special Needs Assessments and Independent Living.

The following table provides a comparative detail of revenues and expenses.

CHANGES IN ETCSA'S NET ASSETS
Governmental Activities

	2003	**2002**
Revenues		
Program revenues		
Charges for services	$ 660,325.63	$ 745,519.02
State grants and contracts	4,899,384.57	5,100,251.84
Federal grant and contracts	193,040.49	182,465.01
Donations	13,503.87	5,722.00
General revenues		
Payment from state	393,661.65	359,197.98
Interest	22,897.68	31,320.76
Total revenues	**6,182,813.89**	**6,424,476.61**
Expenses		
Administration	456,510.52	450,581.76
Child and family case management	2,591,584.70	3,175,348.27
Child and family services	1,513,102.75	1,146,872.48
Mountain View	473,123.08	422,247.91
TennCare transportation	415,103.78	373,531.39
Children's special services	168,758.60	149,382.46
Local health	299,183.42	368,798.08
Americorp Promise Fellows	17,703.21	8,255.69
Community services	55,753.07	41,445.99
Leadership Initiative for Teens	17,467.72	29,379.82
Depreciation-unallocated	20,423.27	24,620.11
Total expenses	**6,028,714.12**	**6,190,463.96**
Increase in net assets	**$ 154,099.77**	**$ 234,012.65**

FINANCIAL ANALYSIS OF THE AGENCY'S INDIVIDUAL FUNDS

As noted earlier, the agency uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Fund

The agency's governmental fund provides information focused on near-term inflows and outflows and balances of liquid resources. Such information is useful in assessing the agency's financing requirements. In particular, unreserved fund balance may serve as a useful measure of an agency's net resources available for future spending. As of June 30, 2003, and 2002, the agency's governmental fund reported a fund balance of $1,564,463.00 and $1,406,157.79, respectively, an increase in each instance of $158,305.21 and $253,498.35 over the prior year. These increases do not reflect depreciation in excess of capital outlays or compensated absences earned in excess of those paid. These two items would reduce the respective increases to $154,099.77, and 234,012.65, the amounts explained above in the Changes in Net Assets section.

GENERAL FUND BUDGETARY HIGHLIGHTS

The final fiscal year 2002-2003 budgeted expenditures exceeded original budgeted expenditures by $166,600, primarily due to increased administrative and direct service dollars ($658,000), decreased case management expenses ($398,000), reductions in local health positions ($103,400) and increases to Children's Special Services health position salaries ($20,200) to provide parity with comparable state positions.

The final fiscal year 2001-2002 budget increased original budgeted expenditures approximately $116,500. The changes resulted primarily because the agency added two new programs during the year, including Americorp ($39,200) and Leadership Initiative for Teens (LIFT) ($60,000). The agency also increased the salaries of certain local health employees ($18,600), providing equity with comparable state positions.

Budgeted revenues exceeded actual revenues by $1,391,162 in 2001-2002 and $1,622,686 during 2002-2003, due primarily to reimbursable expenditures being less that anticipated due to unfilled positions and unspent program service dollars. For the aforesaid fiscal years, all budget line item amounts, as modified by approved plan changes during both fiscal years, were sufficient to cover the agency's actual expenditures.

CAPITAL ASSET AND LONG-TERM DEBT ACTIVITY

The agency's investment in capital assets for its governmental activities as of June 30, 2003, and 2002, amounted to $167,581.35, which, net of accumulated depreciation of $116,846.09 and $96,422.82, left net book values of $50,735.26 and $71,158.53 at the end of each respective fiscal year. The agency had no commitments for capital expenditures or debt arrangements to provide financing for facilities or services. For additional capital asset activity detail, see the notes to the financial statements (Note 3). Obligations to make future payments for compensated absences are described in detail in the Notes to the Financial Statements (Note 4).

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

Increased competition and reduced fees from customer MCOs and BHOs continue to reduce revenues in the TennCare Transportation business. The Department of Health continues to transfer positions formerly subcontracted to ETCSA to state employment positions as does the Department of Children's Services. These changes will tend to reduce agency revenues from its contracts with the Department of Health, the MCOs and BHOs of the TennCare Medical Program, and the Department of Children's Services.

The agency continues to provide prompt and efficient service on behalf of its primary customer, the Tennessee Department of Children's Services. That department's emphasis on social services to non-custodial children provides continued opportunities for the agency. Federal court settlements mandate continued state dedication of resources to affected children's programs for which the agency is in a unique position to provide superior, cost-effective service. Also, the agency is actively seeking new opportunities to expand its services to existing and evolving social programs and to implement cost-effective innovations in its existing programs. These pro-active measures continue to make the agency a valuable provider of social services to the State of Tennessee.

CONTACTING THE AGENCY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our grantors, customers, and the citizens of the State of Tennessee with a general overview of the agency's finances and its use of the funds it receives. If you have any questions about this report or need additional information, contact the agency's Director of Fiscal Services, P.O. Box 630, Clinton, TN 37717-0630.

Exhibit A

East Tennessee Community Services Agency
Statements of Net Assets
June 30, 2003, and June 30, 2002

	Governmental Activities	
Assets	June 30, 2003	June 30, 2002
Cash (Note 2)	$ 1,370,487.65	$ 1,619,192.48
Accounts Receivable	14,347.27	-
Due from the State of Tennessee	838,314.74	317,242.72
Prepaid items and security deposits	7,131.27	4,503.58
Capital assets (Note 3):		
Equipment	167,581.35	167,581.35
Less accumulated depreciation	(116,846.09)	(96,422.82)
Total assets	2,281,016.19	2,012,097.31
Liabilities		
Accrued payroll, payroll taxes, and benefits	141,160.92	152,945.45
Accounts payable	341,490.47	181,898.56
Due to the State of Tennessee	183,166.54	164,786.83
Due to the local government	-	35,150.15
Long-term liabilities:		
Portion due or payable within one year:		
Compensated absences (Note 4)	89,888.32	98,574.67
Portion due or payable after one year:		
Compensated absences (Note 4)	36,504.23	44,035.71
Total liabilities	792,210.48	677,391.37
Net Assets		
Invested in capital assets	50,735.26	71,158.53
Unrestricted	1,438,070.45	1,263,547.41
Total net assets	$ 1,488,805.71	$ 1,334,705.94

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

Exhibit B

East Tennessee Community Services Agency
Statements of Activities
For the Years Ended June 30, 2003, and June 30, 2002

Programs	2003 Expenses	2003 Program Revenues: Charges for Services	2003 Program Revenues: Operating Grants and Contributions	2003 Net (Expense) Revenue and Change in Net Assets	2002 Expenses	2002 Program Revenues: Charges for Services	2002 Program Revenues: Operating Grants and Contributions	2002 Net (Expense) Revenue and Change in Net Assets
Governmental Activities:								
Administration	$ 456,510.52	$ -	$ -	$ (456,510.52)	$ 450,581.76	$ -	$ -	$ (450,581.76)
Child and Family Case Management (Note 13)	2,591,584.70	-	2,607,548.41	15,963.71	3,175,348.27	-	3,162,057.66	(13,290.61)
Child and Family Services (Note 13)	1,513,102.75	-	1,512,977.10	(125.65)	1,146,872.48	-	1,146,872.48	-
Mountain View	473,123.08	-	469,955.75	(3,167.33)	422,247.91	-	422,626.11	378.20
TennCare Transportation	415,103.78	660,325.63	-	245,221.85	373,531.39	745,519.02	-	371,987.63
Children's Special Services	168,758.60	-	166,107.86	(2,650.74)	149,382.46	-	150,522.31	1,139.85
Local Health	299,183.42	-	308,903.31	9,719.89	368,798.08	-	368,695.59	(102.49)
AmeriCorp Promise Fellows	17,703.21	-	8,100.00	(9,603.21)	8,255.69	-	2,700.00	(5,555.69)
Community Services	55,753.07	-	13,503.87	(42,249.20)	41,445.99	-	5,722.00	(35,723.99)
Leadership Initiative for Teens	17,467.72	-	18,832.63	1,364.91	29,379.82	-	29,242.70	(137.12)
Depreciation - unallocated	20,423.27	-	-	(20,423.27)	24,620.11	-	-	(24,620.11)
Total	$ 6,028,714.12	$ 660,325.63	$ 5,105,928.93	(262,459.56)	$ 6,190,463.96	$ 745,519.02	$ 5,288,438.85	(156,506.09)

	2003		2002
General revenues:		General revenues:	
Payment from the State of Tennessee	393,661.65	Payment from the State of Tennessee	359,197.98
Unrestricted investment earnings	22,897.68	Unrestricted investment earnings	31,320.76
Total general revenues	416,559.33	Total general revenues	390,518.74
Change in net assets	154,099.77	Change in net assets	234,012.65
Net assets - July 1	1,334,705.94	Net assets - July 1	1,100,693.29
Net assets - June 30	$ 1,488,805.71	Net assets - June 30	$ 1,334,705.94

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

Exhibit C

East Tennessee Community Services Agency
Balance Sheets
General Fund
June 30, 2003, and June 30, 2002

	June 30, 2003	June 30, 2002
Assets		
Cash (Note 2)	$ 1,370,487.65	$ 1,619,192.48
Accounts Receivable	14,347.27	-
Due from the State of Tennessee	838,314.74	317,242.72
Prepaid items and security deposits	7,131.27	4,503.58
Total assets	$ 2,230,280.93	$ 1,940,938.78
Liabilities and Fund Balance		
Liabilities:		
Accrued payroll, payroll taxes, and benefits	$ 141,160.92	$ 152,945.45
Accounts payable	341,490.47	181,898.56
Due to the State of Tennessee	183,166.54	164,786.83
Due to the local government	-	35,150.15
Total liabilities	665,817.93	534,780.99
Fund balance:		
Reserved for prepaid items	7,131.27	4,470.58
Unreserved	1,557,331.73	1,401,687.21
Total fund balance	1,564,463.00	1,406,157.79
Total liabilities and fund balance	$ 2,230,280.93	$ 1,940,938.78

Reconciliation of the general fund balance sheet to the statement of net assets:

	June 30, 2003	June 30, 2002
Total fund balance	$ 1,564,463.00	$ 1,406,157.79
Amounts reported in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported as assets in the general fund.	50,735.26	71,158.53
Long-term liabilities are not due and payable in the current period and therefore are not reported as liabilities in the general fund. Long-term liabilities at year-end consist of:		
Compensated absences	(126,392.55)	(142,610.38)
Total net assets	$ 1,488,805.71	$ 1,334,705.94

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

Exhibit D

East Tennessee Community Services Agency
Statements of Revenues, Expenditures, and Changes in Fund Balance
General Fund
For the Years Ended June 30, 2003, and June 30, 2002

	For the Year Ended June 30, 2003	For the Year Ended June 30, 2002
Revenues		
State grants and contracts	$ 5,282,236.70	$ 5,459,449.82
Federal grants and contracts	203,850.01	182,465.01
TennCare Transportation contracts	660,325.63	745,519.02
Interest	22,897.68	31,320.76
Donations	13,503.87	5,722.00
Total revenues	6,182,813.89	6,424,476.61
Expenditures		
Administration	453,148.60	453,067.07
Child and Family Case Management (Note 12)	2,607,548.41	3,164,681.66
Child and Family Services (Note 12)	1,512,977.10	1,144,248.48
Mountain View	469,955.75	422,626.11
TennCare Transportation	414,943.65	388,192.66
Children's Special Services	166,107.86	150,522.31
Local Health	308,903.31	368,695.59
AmeriCorp Promise Fellows	17,703.21	8,255.69
Community Services	55,753.07	41,445.99
Leadership Initiative for Teens	17,467.72	29,242.70
Total expenditures	6,024,508.68	6,170,978.26
Excess of revenues over expenditures and net change in fund balance	158,305.21	253,498.35
Fund balance - July 1	1,406,157.79	1,152,659.44
Fund balance - June 30	$ 1,564,463.00	$ 1,406,157.79

Reconciliation of the general fund statement of revenues, expenditures, and changes in fund balance to the statement of activities:

	2003	2002
Net change in fund balance	$ 158,305.21	$ 253,498.35
Amounts reported in the statement of activities are different because:		
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which depreciation expense exceeded capital outlays in the period.	(20,423.27)	(16,120.11)
The expense for compensated absences reported in the statement of activities does not require the use of current financial resources and, therefore, is not reported as an expenditure in governmental funds.	16,217.83	(3,365.59)
Changes in net assets of governmental activities	$ 154,099.77	$ 234,012.65

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

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 East Tennessee 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). The CSA's reporting entity does not include any component units.

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).

Certain amounts presented for the preceding year have been reclassified for comparative purposes.

The CSA's basic financial statements consist of government-wide financial statements (the statement of net assets and the statement of activities) and fund financial statements (the balance sheet and the statement of revenues, expenditures, and changes in fund balance). The East Tennessee Community Services Agency does not have any proprietary or fiduciary funds, and its only governmental fund is the general fund.

The statement of net assets presents all of the CSA's financial and capital resources including both short-term and long-term information. The statement of activities presents a comparison between the direct expenses and program revenues for each of the CSA's programs. Direct expenses are those that are specifically associated with a program. Program revenues include (a) charges paid by the recipients for services provided by the program and (b) grants and contributions that are restricted to meeting the operational requirements of the program. Revenues that are not classified as program revenues are presented as general revenues.

Measurement Focus and Basis of Accounting

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become susceptible to accrual, generally when they are measurable and become available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. Revenues that the CSA earns by incurring obligations are recognized in the same period the obligations are recognized. All other revenue items are considered to be available if collected within 60 days after the end of the current period.

Expenditures are recorded when the related fund liability is incurred, except for compensated absences and capital lease principal and interest, which are recognized as expenditures only when payment is due. Capital asset acquisitions are reported as expenditures in governmental funds. Acquisitions under capital leases are reported as other financing sources. However, the agency had no capital lease activity during the fiscal years ended 2003 and 2002.

Under the terms of grant agreements, the CSA funds certain programs by a combination of specific cost-reimbursement grants and general revenues. It is the CSA's policy to first apply restricted resources to such programs and then unrestricted resources.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, are followed in the government-wide statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

Assets and Liabilities

Cash

Cash reported in both the government-wide and the fund financial statements consists of petty cash, demand deposits, and deposits in the Local Government

Investment Pool (LGIP) administered by the State Treasurer. The liquidity of the LGIP is sufficient to cover any withdrawal request by a participant.

Prepaid Items

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both the government-wide and the fund financial statements.

Capital Assets

Capital assets are defined by the CSA as assets with an initial, individual cost of more than $5,000 and an estimated useful life in excess of one year. Capitalized assets are reported in the government-wide financial statements. Capitalized assets are recorded at historical cost. Donated capital assets are recorded at estimated fair value at the date of donation. The CSA does not own any infrastructure. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Capitalized assets are depreciated on a straight-line basis over the following estimated useful lives of the assets.

Description	Estimated Life
Copier Equipment	5 years
Telephone Equipment	7 years

Compensated Absences

It is the CSA's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the CSA's policy is to pay this benefit only if the employee is sick or upon death. In the government-wide financial statements, the liability for all vacation pay is accrued when earned. In the fund financial statements, a liability for these amounts is reported only if they have matured, for example, because of employee resignations and retirements.

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.

NOTE 2. DEPOSITS

The East Tennessee 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. 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 East Tennessee 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* for the years ended June 30, 2003, and June 30, 2002. The 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. CAPITAL ASSETS

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

	Beginning Balance	Increases	Decreases	Ending Balance
Equipment	$ 167,581.35	$ -	$ -	$ 167,581.35
Less accumulated depreciation	(96,422.82)	(20,423.27)	-	(116,846.09)
Total capital assets, net of depreciation	$ 71,158.53	$ (20,423.27)	$ -	$ 50,735.26

Capital asset activity for the year ended June 30, 2002, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Equipment	$ 159,081.35	$ 8,500.00	$ -	$ 167,581.35
Less accumulated depreciation	(71,802.71)	(24,620.11)	-	(96,422.82)
Total capital assets, net of depreciation	$ 87,278.64	$ (16,120.11)	$ -	$ 71,158.53

All capital assets essentially serve all of the CSA's programs. Therefore, all depreciation expense is reported on the statement of activities as depreciation–unallocated.

NOTE 4. LONG-TERM LIABILITIES

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

	Beginning Balance	Increases	Decreases	Ending Balance
Compensated absences	$ 142,610.38	$ 129,824.68	$ 146,042.51	$ 126,392.55
Total long-term liabilities	$ 142,610.38	$ 129,824.68	$ 146,042.51	$ 126,392.55

Long-term liability activity for the year ended June 30, 2002, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Compensated absences	$ 139,244.79	$ 156,274.10	$ 152,908.51	$ 142,610.38
Total long-term liabilities	$ 139,244.79	$ 156,274.10	$ 152,908.51	$ 142,610.38

NOTE 5. OPERATING LEASES

The agency leases office space, storage space, and equipment to carry out its activities and to administer the various grant programs. Total expenditures under operating leases for space and equipment were $8,869.34 and $7,676.11 for the years ended June 30, 2003, and 2002, respectively. These amounts included month to month rental for storage space ($2,863.78 in fiscal year 2003 and $3,753.72 in fiscal year 2002) and noncancelable equipment lease payments ($6,005.56 in fiscal year 2003 and $3,922.39 in fiscal year 2002).

The following is a schedule by years of future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms exceeding one year as of June 30, 2003.

Year Ending June 30		
2004	$	6,639.61
2005		6,089.40
2006		6,089.40
2007		6,089.40
2008		6,089.40
2009		253.73
Total minimum payments required	$	31,250.94

In addition, the State of Tennessee has entered into cancelable lease agreements for space and equipment on behalf of the agency. The agency reimburses the state for these lease payments every three months. Total reimbursements to the state for operating leases were $140,333.44 for the year ended June 30, 2003, and $170,260.90 for the year ended June 30, 2002. The agency is not obligated to continue making the lease payments should it discontinue use of the space and equipment.

NOTE 6. DEFINED BENEFIT PENSION PLAN

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. The report may be obtained by writing to the Tennessee Department of the Treasury, Consolidated Retirement System, 10th Floor Andrew Jackson Building, 500 Deaderick Street, Nashville, Tennessee 37243-0230, or can be accessed at www.treasury.state.tn.us.

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, 2003, the rate was 7.70% of annual covered payroll and for the year ended June 30, 2002, the rate was 7.13% 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.

Annual Pension Cost

The agency's annual pension cost of $204,519 for the year ended June 30, 2003, was were equal to the agency's required and actual contributions.

The required contributions for the years ended June 30, 2003, and June 30, 2002, were determined as part of the July 1, 2001, and July 1, 1999, actuarial valuations using the frozen initial liability actuarial cost method, a projected-benefit cost method. 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 and a projected annual increase in post-retirement benefits of 3% of the retiree's most recent benefit. Projected salary increases used in the 2001 valuation were 4.75% a year compounded annually down from 5.5% a year in the 1999 valuation (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries). The 2001 valuation projected a 3.5% annual increase in the social security wage base, down from 4.5% in the 1999 valuation. 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.

Three-Year Trend Information

Fiscal Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 2003	$ 204,519	100 %	-
June 30, 2002	$ 213,849	100 %	-
June 30, 2001	$ 200,554	100 %	-

NOTE 7. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee administers a group health insurance program that provides post-employment health insurance benefits to eligible agency retirees. This benefit is provided and administered by the State of Tennessee. The agency 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*. Note 2 includes the information to obtain the report.

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 $158,517.55 at June 30, 2003, and $194,905.68 at June 30, 2002.

Litigation—The agency is involved in several lawsuits, none of which are expected to have a material effect on the accompanying financial statements.

NOTE 9. DONATED FACILITIES

The Departments of Children's Services and Health donate office space, utilities, telephone service, and copier and computer use to the East Tennessee Community Services Agency. The value of the donation is not recorded in the financial statements.

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.

Commercial Coverage

The agency carries commercial insurance for risks of loss of its personal property and surety bond coverage for risks of employee dishonesty and forgery or alteration. In the past three fiscal years, the agency has had no claims filed with the commercial insurer.

State of Tennessee's Claims Award Fund

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, Section 9-8-101 et seq., *Tennessee Code Annotated*. 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 Section 50-6-101 et seq., *Tennessee Code Annotated*.

Health Coverage

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 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 John Deere Health Care, 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 John Deere Health Care, Inc.

The Local Government Group Insurance Fund issues separate financial statements that may be obtained by writing the Department of Finance and Administration, Division of Accounts, 312 Eighth Avenue North, 14th Floor William R. Snodgrass Tennessee Tower, Nashville, TN 37243-0298.

NOTE 11. NEW ACCOUNTING PRONOUNCEMENTS

The East Tennessee Community Services Agency has implemented the provisions of Governmental Accounting Standards Board (GASB) Statements 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments;* and 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus—an amendment of GASB Statements No. 21 and No. 34.* These statements establish new financial reporting requirements and restructure much of the information that governments have presented in the past. Comparability with reports issued in all prior years will be affected. The State of Tennessee implemented these statements, as required, for the year ended June 30, 2002. As a component unit of the state, the East Tennessee Community Services Agency has also implemented the statements for the year ended June 30, 2002.

NOTE 12. RECLASSIFICATION FOR COMPARATIVE PURPOSES

Certain amounts presented for the preceding year have been reclassified for comparative purposes. Expenditures reported as Children and Family Services, Family Support Services, Flexible Funding, and Emergency Residential for the year ended June 30, 2002, were reclassified and reported as Child and Family Case Management and Child and Family Services.

NOTE 13. RELATED-PARTY TRANSACTIONS

Section 37-5-305, *Tennessee Code Annoted,* defines the membership of the Community Services Agency's (CSA) Board of Directors. Included on each rural CSA's board is the Commissioner of the Department of Children's Services (DCS) or the commissioner's designee. The commissioner has designated the DCS Regional Administrator, a management-level DCS employee assigned to the CSA service area. As a board member, the Regional Administrator can vote on all CSA business including: the adoption of written policies, procedures or rules and regulations to govern the CSA's internal operations; the making and executing of contracts; or the receiving, administering, allocating and disbursing of funds made available under any federal or state assistance program. As a DCS employee, the Regional Administrator can authorize transactions that will be paid by the CSA. DCS is the primary funding source of the East Tennessee CSA, providing over $4.9 million in revenue.

In addition, the DCS Commissioner appoints the agency's Executive Director with the approval of the CSA's board of Directors. The DCS Commissioner also approves any CSA policies, procedures or rules and regulations proposed by the board of directors, as well as all contracts for the purchase of services or the acquisition or improvement of real property. Furthermore, the Commissioner is responsible for the review and approval of the CSA's plan of operation submitted in accordance with Section 37-5-310, *Tennessee Code Annotated.*

East Tennessee 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, 2001	$2,952,772	$2,952,772	-	100 %	$2,880,109	-
July 1, 1999	$2,204,715	$2,204,715	-	100 %	$2,538,970	-
June 30, 1997	$1,528,048	$1,528,048	-	100 %	$2,619,886	-

Changes in Actuarial Assumptions

An actuarial valuation was performed as of July 1, 2001, to establish contribution rates as of July 1, 2002. The July 1, 1999, actuarial valuation established contribution rates for the year ended June 30, 2002. 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 and projected an annual increase in post-retirement benefits of 3% of the retiree's most recent benefit. Projected salary increases used in the 2001 valuation were 4.75% a year compounded annually, down from 5.5% a year in the 1999 valuation (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries). The 2001 valuation projected a 3.5% annual increase in the social security wage base, down from 4.5% in the 1999 valuation.

Supplementary Information
East Tennessee Community Services Agency
Budgetary Comparison Schedules
General Fund
For the Years Ended June 30, 2003, and June 30, 2002

	For Year ended June 30, 2003				For Year ended June 30, 2002			
	Budgeted Amounts			Variance with Final Budget - Over	Budgeted Amounts			Variance with Final Budget - Over
	Original	Final	Actual	(Under)	Original	Final	Actual	(Under)
Sources of Financial Resources								
Fund Balance, July 1								
Amount approved for expenditure	$ 821,726.00	$ 427,960.00	$ 427,960.00		$ 569,397.00	$ 589,722.00	$ 589,722.00	
Amount not approved for expenditure	584,431.79	978,197.79	978,197.79		583,262.44	562,937.44	562,937.44	
Revenues								
Department of Children's Services	5,728,472.00	6,378,980.00	4,953,020.20	$ (1,425,959.80)	6,313,774.00	6,309,944.00	5,090,754.23	$ (1,219,189.77)
TennCare Managed Care Organizations/ Behavioral Health Organizations	680,520.00	680,520.00	660,325.63	(20,194.37)	629,115.00	629,115.00	745,519.02	116,404.02
Department of Health	780,363.00	690,200.00	506,133.88	(184,066.12)	776,585.00	797,690.00	519,217.90	(278,472.10)
Tennessee Commission on National and Community Service	10,800.00	10,800.00	8,100.00	(2,700.00)	-	10,800.00	2,700.00	(8,100.00)
Tennessee Commission on Children and Youth	45,000.00	45,000.00	18,832.63	(26,167.37)	-	60,000.00	29,242.70	(30,757.30)
				-			-	-
In-kind Contributions	-		-	-	-	8,090.00	-	(8,090.00)
Donations	-		13,503.87	13,503.87	-	-	5,722.00	5,722.00
Interest revenue	-		22,897.68	22,897.68	-	-	31,320.76	31,320.76
Total revenues	7,245,155.00	7,805,500.00	6,182,813.89	(1,622,686.11)	7,719,474.00	7,815,639.00	6,424,476.61	(1,391,162.39)
Total sources of financial resources	8,651,312.79	9,211,657.79	7,588,971.68	(1,622,686.11)	8,872,133.44	8,968,298.44	7,577,136.05	(1,391,162.39)
Expenditures								
Administration	615,412.00	732,312.00	453,148.60	(279,163.40)	556,361.00	554,645.00	453,067.07	(101,577.93)
Child and Family Case Management	3,269,024.00	2,871,080.00	2,607,548.41	(263,531.59)	3,881,452.00	3,889,082.00	3,162,057.66	(727,024.34)
Child and Family Services	1,980,050.00	2,521,200.00	1,512,977.10	(1,008,222.90)	1,779,210.00	1,779,210.00	1,146,872.48	(632,337.52)
Mountain View YDC	519,929.00	519,000.00	469,955.75	(49,044.25)	447,840.00	440,585.00	422,626.11	(17,958.89)
TennCare Transportation	645,412.00	636,000.00	414,943.65	(221,056.35)	595,168.00	595,168.00	388,192.66	(206,975.34)
Children's Special Services	167,106.00	187,310.00	166,107.86	(21,202.14)	165,823.00	165,823.00	150,522.31	(15,300.69)
Local Health	581,210.00	477,820.00	308,903.31	(168,916.69)	581,209.00	599,825.00	368,695.59	(231,129.41)
AmeriCorp Promise Fellows	31,297.00	31,297.00	17,703.21	(13,593.79)	-	39,215.00	8,255.69	(30,959.31)
Community Services	170,068.00	170,068.00	55,753.07	(114,314.93)	281,808.00	281,808.00	41,445.99	(240,362.01)
Leadership Initiative for Teens	87,373.00	87,373.00	17,467.72	(69,905.28)	-	60,000.00	29,242.70	(30,757.30)
Total expenditures	8,066,881.00	8,233,460.00	6,024,508.68	(2,208,951.32)	8,288,871.00	8,405,361.00	6,170,978.26	(2,234,382.74)
Fund Balance - June 30	$ 584,431.79	$ 978,197.79	$ 1,564,463.00	$ 586,265.21	$ 583,262.44	$ 562,937.44	$ 1,406,157.79	$ 843,220.35

Note: The budgeted and actual expenditures reported as Children and Family Services, Family Support Services, Flexible Funding, and Emergency Residential for the year ended June 30, 2002, were reclassified and reported as Child and Family Case Management and Child and Family Services for the year ended June 30, 2003.

APPENDIX

EAST TENNESSEE COMMUNITY SERVICES AGENCY

Mike Harkleroad, Executive Director

BOARD OF DIRECTORS

Board Officers and Executive Committee Members

Mr. Eddie Davis, Chair
Mr. John Galloway, Vice-Chair
Ms. Sherrie Claiborne, Treasurer
Mr. David Lietzke, Secretary

Other Members of the Board of Directors

Ms. Flo Charles
Mr. James Gaddis
Ms. Jan Laxton
Ms. Anne Phillips
Ms. Nancy Rader
Ms. Ann Richardson
Ms. Paula Rugel
Mr. Mickey Webb
Mr. Robert Webb
Mr. Jerry Wilson
Mr. Jim Wilson
Mr. Rick Thomas