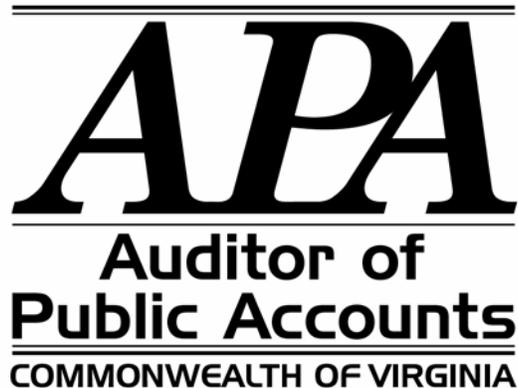


**DEPARTMENT OF MENTAL HEALTH,
MENTAL RETARDATION,
AND SUBSTANCE ABUSE SERVICES**

**REPORT ON AUDIT
FOR THE PERIOD
JULY 1, 2003 THROUGH DECEMBER 31, 2004**



AUDIT SUMMARY

Our audit of the Department of Mental Health, Mental Retardation, and Substance Abuse Services for the audit period July 1, 2003, through December 31, 2004, found:

- amounts reported in the Commonwealth Accounting and Reporting System and the Department's accounting records were fairly stated;
- no matters involving internal control and its operation that we consider material weaknesses; and
- no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

SUMMARY OF FINANCIAL POLICY ISSUES

Change Budgeting Process

Although the Department operates within its appropriation, expenses exceed revenues at most of the mental health facilities because there are limits on the amount of Medicaid and Medicare revenue they can generate since their patients, who are mentally ill, have a lower percentage of eligibility as compared to the patients serviced by mental retardation facilities.

Anticipating that the mental health facilities will not generate sufficient revenues to cover expenses, the Central Office monitors the revenues of each facility. When it is apparent that the mental retardation facility will generate sufficient revenues to cover expenses, the Central Office transfers the excess collections to cover the shortfall in the mental health facilities.

While this practice allows the Department to operate its facilities within its overall appropriation, this practice masks from policymakers the actual funding source of facility operations and further distorts the dependence that mental health facilities have on the mental retardation units generating a positive cash flow. This budgetary method may have long-term critical consequences as the federal government enacts changes to the Medicaid reimbursement policies. Additionally, this practice also tends to show a more even distribution of General Fund appropriations among all facilities, when in reality the transfer of special fund revenue indicates that the mental retardation units could operate more independently and the mental health facilities should receive this shift in General fund appropriations.

Dependence on Medicaid Reimbursements

Constraints on Medicaid growth both at the federal and state level will have a direct effect on the Department's funding model or operations. As a result, the Department will need to address its long-term funding model or operations. Restriction on Medicaid billing growth without additional funding from other sources will lead the Department to either having to reduce or eliminate services.

Sharing Pharmacy Costs

The Department through Hiram Davis Medical Center provides prescriptions to clients of the CSBs. However, while the CSBs should help Hiram Davis attempt to bill and recover some of these costs, the current process does not facilitate the recovery of these costs.

- TABLE OF CONTENTS -

AUDIT SUMMARY

AGENCY HIGHLIGHTS

Health Insurance Portability and Accountability Act

Central Office

Community Service Boards

Facilities

Comparison of Facility Operations

Special Revenue Comparison

Facility Buildings and Square Feet

FINANCIAL POLICY ISSUES

INDEPENDENT AUDITOR'S REPORT

AGENCY RESPONSE

AGENCY OFFICIALS

AGENCY HIGHLIGHTS

The Department of Mental Health, Mental Retardation, and Substance Abuse Services (the Department) provides a wide array of services to individuals in state-operated facilities and communities throughout the Commonwealth. The Department has a central office that performs most of its administrative functions and sixteen facilities that provide direct services to the Department's consumers. In addition, the Department partially funds and monitors the activities of forty local Community Service Boards (CSBs).

Health Insurance Portability and Accountability Act

The Health Insurance Portability and Accountability Act (HIPAA) provides standards for the billing and payment of health claims, medical information, and federal protection for health information. This set of federal regulations creates standards for the preparation and communication of health information and controls the privacy of patient information. HIPAA encompasses system security, privacy, and electronic transaction requirements. Each set of requirements has a different compliance deadline. The Department is currently compliant with the Privacy Rule and the Electronic Transaction Standard. The deadline for complying with the Final Security Rule was April 21, 2005. The Department is not currently compliant with the Security Rule and is working on finalizing policies and procedures which will bring them to full compliance. Their goal is to be fully compliant with the Security Rule by June 30, 2005.

Central Office

The central office has direct responsibility for the programmatic, financial, and administrative operations of the state facilities that it operates. The central office also has responsibility for monitoring and overseeing the programmatic and financial activities of the CSBs. In fiscal 2004, the central office spent \$34 million (4.6 percent) of the Department's total expenses.

The central office provides a variety of services to the facilities including:

- providing overall management and direction,
- developing overall budgets,
- developing all financial management policies,
- developing interim per diem rates
- approving and submitting annual Medicare and Medicaid cost reports,
- providing internal audit services,
- performing all architectural and engineering services,
- budgeting and administering the majority of capital outlay projects,
- investigating human rights violations and oversees human rights regulations,
- licensing all public and private providers of mental health, mental retardation, and substance abuse services across the entire state,
- providing technical assistance and guidance on Human Resource issues, and
- working with facilities regarding an array of information systems.

In addition, the central office is responsible for billing and collection of third party reimbursements, such as Medicaid and Medicare. The central office performs this function through field reimbursement offices located at various facilities. During fiscal 2004, the central office implemented a new billing system, AVATAR, to comply with the HIPAA and Department of Medical Assistance Services requirements. Due to system implementation issues, the electronic claims processing was not fully available until April 2005. A majority of the reimbursement offices delayed their billings until they could process their claims electronically, while other offices manually billed their claims. The backlog of bills, as well as an increase in the billing rate of 8 percent, caused the 17 percent increase in receivables from June 30, 2004, to December 31, 2004 as reflected in the table below.

Table 1

| <u>Department's Total Gross Receivables by Aging Category</u> | | | |
|---|----------------------|----------------------|--------------------------|
| <u>Aging of Total Gross Receivables</u> | <u>June 30, 2003</u> | <u>June 30, 2004</u> | <u>December 31, 2004</u> |
| Not past due | \$ 26,455,214 | \$ 26,871,716 | \$ 22,944,038 |
| 1-30 days | 22,799,677 | 5,754,060 | 9,791,564 |
| 31-60 days | 2,009,691 | 2,574,834 | 5,011,427 |
| 61-90 days | 1,313,375 | 2,345,386 | 4,348,517 |
| 91-120 days | 613,007 | 3,714,333 | 4,743,226 |
| 121-180 days | 1,021,323 | 5,222,931 | 5,343,294 |
| 180 days-1 year | - | 1,269,022 | 3,550,372 |
| Over 1 year | <u>2,109,714</u> | <u>48,943</u> | <u>-</u> |
| Totals | <u>\$ 56,322,001</u> | <u>\$ 47,801,225</u> | <u>\$ 55,732,438</u> |

Community Service Boards

CSBs are the single point of entry into the Commonwealth's Mental Health, Mental Retardation, and Substance Abuse Services system, including access to state mental health and mental retardation facility services. CSBs provide preadmission screening and discharge planning services for consumers entering or leaving state facilities. Individuals who seek publicly funded services from a CSB receive an intake evaluation to determine the type and duration of services needed.

CSBs function as providers of services (directly or contractually), advisors to their local government, client advocates, community educators, and planners on issues related to mental health, mental retardation, and substance abuse. In comparison to hospitalization, CSBs provide more individualized, flexible, and integrated services. CSBs draw upon community resources and support systems, such as family and friends.

Core CSB services include the following.

- Emergency services;
- Local inpatient services;
- Outpatient services;
- Case management services;
- Day support services;
- Residential services; and
- Prevention and early intervention services

In fiscal 2004, the Department transferred \$231 million (30 percent) of the Department's total budget to the CSBs. Transfers to CSB's do not include the cost of certain drugs which are included in expenses for Hiram Davis Medical Center. In fiscal 2004, Hiram Davis has \$25 million in drug purchases for the CSBs.

Hiram Davis only bills the CSBs for pharmacy costs if a client meets one of the following three criteria: 1) the prescription is not for an atypical anti-psychotic drug, 2) the client has never been a client in a Commonwealth mental health or mental retardation facility, or 3) the client is not Medicaid eligible. Atypical anti-psychotic drugs represent 72 percent of the total drugs provided by Hiram Davis. These new generation drugs tend to be more costly than other drugs. If the client is Medicaid eligible, the Medical Center is responsible for initiating Medicaid billing; however, it is the CSBs responsibility to provide the necessary information, which Medicaid requires, to Hiram Davis. By not requiring reimbursement for certain prescriptions, the CSBs do not have an incentive to control drug costs for those clients.

Facilities

There are a total of sixteen facilities in the Commonwealth that provide inpatient consumer care to over 3,000 individuals. Ten mental health facilities, referred to as "hospitals," provide acute care and chronic psychiatric services to children, adults, and the elderly. There are also five mental retardation facilities referred to as "training centers" that offer residential care and training in areas such as language, self-care, independent living, academic skills, and motor development. In addition, there is one medical center that cares for patients that have severe physical and mental illnesses. The medical center also operates a pharmacy that serves the patients on the Petersburg complex, as well as the clients under the care of the CSBs.

In fiscal 2004, the Department opened a new mental health facility, Virginia Center for Behavioral Rehabilitation at the Petersburg complex. As of April 2005, this facility housed 14 residents in the Commonwealth's Sexual Offender Program. These individuals have completed their sentences in a Correctional facility and are now civilly-committed in this facility.

The table below summarizes the individual facilities' revenues, expenses, and population for fiscal 2004.

COMPARISON OF FACILITY OPERATIONS
Mental Retardation Facilities

| | Central Virginia Training Center | Southeastern Virginia Training Center | Northern Virginia Training Center |
|--|-------------------------------------|---|---|
| Average resident census | 590 | 194 | 185 |
| Total resident days | 215,803 | 70,926 | 67,637 |
| Revenue: | | | |
| Adjusted General Fund appropriation | \$ 6,139,342 | \$ 3,592,948 | \$ 3,567,203 |
| Collections (third party reimbursements) | 67,320,757 | 23,645,516 | 31,011,663 |
| Other revenues | 4,715 | 197 | 35 |
| Total revenue | 73,464,814 | 27,238,661 | 34,578,901 |
| Expenses: | | | |
| Personal services | 59,385,755 | 16,926,154 | 24,127,446 |
| Contractual services | 1,681,674 | 986,195 | 1,328,159 |
| Supplies and materials | 7,140,802 | 1,150,280 | 2,312,619 |
| Transfer payments | - | 32,174 | 18,157 |
| Insurance, rentals, and utilities | 2,733,463 | 516,000 | 723,563 |
| Property, plant, and equipment | 118,353 | 264,541 | 216,449 |
| Total expenses | 70,941,694 | 19,875,344 | 28,726,393 |
| Excess (deficiency) of revenue over expenses | 2,523,120 | 7,363,317 | 5,852,508 |
| Special Revenue Transfers In (Out) | (3,685,000) | (6,800,000) | (5,779,626) |
| Excess (deficiency) of funds available over expenses | \$ (1,161,880) | \$ 563,317 | \$ 72,882 |
| Expenses per resident | \$ 120,240 | \$ 102,450 | \$ 155,278 |
| Expenses per resident day | \$ 329 | \$ 280 | \$ 425 |
| Revenues per resident | \$ 124,517 | \$ 140,405 | \$ 186,913 |
| Revenues per resident day | \$ 340 | \$ 384 | \$ 511 |

Source: CARS and Monthly Financial Report

| Southside Virginia Training Center | Southwestern Virginia Training Center | Total for Mental Retardation Training Centers |
|--|---|---|
| 384 | 216 | 1,569 |
| 140,656 | 78,911 | 573,933 |
| \$ 11,988,425 | \$ 1,674,240 | \$ 26,962,158 |
| 50,768,083 | 20,033,729 | 192,779,748 |
| 3,654 | 150 | 8,750 |
| 62,760,161 | 21,708,119 | 219,750,656 |
| 49,814,647 | 16,128,305 | 166,382,307 |
| 3,256,875 | 414,341 | 7,667,244 |
| 4,774,961 | 791,169 | 16,169,831 |
| 24,290 | 105,436 | 180,057 |
| 1,897,696 | 811,472 | 6,682,194 |
| 2,260,282 | 99,996 | 2,959,621 |
| 62,028,751 | 18,350,719 | 199,922,901 |
| 731,410 | 3,357,400 | 19,827,755 |
| (690,000) | (3,275,000) | (20,229,626) |
| \$ 41,410 | \$ 82,400 | \$ (401,871) |
| \$ 161,533 | \$ 84,957 | \$ 127,421 |
| \$ 441 | \$ 233 | \$ 348 |
| \$ 163,438 | \$ 100,501 | \$ 140,058 |
| \$ 446 | \$ 275 | \$ 383 |

COMPARISON OF FACILITY OPERATIONS

Mental Health Facilities

| | Eastern State Hospital | Central State Hospital | Western State Hospital |
|--|---------------------------|---------------------------|---------------------------|
| Average resident census | 443 | 245 | 235 |
| Total resident days | 162,045 | 89,525 | 86,155 |
| Revenue: | | | |
| Adjusted General Fund appropriations | \$ 43,620,973 | \$ 36,943,648 | \$ 36,732,444 |
| Collections (third party reimbursements) | 23,557,178 | 222,486 | 2,784,593 |
| Other revenues | 19,916 | 28,920 | 104,124 |
| Total revenue | 67,198,068 | 37,195,054 | 39,621,161 |
| Expenses: | | | |
| Personal services | 51,994,372 | 35,746,883 | 35,490,086 |
| Contractual services | 2,477,942 | 4,266,912 | 2,094,734 |
| Supplies and materials | 6,849,957 | 584,414 | 4,056,282 |
| Transfer payments | 53,752 | 95,253 | 21,028 |
| Insurance, rentals, and utilities | 2,404,426 | 1,105,743 | 2,116,125 |
| Property, plant, and equipment | 430,620 | 649,811 | 381,658 |
| Total expenses | 64,211,069 | 42,449,016 | 44,159,913 |
| Excess (deficiency) of revenues over expenses | 2,986,999 | (5,253,962) | (4,538,752) |
| Special Revenue Transfers In (Out) | (2,850,000) | 5,231,000 | 4,500,000 |
| Excess (deficiency) of funds available over expenses | \$ 136,999 | \$ (22,962) | \$ (38,752) |
| Expenses per resident | \$ 144,946 | \$ 173,261 | \$ 187,915 |
| Expenses per resident day | \$ 396 | \$ 474 | \$ 513 |
| Revenues per resident | \$ 151,689 | \$ 151,817 | \$ 168,601 |
| Revenues per resident day | \$ 415 | \$ 415 | \$ 460 |

Source: CARS and Monthly Financial Report

** Supplies and materials costs include the cost of pharmaceuticals provided to the CSBs net the collections from CSBs and Medicaid.

| Commonwealth Center for Children | Southwestern Virginia Mental Health Institute | Northern Virginia Mental Health Institute | Southern Virginia Mental Health Institute | Catawba Hospital | Piedmont Geriatric Hospital |
|--|---|---|---|---------------------|-----------------------------------|
| 34 | 147 | 121 | 76 | 97 | 122 |
| 12,463 | 53,941 | 44,447 | 27,368 | 35,399 | 44,652 |
| \$ 5,649,885 | \$ 17,433,996 | \$ 22,216,195 | \$ 8,123,351 | \$ 5,318,880 | \$ 2,767,492 |
| 1,188,305 | 6,020,812 | 872,422 | 982,503 | 10,753,937 | 17,848,974 |
| 1,255 | 5,114 | 3,223 | 37 | 31,939 | 893 |
| 6,839,445 | 23,459,922 | 23,091,840 | 9,105,890 | 16,104,756 | 20,617,359 |
| 6,360,074 | 22,421,272 | 18,217,216 | 8,025,836 | 13,874,679 | 14,123,674 |
| 385,067 | 1,911,151 | 3,442,172 | 778,121 | 1,316,493 | 1,166,176 |
| 424,074 | 3,014,037 | 1,927,088 | 919,245 | 1,474,423 | 1,843,294 |
| 1,244 | 9,956 | 24,583 | 9,866 | 13,223 | 24,009 |
| 300,665 | 526,454 | 754,658 | 291,046 | 625,244 | 439,314 |
| 148,116 | 209,869 | 94,522 | 49,615 | 140,190 | 339,252 |
| 7,619,240 | 28,092,739 | 24,460,239 | 10,073,729 | 17,444,252 | 17,935,719 |
| (779,795) | (4,632,817) | (1,368,399) | (967,839) | (1,339,496) | 2,681,640 |
| 825,000 | 4,650,000 | 1,410,000 | 1,025,000 | 1,575,000 | (2,705,000) |
| \$ 45,205 | \$ 17,183 | \$ 41,601 | \$ 57,161 | \$ 235,504 | \$ (23,360) |
| \$ 224,095 | \$ 191,107 | \$ 202,151 | \$ 132,549 | \$ 179,838 | \$ 147,014 |
| \$ 611 | \$ 521 | \$ 550 | \$ 368 | \$ 493 | \$ 402 |
| \$ 201,160 | \$ 159,591 | \$ 190,842 | \$ 119,814 | \$ 166,028 | \$ 168,995 |
| \$ 549 | \$ 435 | \$ 520 | \$ 333 | \$ 455 | \$ 462 |

COMPARISON OF FACILITY OPERATIONS

Mental Health Facilities

| | Hiram Davis Medical Center ** | Virginia Center for Behavioral Rehabilitation | Total for Mental Health Facilities |
|--|-------------------------------------|---|--|
| Average resident census | 69 | 4 | 1,593 |
| Total resident days | 25,335 | 789 | 582,119 |
| Revenue: | | | |
| Adjusted General Fund appropriations | \$ 22,700,585 | \$ 2,731,438 | 204,238,887 |
| Collections (third party reimbursements) | 9,672,943 | | 73,904,152 |
| Other revenues | 4,767 | | 200,188 |
| Total revenue | 32,378,294 | 2,731,438 | 278,343,226 |
| Expenses: | | | |
| Personal services | 8,708,708 | 1,868,484 | 216,831,284 |
| Contractual services | 2,299,984 | 495,603 | 20,634,355 |
| Supplies and materials | 23,109,703 | 68,723 | 44,271,240 |
| Transfer payments | 460 | | 253,374 |
| Insurance, rentals, and utilities | 103,902 | 83,852 | 8,751,429 |
| Property, plant, and equipment | 99,294 | 214,774 | 2,757,721 |
| Total expenses | 34,322,051 | 2,731,436 | 293,499,403 |
| Excess (deficiency) of revenues over expenses | (1,943,757) | 2 | (15,156,177) |
| Special Revenue Transfers In (Out) | 2,194,000 | - | 15,855,000 |
| Excess (deficiency) of funds available over expenses | \$ 250,243 | \$ 2 | 698,823 |
| Expenses per resident | \$ 497,421 | \$ 682,859 | \$ 184,243 |
| Expenses per resident day | \$ 1,355 | \$ 3,462 | \$ 504 |
| Revenues per resident | \$ 469,251 | \$ 682,860 | \$ 174,729 |
| Revenues per resident day | \$ 1,278 | \$ 3,462 | \$ 478 |

Table 2 shows that per diem expenses range from \$233 to \$1,355 with an average per diem of \$493 for all facilities. Hiram Davis Medical Center accounts for the highest per diem cost due to the severe nature of its patient census and the pharmacy services that it provides to clients outside of its facility.

Overall, personal services account for the facilities' largest expense. In fiscal 2004, the facilities spent over \$381 million, or 78 percent of their total expenses, on personal services. The facilities largest source of revenue is collections from third party payers, primarily Medicaid. In fiscal 2004, these collections accounted for 54 percent of the facilities' total available resources, or roughly \$267 million.

Although the Department operates within its appropriation, expenses exceed revenues at most of the mental health facilities because there are limits on the amount of Medicaid and Medicare revenue they can generate since their patients, who are mentally ill, have a lower percentage of eligibility as compared to the patients serviced by mental retardation facilities. Medicaid and Medicare fees collected are special revenue and appropriated by facility. However, the central office can transfer the appropriations and accompanying special revenues among the individual facilities to cover those facilities where expenses exceed revenues.

Since each facility receives both a General and Special Revenue Fund appropriation and anticipating that the mental health facilities will not generate sufficient revenues to cover expenses, the Central Office monitors the income and revenues of each facility. When it is apparent that the mental retardation facility will generate sufficient revenues to cover expenses, the Central Office transfers the excess collections to cover the shortfall in the mental health facilities.

While this practice allows the Department to operate its facilities within its overall appropriation, this practice masks from policymakers the actual funding source of facility operations and further distorts the dependence that mental health facilities have on the mental retardation units generating a positive cash flow. This budgetary method may have long-term critical consequences as the federal government enacts changes to the Medicaid reimbursement policies. Additionally, this practice also tends to show a more even distribution of General Fund appropriations among all facilities, when in reality the transfer of special fund revenue indicates that the mental retardation units could operate more independently and the mental health facilities should receive this shift in General fund appropriations.

Table 3

Fiscal 2004 Special Revenue Comparison

| | <u>Appropriation</u> | <u>Adjusted Budget</u> | <u>Revenues Collected</u> | <u>Transfers In (Out)</u> | <u>Expenses</u> |
|---------------------------------------|----------------------|------------------------|---------------------------|---------------------------|-----------------|
| Mental health facilities: | | | | | |
| Catawba | \$12,964,818 | \$12,124,839 | \$ 10,754,243 | \$ 1,575,000 | \$ 12,124,467 |
| Central State | 6,310,336 | 5,518,412 | 222,486 | 5,231,000 | 5,518,412 |
| Commonwealth Center | 1,987,172 | 1,868,477 | 1,188,305 | 825,000 | 1,868,477 |
| Eastern State | 21,126,541 | 20,547,271 | 23,568,787 | (2,850,000) | 20,547,248 |
| Hiram Davis | 8,837,302 | 11,621,719 | 9,672,943 | 2,194,000 | 11,621,681 |
| Northern Virginia | 1,728,847 | 2,240,790 | 875,535 | 1,410,000 | 2,244,080 |
| Piedmont | 15,729,420 | 15,173,930 | 17,849,589 | (2,705,000) | 15,168,227 |
| Southern Virginia | 1,781,323 | 1,943,140 | 982,539 | 1,025,000 | 1,943,140 |
| Southwestern Virginia | 10,242,866 | 10,670,593 | 6,023,636 | 4,650,000 | 10,670,584 |
| Western State | 7,275,539 | 7,326,958 | 2,885,333 | 4,500,000 | 7,426,958 |
| Mental retardation facilities: | | | | | |
| Central Virginia | 65,241,034 | 65,345,598 | 67,321,299 | (3,685,000) | 65,316,169 |
| Northern Virginia | 25,217,076 | 25,153,249 | 31,011,663 | (5,779,626) | 25,153,249 |
| Southside Virginia | 50,775,919 | 50,039,392 | 50,771,736 | (690,000) | 50,039,106 |
| Southeastern Virginia | 16,314,758 | 16,260,483 | 23,645,713 | (6,800,000) | 16,261,043 |
| Southwestern Virginia | 16,071,071 | 16,660,614 | 20,033,879 | (3,275,000) | 16,660,978 |

Source: Commonwealth Accounting and Reporting System and Client Prepared Monthly Financial Report

In total, the facilities own 408 buildings for a total of 6,563,400 square feet. However, due to the condition of a number of the buildings, the facilities only occupy 358 buildings or 5,686,000 square feet. The majority of the unoccupied buildings are either inhabitable, require extensive renovation, or are simply not suited for the facilities current patient and resident needs. The table below summarizes buildings and square feet by facility.

Table 4

| Facility Buildings and Square Feet | | | | | | | | |
|--|---------------------|------------------|----------------------------|------------------------|----------------------|----------------|-------------------------|------------------|
| Facility | Number of Buildings | Square Feet | Number of Vacant Buildings | Unoccupied Square Feet | Occupied Square Feet | Patient Census | Square Feet Per Patient | Percent Occupied |
| Central State Southside Virginia Training Center | 19 | 680,800 | 6 | 170,800 | 510,000 | 245 | 2,082 | 75 |
| Hiram Davis Medical Center | 68 | 613,800 | 6 | 47,000 | 566,800 | 384 | 1,476 | 92 |
| Eastern State Hospital | 1 | 726,300 | - | - | 726,300 | 69 | 10,526 | 100 |
| Southwestern Virginia Mental Health Institute | 29 | 816,800 | 5 | 200,500 | 616,300 | 443 | 1,391 | 75 |
| Western State Hospital | 35 | 411,400 | 3 | 52,400 | 359,000 | 147 | 2,442 | 87 |
| Central Virginia Training Center | 24 | 708,700 | 5 | 175,600 | 533,100 | 235 | 2,269 | 75 |
| Commonwealth Center | 97 | 1,253,100 | 15 | 177,800 | 1,075,300 | 590 | 1,823 | 86 |
| Southeastern Virginia Training Center | 1 | 56,000 | - | - | 56,000 | 34 | 1,647 | 100 |
| Catawba | 31 | 178,500 | - | - | 178,500 | 194 | 920 | 100 |
| Northern Virginia Training Center | 28 | 278,200 | 4 | 26,000 | 252,200 | 97 | 2,600 | 91 |
| Northern Virginia Mental Health Institute | 11 | 227,900 | - | - | 227,900 | 185 | 1,232 | 100 |
| Piedmont Geriatric Hospital | 4 | 108,300 | - | - | 108,300 | 121 | 895 | 100 |
| Southwestern Virginia Training Center | 34 | 256,200 | 6 | 27,300 | 228,900 | 122 | 1,876 | 89 |
| Southern Virginia Mental Health Institute | 22 | 176,000 | - | - | 176,000 | 216 | 815 | 100 |
| | 4 | 71,400 | - | - | 71,400 | 75 | 952 | 100 |
| Total | 408 | 6,563,400 | 50 | 877,400 | 5,686,000 | 3,157 | 32,945 | 87 |

FINANCIAL POLICY ISSUES

Change Budgeting Process

Although the Department operates within its appropriation, expenses exceed revenues at most of the mental health facilities because there are limits on the amount of Medicaid and Medicare revenue they can generate since their patients, who are mentally ill, have a lower percentage of eligibility as compared to the patients serviced by mental retardation facilities. Medicaid and Medicare fees collected are special revenue and appropriated by facility. However, the central office can transfer the appropriations and accompanying special revenues among the individual facilities to cover those facilities where expenses exceed revenues.

Since each facility receives both a General and Special Revenue Fund appropriation and anticipating that the mental health facilities will not generate sufficient revenues to cover expense, the Central Office monitors the income and revenues of each facility. When it is apparent that the mental retardation facility will generate sufficient revenues to cover expenses, the Central Office transfers the excess collections to cover the shortfall in the mental health facilities.

While this practice allows the Department to operate its facilities within its overall appropriation, this practice masks from policymakers the actual fund source of facility operations and further distorts the dependence that mental health facilities have on the mental retardation units generating a positive cash flow. This budgetary method may have long-term critical consequences as the federal government enacts changes to the Medicaid reimbursement policies. Additionally, this practice also tends to show a more even distribution of General Fund appropriations among all facilities, when in reality the transfer of special fund revenue indicates that the mental retardation units could operate more independently and the mental health facilities should receive this shift in General fund appropriations.

Dependence on Medicaid Reimbursements

The Department's facility operations are heavily dependent on the timing and extent of its Medicaid billing and cost settlements. Delays in receiving payments at year end already require the Department to have a Treasury Loan and errors such as the one discussed above create the need for an increase in this loan. The dependence also forces the Department to delay and control vendor and other payments at year end to prevent the further deterioration of its cash position.

Constraints on Medicaid growth both at the federal and state level will have a direct effect on the Department's funding model or operations. Currently, the training facilities are generating sufficient revenue to cover their operations and provide the hospital operations with needed resources from the General Fund, and maintenance of overall cash flow. The Governor, the Department, and the Secretary of Health and Human Resources with the General Assembly will need to address the Department's long-term funding model or operations. Restriction on Medicaid billing growth without additional funding from other sources will lead the Department to either having to reduce or eliminate services or undergo further staffing reductions, which will also result in reduced or eliminated services.

Sharing Pharmacy Costs

As discussed earlier in the report, the Department through Hiram Davis Medical Center provides prescriptions to clients of the CSBs. However, while the CSBs should help Hiram Davis attempt to bill and recover some of these costs, the current process does not facilitate the recovery of these costs. Drugs and related supplies constitutes one of the Department's fastest growing costs. While operationally the Hiram Davis pharmacy is controlling its costs, the loss of this revenue results in the Department having to take funding from other programs to support this activity. As opposed to reducing the funding in other programs, the Department may experience the dilemma of not having sufficient funds to provide prescriptions to CSB clients without receiving payment in advance to cover their prescription costs. Under this alternative, the

CSB client would suffer for the failure of the CSB staff not providing the Medicaid eligibility information. With the rising cost of drugs, the Department and the CSB staff need to find a way to resolve this issue without the client not receiving service.

Calculation of Interim Per Diem Rates

The Department typically receives Treasury Loans annually to meet temporary working capital needs created by a timing difference between the Medicaid billings and the actual costs spent to serve Medicaid clients. The fiscal 2005 loan amount exceeded the prior loan because the formula used to set fiscal 2004's Medicaid Interim Per Diem Rates did not include \$10.9 million in a central appropriation that the Department later allocated to individual facilities to authorize spending. The central appropriation would have authorized the cost of the 2.25 percent pay increase that state employees received in December 2003. The exclusion of this authorized spending from the calculation of the interim per diem resulted in the Department under-billing Medicaid.

Management expects that before the end of fiscal 2005 the Department will repay this loan through the Medicaid Cost Settlement process. The Department continues the use of central appropriations to authorize additional spending. Furthermore, the Department did not include its central appropriations when developing its fiscal 2005's Medicaid Interim Per Diem Rates that it is currently using for Medicaid billings to support operations.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

May 20, 2005

The Honorable Mark R. Warner
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE

We have audited selected financial records and operations of the **Department of Mental Health, Mental Retardation, and Substance Abuse Services** (the Department) for the period July 1, 2003, through December 31, 2004. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objectives, Scope, and Methodology

Our audit's primary objective were to evaluate the accuracy of the Department's recording of financial transactions in the Commonwealth Accounting and Reporting System and the Department's accounting records, review the adequacy of the Department's internal control, and test for compliance with applicable laws and regulations.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the Department's operations. We also tested transactions and performed such other auditing procedures as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

Accounts receivable
Institutional revenue
Individual and family services expenses

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether the Department's controls were adequate, had been placed in operation, and were being followed.

Management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

Our audit was more limited than would be necessary to provide assurance on internal control or to provide an opinion on overall compliance with laws and regulations. Because of inherent limitations in internal control, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of internal control to future periods is subject to the risk that the controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

Audit Conclusions

We found that the Department properly stated, in all material respects, the selected financial records in the Commonwealth Accounting and Reporting System and in the Department's accounting records listed in the scope section of this report.

We noted no matters of internal control and its operation that we consider to be material weaknesses. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of the specific internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to financial operations may occur and not be detected promptly by employees in the normal course of performing their duties.

The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

This report is intended for the information and use of the Governor and General Assembly, management, and citizens of the Commonwealth of Virginia and is a public record.

EXIT CONFERENCE

We discussed this letter with management at an exit conference held on May 25, 2005.

AUDITOR OF PUBLIC ACCOUNTS



COMMONWEALTH of VIRGINIA

DEPARTMENT OF

MENTAL HEALTH, MENTAL RETARDATION AND SUBSTANCE ABUSE SERVICES

Post Office Box 1797

Richmond, Virginia 23218-1797

JAMES S. REINHARD, M.D.
COMMISSIONER

Telephone (804) 786-3921
Voice/TDD (804) 371-8977
www.dmhmsas.state.va.us

June 1, 2005

Auditor of Public Accounts
P. O. Box 1295
Richmond, Virginia 23219

Dear Sir:

Presented below are the responses of the Department of Mental Health, Mental Retardation and Substance Abuse Services to the APA audit covering the period beginning July 1, 2003 and ending December 31, 2004.

Change Budgeting Process

The Department continues to refine budgetary processes in order to meet the needs of management and the general public. The Department will continue to attempt to align the Special Revenue Fund appropriation with the reimbursement potential of each facility, however, we continue to view the facility budget process from a system wide perspective as opposed to a facility by facility view. This allows for needed flexibility in the management of our financial resources.

Dependence on Medicaid

Approximately 43% of facility operations are funded by Medicaid reimbursements. The Department will continue to bill the Department of Medical Assistance Services (DMAS) for services provided to those who are eligible for Medicaid. While it is true that changes in the Medicaid program at the national and state level will have an impact on our facility operations, such changes are outside of our control. Any reduction in Medicaid reimbursement to the system of facilities would require program adjustment and/or additional General Fund appropriation.

Auditor of Public Accounts
Page 2
June 1, 2005

Sharing Pharmacy Costs

The Department is in the process of revamping its pharmacy procedures, particularly with respect to the Aftercare pharmacy at Hiram Davis Medical Center. The Office of Health and Quality Care, the Office of Reimbursement and the Office of Internal Audit have been reviewing pharmacy operations for the last several months and have recommended a number of changes. The Department also has a pharmacy and therapeutic committee working on these issues. Their recommendations will be included. These changes in operations will be made in the near future.

Calculation of Per Diem Charge Rates

The Department will continue to include all applicable elements of cost related to the calculation of per diem rates. Cost settlements, however, will continue to be a part of the management of the Special Revenue Fund.

Sincerely,


Joy Yeh, Ph.D., CPA
Assistant Commissioner
Finance and Administration

JY/bm

cc: James S. Reinhard, M.D., Commissioner
Ray Ratke, Deputy Commissioner

DEPARTMENT OF MENTAL HEALTH, MENTAL RETARDATION,
AND SUBSTANCE ABUSE SERVICES

Richmond, Virginia

James Reinhard, M.D., Commissioner

BOARD MEMBERS

B. Hunt Gunter, Acting Chairman

Linda Bartlett
Victoria Cochran
Virginia Dofflemyer
Ruth Jarvis

Elaine McConnell
Garnett Robinson
David B. Trinkle, M.D.
Daniel Karner