Memphis and Shelby County Community Services Agency
(Formerly Memphis and Shelby County Community Health Agency)

For the Year Ended
June 30, 1996

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July 14, 1997

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
Memphis, Tennessee 38104

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Memphis and Shelby County Community Services Agency, formerly the Memphis and Shelby County Community Health Agency, for the year ended June 30, 1996. 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 the internal control structure 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.

Very truly yours,

W. R. Snodgrass
Comptroller of the Treasury

WRS/tp
96/138

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, 1996

AUDIT OBJECTIVES

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

COMPLIANCE FINDINGS

The Agency Poorly Managed Financial Activities*
The agency did not pay its vendors timely and did not properly account for its encumbrances (page 9).

The Agency Failed to Properly Close Books and Prepare Financial Statements*
The agency failed to properly close its books and prepare financial statements and related disclosures (page 10).

Deferred Compensation Plan Was Inadequately Disclosed
Disclosure of the plan was understated by $46,070.53 on the balance sheet before audit adjustments (page 13).

INTERNAL CONTROL FINDINGS

Controls Over Property and Equipment Are Not Adequate
The agency does not have written policies governing fixed assets, and a physical inventory was not completed by year-end (page 13).

Controls Over Payroll Deductions and Authorizations Are Not Adequate
Payroll taxes were not calculated properly, and direct deposit authorizations were not maintained (page 14).

INTERNAL CONTROL AND COMPLIANCE FINDING

Accounting Policies and Procedures Were Not Approved
Policies and procedures were not submitted to the Commissioner of Children's Services for approval in accordance with state law, and the agency was not always following the draft policies and procedures the board had approved. (page 12).

* This finding is repeated from the prior audit.
** This finding is repeated from prior audits.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is 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

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 741-3697

Audit Report
Memphis and Shelby County Community Services Agency
For the Year Ended June 30, 1996

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Memphis and Shelby County Community Services Agency
For the Year Ended June 30, 1996

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, legislation known as 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.

ORGANIZATION

The governing body of the Memphis and Shelby County Community Services Agency is the board of directors. As of June 30, 1996, the board was composed of 14 members. (See Appendix.)

An executive committee, consisting of five 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 a staff under the supervision of an executive director, who is appointed by the Mayor of Shelby County upon recommendation by the board.

AUDIT SCOPE

The audit was limited to the period July 1, 1995, through June 30, 1996, and was conducted in accordance with generally accepted government auditing standards. Financial statements are presented for the year ended June 30, 1996, and for comparative purposes, the year ended June 30, 1995. The Memphis and Shelby County Community Services Agency has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report.*

OBJECTIVE OF THE AUDIT

The objectives of the audit were

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

2. to determine the fairness of the presentation of the financial statements;

3. to determine compliance with laws, regulations, contracts, and grants; and

4. to recommend appropriate actions to correct any deficiencies.

Although this audit was not intended to serve as an organization-wide audit as described in the Single Audit Act of 1984 and Office of Management and Budget (OMB) Circular A-128, "Audits of State and Local Governments," it included tests of compliance with applicable federal laws and regulations and consideration of the internal control structure used in administering federal financial assistance programs. This audit is a segment of the organization-wide audit of the State of Tennessee, which is conducted in accordance with the Single Audit Act of 1984 and OMB Circular A-128.

OBSERVATIONS AND COMMENTS

During the audit period, the Memphis and Shelby County Community Services Agency entered into a contract with the Department of Health, specifying that the agency would provide fiscal support services to the Community Development Program.

The CSAs were responsible for personnel and administrative procedures. The Department of Health's regional directors would interview for personnel positions and hire staff. The regional directors would also be responsible for supervising all Community Development staff and for operating the program.

The salaries for all program employees, except for the director of community development, along with travel costs and other program costs, were paid by the agency. The Department of Health reimbursed the agency for these costs, including the agency's administrative costs for serving as a fiscal agent. The program director is a state employee and is paid by the Department of Health.

The Attorney General has previously advised that contracts of this type are unauthorized. The contracts with the Memphis and Shelby County Community Services Agency and other agencies serving the Department of Health were also noted in the most recent audit report on the department.

According to the 1989 Community Health Agency Act, the executive director is to be appointed by the Shelby County Mayor and is thus an employee of Shelby County Government. Under the new 1996 Department of Children's Services legislation, the executive director is to be an appointee of the Commissioner of the Department of Children's Services and will be a CSA employee. However, this transition has not taken place, and the executive director is still a county employee.

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, formerly the Memphis and Shelby County Community Health Agency, filed its report with the Department of Audit on July 19, 1996. A follow-up of all prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the agency has corrected previous audit findings concerning controls over expenditures, compliance with assessment and care coordination team guidelines, following purchasing policies, adequately collateralizing deposits, charging extended special leave to agency grants, safeguarding data on the agency's local area network, and ensuring that the CORS system contains correct information.

REPEATED AUDIT FINDINGS

The prior audit report also contained findings concerning following proper financial procedures and properly closing the books and preparing financial statements in a timely manner. These findings have not been resolved and are repeated in this report.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control Structure

As part of the audit of the agency's financial statements for the year ended June 30, 1996, we considered the internal control structure to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by generally accepted government auditing standards. The report on the internal control structure is on the following pages. Reportable conditions, along with recommendations and management's responses, are detailed in the findings and recommendations, which follow the report on the internal control structure. Consideration of the internal control structure disclosed no material weaknesses.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the financial statements of the Memphis and Shelby County Community Services Agency. In our opinion, the statements included in this report present fairly, in all material respects, the agency's financial position as of June 30, 1996, and the results of its operations for the year then ended. The independent auditor's report follows the compliance report.

Compliance with Laws and Regulations

The results of our audit tests disclosed no instances of noncompliance that are required to be reported herein under generally accepted government auditing standards. Immaterial instances of noncompliance, along with recommendations and management's responses, are included in the findings and recommendations. The compliance report follows the findings and recommendations.

**Report on the Internal Control Structure
Based on an Audit of the Financial Statements Performed in
Accordance With *Government Auditing Standards***

November 15, 1996

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

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, 1996, and have issued our report thereon dated November 15, 1996.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The agency's management is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the agency's financial statements for the year ended June 30, 1996, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure 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.

We noted the following reportable conditions:

- Accounting policies and procedures have not been approved in accordance with state law
- Controls over property and equipment are not adequate
- Controls over payroll deductions and authorizations are not adequate

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

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities 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 structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above are material weaknesses.

We also noted other matters involving the internal control structure and its operation that we have reported to the agency's management in a separate letter.

This report is intended for the information of the General Assembly of the State of Tennessee, the board of directors, and management. However, this report is a matter of public record, and its distribution is not limited.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/tp

FINDINGS AND RECOMMENDATIONS

1. <u>Proper financial procedures were not followed</u>

Finding

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

- Three of 12 copier lease payments (25%) and three of 12 fax machine lease payments (25%) were not paid within 45 days. Payments were made 47 to 76 days after the invoice was received. Also, three of 29 sample payments tested (10%) were made 72 to 130 days after the invoice was received. Cellular phone bills for April, May, and June were not paid until August 26, 1996. By not paying invoices timely, the agency could lose purchase discounts, and relations with vendors could deteriorate.

- The miscellaneous revenue account shown on the Statement of Revenues, Expenditures, and Changes in Fund Balance contains an unexplained amount of $7,748.99. This number could be attributable to various reconciling and correcting entries made by the former chief financial officer.

- The agency could not reconcile total checks written with total expenditures reported in the financial statements. A difference of $27,412.33 could not be explained by the former chief financial officer. Failure to resolve variances between checks written and expenditures reported in the financial statements could cause inaccurate financial reporting.

- The 1996 encumbrance report submitted to the Department of Health's Bureau of Health Services showed total encumbrances as $128,343.06. However, testwork revealed that only $58,696.97 were valid 1996 encumbrances. The remainder consisted of the following amounts: $1,400 was neither an encumbrance nor an expenditure for 1996 or 1997, $6,851.41 was 1996 expenditures, and $61,394.68 were for purchase orders that had not been submitted to vendors. The *Codification of Governmental Accounting and Financial Reporting Standards*, Section 1700.129(b), states, "Encumbrances outstanding at year-end represent the estimated amount of the expenditures ultimately to result if unperformed contracts in process at year-end are completed. Encumbrances outstanding at year-end do not constitute expenditures or liabilities." Corrective audit adjustments were made.

- Accounts payable at June 30, 1996, included $52,545.54 for goods received and services performed in fiscal year 1997 and did not include $1,306.27 of services performed in fiscal year 1996. Corrective audit adjustments were made.

- In some instances, the former chief financial officer incorrectly recorded $7,395 collected or due from an outside vendor as earned revenue from the state. Also, earned revenue was not recorded when the agency incurred $6,680.48 in grant expenditures.

Findings 2, 3, 4, and 5 also represent the agency's failure to properly manage its financial activities: the agency did not properly close its books or prepare financial statements in a timely manner, has not obtained approval for its accounting policies and procedures, did not adequately disclose the 457 Deferred Compensation Plan, and did not complete a physical inventory prior to year-end.

Recommendation

The executive director should ensure that the chief financial officer manages the agency's financial activities prudently and correctly. All financial reconciliations should be performed, and payments to vendors should be made timely. Management is responsible for all the financial statements and for adequate supporting documentation for those financial statements. The encumbrance listing should only reflect those contracts that are uncompleted at year-end.

Management's Comment

We concur. A new Chief Financial Officer (CFO) has been hired, and the agency is currently making payments within forty-five (45) days. The errors in the encumbrances have been resolved and reconciliations are being made promptly.

2. The agency failed to properly close its books and prepare financial statements in a timely manner

Finding

As noted in the prior audit, the agency failed to properly close its books at year-end. Although the agency did perform some cutoff procedures and prepare certain financial statements and notes to the financial statements, technical assistance from the auditors was necessary to arrive at the correct trial balance and subsequent financial statements. The former chief financial officer did not prepare the following financial statement and notes to the financial statements:

- Statement of Asset and Liabilities for the Agency Fund

- Operating Leases

- Contingencies

- Risk Management

- Related-Party Transactions

Because its books were not closed properly, the agency could not determine its financial condition at year-end, nor could it determine the results of operations for the year. The books were subsequently closed on October 31, 1996. This delay in closing the books resulted in the final amendment to its plan of operation being submitted in December 1996.

Section 37-5-313(b), *Tennessee Code Annotated*, states, "The community services agencies shall maintain all books and records in accordance with generally accepted accounting principles, and at no less than those recommended in the 'Accounting Manual for Recipients of Grant Funds in Tennessee' published by the comptroller of the treasury." The *Accounting Manual for Recipients of Grant Funds in Tennessee* states:

> <u>Financial reporting is the responsibility of management</u>. The auditor's responsibility is to express an opinion on the fair presentation of the financial statements. . . . If management has properly prepared the financial statements, schedules, and other required disclosures, the auditor may be able to perform the engagement more economically and efficiently.

In addition, the manual states that quasi-governmental agencies are

> required to present as a part of their financial report a combined balance sheet and a combined statement of revenues, expenditures, and changes in fund balances. . . . Also, the financial report should contain all notes . . . that are necessary to the understanding of the financial statements or to demonstrate compliance with legal and contractual provisions.

Recommendation

The executive director should ensure accounting staff adequately maintain the agency's accounting records so that the agency's books may be closed and all financial statements and notes may be prepared promptly. The agency should follow the guidelines in the *Accounting Manual for Recipients of Grant Funds in Tennessee.*

Management's Comment

We concur. A new CFO has been hired, and the agency is maintaining its books in accordance with generally accepted accounting principles and those recommended in the "Accounting

Manual for Recipients of Grant Funds in Tennessee." As a result, the agency will close its books and all financial statements will be prepared on time.

3. <u>Accounting policies and procedures have not been approved in accordance with state law</u>

Finding

On June 14, 1995, the Memphis and Shelby County Community Services Agency board unanimously approved the draft *Accounting Procedures Manual*. However, this manual has not been submitted to the Commissioner of the Department of Children's Services for approval.

Section 37-5-306 (1), *Tennessee Code Annotated*, states that the board has the power and duty to "adopt written policies, procedures or rules and regulations to govern its internal operations." It also states that "if such rules and regulations are proposed, they must be submitted for prior approval to the commissioner."

Testwork also revealed that in some instances (bank reconciliation procedures and revenue-receipting procedures), the agency was not following the draft policies and procedures the board had approved.

Without approved accounting policies and procedures, management has no official guidelines for monitoring internal controls, ensuring assets are sufficiently safeguarded, and providing accountability.

Recommendation

The executive director should present the accounting policies and procedures to the Commissioner of the Department of Children's Services for approval. The agency should follow board-approved policies and procedures.

Management's Comment

We concur with this finding; however, a statewide policies and procedures committee was working on standard CSA policies for the new Department of Children's Services. The MSC-CSA was waiting to get the Commissioner's signature on these standard policies. At the recommendation of the auditors, however, the agency has adopted local accounting policies and procedures. These procedures have been approved by the board. The agency will obtain additional approval from the Commissioner of the Department of Children's Services. The accounting department is currently following these new policies until the statewide policies are in place.

4. **<u>Disclosure of the agency's 457 Deferred Compensation Plan was inadequate</u>**

Finding

The former chief financial officer failed to prepare a Statement of Changes in Assets and Liabilities for the Agency Fund and to properly disclose the value of the agency's 457 Deferred Compensation Plan on the balance sheet. Because the former chief financial officer did not obtain the year-end plan balances from the plan administrator, the activity of the 457 plan was not accurately presented. As a result, the agency fund was understated by $46,070.53 (see finding 2).

Codification of Governmental Accounting and Financial Reporting Standards, Section D25.109, states, "IRC Section 457 deferred compensation plan balances should be displayed in an agency fund . . . the balance sheet should display the plan assets with a corresponding liability to employees for deferred compensation and related accumulated net earnings."

Recommendation

In order for the agency to adequately disclose the 457 Deferred Compensation Plan, the chief financial officer should obtain monthly plan statements or confirm the year-end balance with the plan administrator to determine the amount to be reported in the financial statements. The chief financial officer should also prepare the Statement of Changes in Assets and Liabilities for the Agency Fund.

Management's Comment

We concur. A new CFO has been hired, and the agency will get monthly plan statements in order to disclose the correct value of its 457 Deferred Compensation Plan on future balance sheets.

5. **<u>Controls over property and equipment are not adequate</u>**

Finding

The agency does not have written policies and procedures for updating accounting and property records for equipment additions or deletions resulting from surplus, disposal, loss, or theft or for performing a physical inventory of the agency's fixed assets.

Testwork also revealed that the former chief financial officer did not ensure that a physical inventory of the agency's property was completed prior to year-end. As a result, the agency was unable to reconcile the physical inventory with the property records. Also, the equipment expenditure account (accounting records) did not reconcile with the property records for purchases made during the fiscal year. *The Accounting Manual for Recipients of Grant Funds in Tennessee* requires that physical inventories of equipment agree with property records and general ledger accounts. Corrective audit adjustments were made to expenditures and equipment balances.

The failure to conduct a thorough inventory increases the likelihood of undetected loss or theft of items.

Recommendation

The executive director should ensure appropriate policies and procedures are developed for updating accounting and property records. The chief financial officer should ensure that a physical inventory is completed prior to year-end and that the physical inventory reconciles with property records and the general ledger accounts.

Management's Comment

We concur. A new CFO has been hired, and the agency has adopted new policies and procedures for updating property records for equipment additions and deletions. A physical inventory of the agency's property will be completed and reconciled to property records and general ledger accounts before year-end.

6. Controls over payroll deductions and authorizations are not adequate

Finding

The agency did not ensure that all withholding amounts were deducted or that the amounts deducted were correct. The federal income tax withholding for five of 26 deductions tested (19%) was incorrect because the payroll clerk failed to enter the correct withholding information into the agency's accounting system. Also, testwork on the Employer's Quarterly Federal Tax Return revealed that no federal income tax or Federal Insurance Contribution Act (FICA) tax was withheld for two employees for the pay period ending December 1, 1995. The agency subsequently withheld federal income tax and FICA for that pay period for one of the employees, but the amount of the federal income tax withheld was incorrect. Federal income tax and FICA for the other employee had not been withheld for the applicable pay period as of June 30, 1996.

The employees' withholding was calculated incorrectly because the payroll clerk was not trained how to enter withholding information into the accounting system. Correct withholding amounts are based on the Employee's Withholding Allowance Certificate (W-4).

The *Internal Revenue Code*, Section 3401 et seq., requires employers to collect and pay income taxes that are withheld from employees' paychecks. Also, the failure to withhold taxes from an employee's wages does not relieve the employer of the responsibility of paying the tax. Penalties apply to employers who fail to remit the taxes to the government.

In addition, direct deposit authorizations were not on file for 14 of 24 employees tested (58%). If authorizations are not maintained, the agency may not be complying with the desires of the employees.

Recommendation

The executive director, the chief financial officer, and the director of human resources should ensure that the correct amounts of federal income and FICA taxes are deducted from each employee's salary and that any changes are updated correctly. Direct deposit authorizations should be maintained for all applicable employees.

Management's Comment

We concur. The new CFO is working closely with the personnel department to ensure that employees' FICA records in personnel files agree with payroll records. The payroll clerk has received training on how to correctly enter withholding information into the accounting system. Additionally, all personnel records have been updated to include completed direct deposit authorization forms.

Compliance Report Based on an Audit of the Financial Statements Performed in Accordance With *Government Auditing Standards*

November 15, 1996

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

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, 1996, and have issued our report thereon dated November 15, 1996.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to the agency is the responsibility of the agency's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the agency's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under generally accepted 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.

This report is intended for the information of the General Assembly of the State of Tennessee, the board of directors, and management. However, this report is a matter of public record, and its distribution is not limited.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/tp

Independent Auditor's Report

November 15, 1996

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

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, 1996, and June 30, 1995, and the related statements of revenues, expenditures, and changes in fund balances for the years then ended and the statement of changes in assets and liabilities of the agency fund for the year ended June 30, 1996. 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 generally accepted government auditing standards. 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, 1996, and June 30, 1995, and the results of its operations for the years then ended in conformity with generally accepted accounting principles.

In accordance with generally accepted government auditing standards, we have also issued reports dated November 15, 1996, on our consideration of Memphis and Shelby County Community Services Agency's internal control structure and on its compliance with laws and regulations.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/tp

Memphis and Shelby County Community Services Agency
Notes to the Financial Statements
June 30, 1996, and June 30, 1995

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

In May 1996, the Tennessee General Assembly replaced the community health agency (CHA) with the community services agency (CSA). Although the agency's mission has changed from providing health care services to indigent citizens in the state to coordinating care for children and other citizens in the state, CHA employees, financial assets and obligations, and fund balances now belong to the CSA. The Memphis and Shelby County CSA works in conjunction with the Tennessee Department of Children's Services and the Shelby County government to coordinate "funds or programs designated for care of children and other citizens in the state."

Factors considered in determining reporting status were not affected by the above legislation. 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 CSA is financially accountable to the state because the state approves the CSA's Plan of Operation (budget).

B. Basis of Presentation

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). Certain amounts presented for the preceding year have been reclassified for comparative purposes.

C. Fund Structure, Basis of Accounting, and Measurement Focus

The financial records of the Memphis and Shelby County CSA 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 fund is custodial in nature and does not measure results of operations or have a 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 are 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 two fund types and two account groups:

Governmental Fund Type

General Fund—used to account for all resources not accounted for in another fund.

Fiduciary Fund Types

Agency Fund—used to account for *Internal Revenue Code,* Section 457, deferred compensation plan balances.

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.

D. 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.

E. Budgetary Process

Legislation requires the CSA board to submit an annual plan of operation for review and approval to the Commissioners of the Tennessee Departments of Children's Services and Finance and Administration and to the Comptroller of the Treasury. As part of this plan, the CSA is to submit a financial plan for operating and capital expenditures. The agency's 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.

F. Investments

This classification consists of investments in the deferred compensation plan valued at fair value.

G. Prepaid Items

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

NOTE 2. DEPOSITS

The agency's bank accounts are in financial institutions which 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 agency's financial institution began participating in the bank collateral pool on March 1, 1996.

At June 30, 1996, the carrying amount of the agency's deposits was $2,761.37, and the bank balance was $88,892.41. The entire bank balance was insured.

At June 30, 1995, the carrying amount of the agency's deposits was $241,280.59, and the bank balance was $519,811.42. The entire bank balance was insured by Federal Deposit Insurance Corporation coverage and collateralized with securities held by the agency or by its agent in the agency's name. From July 1, 1994, to September 5, 1994, the agency had uncollateralized amounts as high as $151,553.15. The laws of the State of Tennessee require that collateral be pledged to secure all uninsured deposits.

At June 30, 1996, and June 30, 1995, the agency had deposits in the Tennessee Local Government Investment Pool of $517,284.88 and $250,327.56, respectively. The custodial credit risk for cash in the Tennessee Local Government Investment Pool is presented in the *Tennessee Comprehensive Annual Financial Report* for the years ended June 30, 1996, and June 30, 1995.

At June 30, 1996, and June 30, 1995, petty cash on hand was $75.00.

NOTE 3. DUE FROM/TO PRIMARY GOVERNMENT

Year Ended June 30, 1996

Due From:	
Department of Children's Services–program funds	$68,357.61
Total due from primary government	$68,357.61

Due To:	
Department of Health–program funds	$ 41,899.48
Department of the Treasury–retirement contributions	9,688.93
Department of Employment Security–unemployement taxes	146.50
Department of Finance and Administration–Office for Information Resources	11,368.08
Department of Revenue	200.00
Comptroller of the Treasury–audit fees	37,326.42
Total due to primary government	$100,629.41

Year Ended June 30, 1995

Due From:	
Department of Finance and Administration–program funds	$318,896.34
Total due from primary government	$318,896.34
Due To:	
Department of Health–program funds	$ 77,917.71
Comptroller of the Treasury–audit fees	20,131.69
Department of the Treasury–Claims Award Fund	1,420.00
Department of the Treasury–retirement contributions	27,537.56
Local Government Group Insurance	25,668.27
Department of Finance and Administration–Office for Information Resources	96,950.33
Department of Employment Security	3,064.13
Department of Finance and Administration	58.06
Total due to primary government	$252,747.75

NOTE 4. GENERAL FIXED ASSETS

General fixed assets are recorded at cost and are not depreciated. Donations are recorded at fair value at the date of the donation.

The following changes in general fixed assets occurred during the year ended June 30, 1996:

	Balance July 1, 1995	Additions	Deletions	Balance June 30, 1996
Furniture and equipment	$382,722.39	$12,861.94	$5,743.86	$389,840.47
Leased equipment	132,782.46	-	-	132,782.46
Total	$515,504.85	$12,861.94	$5,743.86	$522,622.93

The following changes in general fixed assets occurred during the year ended June 30, 1995:

	Balance July 1, 1994	Additions	Deletions	Balance June 30, 1996
Furniture and equipment	$187,834.30	$194,888.09	$ -	$382,722.39
Leased equipment	-	132,782.46	-	132,782.46
Total	$187,834.30	$327,670.55	$ -	$515,504.85

NOTE 5. GENERAL LONG-TERM OBLIGATIONS

The following changes in general long-term obligations occurred during the year ended June 30, 1996:

	Balance July 1, 1995	Increases (Decreases)	Balance June 30, 1996
Amount to be provided for retirement of general long-term obligations	$201,647.87	$(24,745.81)	$176,902.06

Accrued annual leave	$ 88,487.50	$ (966.29)	$ 87,521.21
Capital lease obligations	113,160.37	(23,779.52)	89,380.85
Total general long-term obligations	$201,647.87	$(24,745.81)	$176,902.06

The following changes in general long-term obligations occurred during the year ended June 30, 1995:

	Balance July 1, 1994	Increases (Decreases)	Balance June 30, 1995
Amount to be provided for retirement of general long-term obligations	$61,596.63	$140,051.24	$201,647.87
Accrued annual leave	$61,596.63	$ 26,890.87	$ 88,487.50
Capital lease obligations	-	113,160.37	113,160.37
Total general long-term obligations	$61,596.63	$140,051.24	$201,647.87

NOTE 6. OPERATING LEASES

The agency leases office 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 $245,062.80 and $138,568.23 for the year ended June 30, 1996, and were $214,498.23 and $105,839.51 for the year ended June 30, 1995. All leases were cancelable at the lessee's option.

NOTE 7. CAPITAL LEASES

The agency has certain lease agreements in effect that are considered capital leases. These agreements have beginning and ending dates ranging from July 1, 1994, to August 31, 1999, and imputed interest rates ranging from 8% to 8.048%. The following is a schedule by years of future minimum lease payments under capital leases together with the present value of the net minimum lease payments at June 30, 1996:

1996-97	$ 32,002.32
1997-98	31,671.20
1998-99	34,730.64
1999-2000	3,177.29
Total minimum lease payments	101,581.45
Less amounts representing interest	12,200.60
Present value of net minimum lease payments	$ 89,380.85

Capital leases for equipment are reported at $132,782.46 in the General Fixed Assets Account Group at June 30, 1996.

NOTE 8. DEFINED BENEFIT PENSION PLAN

A. Plan Description

All full-time employees of the agency are members of an agent multiple-employer pension plan administered by the Tennessee Consolidated Retirement System (TCRS). TCRS acts as a common investment and administrative agent for political subdivisions in the state. The agency participates in the TCRS as a political subdivision and is liable for the costs associated with the operation and administration of its plan. The agency's payroll for employees covered by the plan for the year ended June 30, 1996, was $2,447,392, and total payroll was $2,493,209. At June 30, 1995, covered payroll was $2,309,224, and total payroll was $2,317,629.

The TCRS administers a defined benefit retirement plan covering teachers and general employees of the state, higher education employees, and employees of participating political subdivisions. Membership in the system is mandatory for all participants' full-time employees. The TCRS provides retirement benefits as well as death and disability benefits. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members may retire at age 60 with five years' service or at any age with 30 years' service. Early retirement with reduced benefits is available to vested members who are at least age 55 or have 25 years of service. Members are vested after five years of service. Disability benefits are available to members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member performed duties. Benefit provisions are established and amended by state statute. Amendments to the TCRS plan are not applicable to a political subdivision unless approved by the political subdivision's governing body.

As authorized by the agency's board of directors, the agency pays the total pension contribution for its employees.

B. Funding Status and Progress

The "pension benefit obligation," which is the actuarial present value of credited projected benefits, is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure is intended to help users assess the funding status of the agency's pension program as administered by TCRS on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among public employee retirement systems and among employers. The measure is independent of the actuarial funding method used to determine contributions to the system.

The pension benefit obligation was computed as part of an actuarial valuation performed as of June 30, 1995, and an actuarial update performed as of June 30, 1996. Significant actuarial assumptions used include (a) rate of return on investment of present and future assets of 8 percent a year compounded annually, (b) projected salary increases of 7 percent a year (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries) compounded annually, (c) projected 6 percent annual increase in the Social Security wage base, and (d) projected post-retirement benefit increases of 3 percent of the retiree's initial benefit.

Total assets in excess of pension benefit obligation applicable to agency employees was $263,976 at June 30, 1996, and $91,175 at June 30, 1995, as follows:

	June 30, 1996	June 30, 1995
Pension benefit obligation:		
Retirees and beneficiaries currently receiving benefits and terminated employees entitled to but not yet receiving benefits	$ 10,536	$ 5,093
Current employees:		
Accumulated employee contributions including allocated investment earnings	2,790	2,657
Employer-financed vested	238,132	195,407
Employer-financed nonvested	116,107	95,275
Total pension benefit obligation	$367,565	$298,432
Net assets available for benefits, at cost or amortized cost (market value is $688,996 at June 30, 1996, and $422,793 at June 30, 1995)	631,541	389,607
Assets in excess of pension benefit obligation	$263,976	$ 91,175

C. Actuarially Determined Contribution Requirements and Contributions Made

It is the policy of the Board of Trustees of TCRS to fund pension benefits by actuarially determined contributions which are intended to provide funding for both the normal cost and the unfunded actuarial accrued liability cost, so sufficient assets will be available to pay benefits when due. The frozen initial liability method, a projected-benefit cost method, is used to value the plan. All unfunded actuarial accrued liabilities are amortized over a 30-year period. The accrued liability for basic benefits and cost-of-living benefits is amortized as a level-dollar amount.

The significant actuarial assumptions used to compute the actuarially determined contribution requirement are the same as those used to compute the pension benefit obligation as described in B above.

The contribution to the TCRS for the year ended June 30, 1996, of $193,589 was made in accordance with actuarially determined requirements computed through an actuarial valuation performed as of June 30, 1993. The contribution consisted of (a) $165,199 in normal costs (6.75% of current covered payroll), (b) $24,229 in amortization of the unfunded actuarial accrued liability (.99% of current covered payroll), and (c) $4,161 in administrative costs (.17% of current covered payroll). The agency contributed $193,589 (7.91% of current covered payroll). The actuarial valuation as of June 30, 1993, computed contribution rates effective July 1, 1994, through June 30, 1996. The actuarial valuation as of June 30, 1995, determined the rates for a two-year period beginning July 1, 1996.

Actuarially required contributions for the year ended June 30, 1995, totaled $182,660 (7.91% of covered payroll). The contribution consisted of (a) $155,873 in normal costs (6.75% of current covered payroll), (b) $22,861 in amortization of the unfunded actuarial accrued liability (.99% of current covered payroll), and (c) $3,926 in administrative costs (.17% of current covered payroll).

D. Trend Information

Three-year historical trend information designed to give an indication of the progress made by the agency in accumulating sufficient assets to pay benefits when due is presented below for fiscal years 1996 and 1995. Information for fiscal year 1994 is not available.

Fiscal Year	(1) Net Assets Available For Benefits	(2) Pension Benefit Obligation	(3) Percentage Funded (1)÷(2)	(4) Assets in Excess of PBO (2)-(1)	(5) Annual Covered Payroll	(6) Assets in Excess of PBO as a Percentage of Covered Payroll (4)÷(5)
1996	$631,541	$367,565	171.82%	$(263,976)	$2,447,392	(10.79%)
1995	$389,607	$298,432	130.55%	$ (91,175)	$2,309,224	(3.95%)

Showing assets in excess of pension benefit obligation as a percentage of annual covered payroll approximately adjusts for the effects of inflation for analysis purposes. In addition, for the two years ended June 30, 1996, and 1995, the agency's contributions to the TCRS, made in accordance with actuarially determined requirements, were 7.91% of annual covered payroll. Information for fiscal year 1994 is not available. Ten-year historical trend information for the retirement system as a whole may be found in the *Tennessee Consolidated Retirement System Comprehensive Annual Financial Report* for the year ended June 30, 1996.

NOTE 9. DEFERRED COMPENSATION PLAN

The Memphis and Shelby County Community Services Agency offers its employees a deferred compensation plan in accordance with *Internal Revenue Code* Section 457. The plan, available to all agency employees, permits them to defer a portion of their salaries until future years. The deferred compensation is not available to employees until termination, retirement, death, or emergency.

Section 457 plan balances have been reported as an agency fund in the financial statements. All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights, are (until paid or made available to the employee or other beneficiary) solely the property and rights of the agency (without being restricted to the provisions of benefits under the plan), subject only to claims of the agency's general creditors. Participants' rights under the plan are equal to those of general creditors of the agency in an amount equal to the fair value of the deferred account for each participant. The agency has no liability for losses under the plan but does have the duty of due care that would be required of an ordinary prudent investor. The agency believes it is unlikely that it will use these assets to satisfy the claims of general creditors in the future.

NOTE 10. 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 $72,789.23 at June 30, 1996, and $69,915.72 at June 30, 1995.

NOTE 11. 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 Claims Award Fund, the State of Tennessee's risk pool for risks of loss related to general liability, automobile liability, professional malpractice, and workers' compensation.

   The Claims Award Fund is an internal service fund in which the state has set aside assets for claim settlement. This fund services all claims for risk of loss to which the state is exposed, including general liability, automobile liability, professional malpractice, and workers' compensation. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the participating agencies based on a percentage of each agency's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of each fiscal year-end to determine the fund liability and premium allocation.

C. The 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. To this fund, premiums of participating units are deposited 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 percent of the total premiums. The employees are responsible for the remaining 20 percent of the total premiums. Claims are administered by Blue Cross and Blue Shield of Tennessee, which is 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.

NOTE 12. RELATED-PARTY TRANSACTIONS

During the years ended June 30, 1996, and 1995, a member of the Memphis and Shelby County Community Health Agency's Board of Directors was employed by the Shelby County Government, a subcontractor of the agency.

APPENDIX

MEMPHIS AND SHELBY COUNTY COMMUNITY SERVICES AGENCY

Barbara Holden, Executive Director

BOARD OF DIRECTORS

<u>Board Officers</u>

Michael Cates, Chair
Butch Odom, Treasurer

<u>Other Members of the Board of Directors</u>

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Loretta Bobo-Mosley, MD
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Yvonne Madlock
Alnita McClure
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Ellen Sakornbut, MD
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Judge Kenneth Turner

<u>Executive Committee</u>

Michael Cates
Fred Davis
Peggy Edmiston
Yvonne Madlock
Butch Odom