

Commonwealth of Virginia

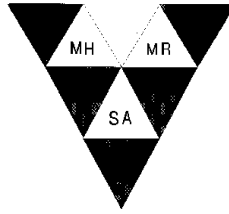
Department of Mental Health, Mental Retardation and
Substance Abuse Services

Annual Financial Report Fiscal Year 2006



James S. Reinhard, M.D.
Commissioner

Written and Published by the
Division of Finance and Administration
Office of Budget and Financial Reporting



TRANSMITTAL LETTER

TO USERS AND READERS OF OUR FINANCIAL STATEMENTS

We are pleased to provide the Annual Financial Report for the Virginia Department of Mental Health, Mental Retardation and Substance Abuse Services (the "Department") for the fiscal year ended June 30, 2006. This report contains informative financial and statistical data about the Department, which includes the Central Office, sixteen (16) state operated facilities, and funding for forty (40) community services boards. This report is also available on the Department's web page @ www.dmhmrzas.virginia.gov.

Since 1987, the Department has produced annual financial statements in accordance with generally accepted accounting principles (GAAP). The financial statements for the fiscal year ended June 30, 2006 are presented in accordance with the enterprise fund model as required by Governmental Accounting Standards Board (GASB) Statement Number 34, "***Basic Financial Statements – and Management Discussion and Analysis – for State and Local Governments***". The use of GAAP requires use of estimates and accruals to match revenues in the period earned and expenses in the period incurred. Readers should note that this report has not been prepared on the budgetary basis of accounting, a cash basis of accounting. Under the cash basis of accounting, revenues and expenditures are recorded at the time cash is actually received or disbursed according to the provisions of the Appropriation Act. This Annual Financial Report represents the Department's commitment to the accurate financial reporting of its activities.

Joy Yeh, CPA, Ph.D.
Assistant Commissioner
Finance and Administration
Dec 22, 2006

James S. Reinhard, M.D.
Commissioner

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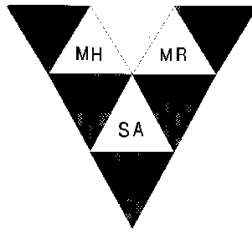
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DMHMRSAS' MISSION STATEMENT:

“We provide leadership and service to improve Virginia’s system of quality treatment, habilitation, and prevention services for individuals and their families whose lives are affected by mental illness, mental retardation, or substance use disorders. We seek to promote dignity, choice, recovery, and the highest possible level of participation in work, relationships, and all aspects of community life for these individuals.”

DMHMRSAS' VISION STATEMENT:

***ENVISION THE POSSIBILITIES
SELF-DETERMINATION
EMPOWERMENT
AND RECOVERY***

“Our vision is of a consumer-driven system of services and supports that promotes self-determination, empowerment, recovery, resilience, health and the highest possible level of consumer participation in all aspects of community life including work, school, family and other meaningful relationships.”

- *Self-determination, Empowerment & Recovery*
- *Quality of Services and Access to Services*
- *Partnerships & Coordination*
- *Accountability, Funding & Efficient Use of Resources*

Timothy M. Kaine

Governor, Commonwealth of Virginia

Marilyn B. Tavenner

Secretary of Health and Human Resources

James S. Reinhard, M.D.

Commissioner

STATE BOARD MEMBERS (June 2006)

Ruth G. Jarvis
Norfolk, Virginia:

B. Hunt Gunter
Richmond, Virginia:

David B. Trinkle
Roanoke, Virginia

Cheryl Ivey Green
Richmond, Virginia:

Linda S. Bartlett
Farnham, Virginia:

Kathryn A. Smith
Martinsville, Virginia:

Victoria Huber Cochran *
Blacksburg, Virginia:

Jewel Booker **
Richmond, Virginia:

Catherine M. Hudgins
Reston, Virginia:

Daniel E. Karnes
Roanoke, Virginia:

* Chair
** Board Secretary

SENIOR MANAGEMENT TEAM

Raymond R. Ratke
Deputy Commissioner

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

Frank L. Tetrick, III
Assistant Commissioner,
Community Services

Gerald E. Deans
Assistant Commissioner,
Facility Operations

James L. Evans, M.D.
Medical Director,
Health and Quality Care

Charline A. Davidson
Director, Planning and
Development

Martha J. Mead
Director, Legislation and
Public Relations

OFFICE DIRECTORS

Neila L. Gunter
Director, Human
Resources

Sanford Hostetter
Director, Information
Technology

Tony Gintout, CPA
Director, Internal
Audit

James Martinez
Director,
Mental Health Services

Lee Price
Director,
Mental Retardation Services

Ken Batten
Director,
Substance Abuse Services

Paul Gilding
Director,
Community Contracting

Rosemarie Bonacum
Director,
Facility Operations

Margaret Walsh
Director,
Human Rights

Shirley Ricks
Director, Child & Family Services

Management's Discussion and Analysis

MANAGEMENT'S DISCUSSION AND ANALYSIS

(unaudited)

For the Fiscal Year Ending June 30, 2006

This section of the annual financial report of the Department of Mental Health, Mental Retardation and Substance Abuse Services (the Department) represents our discussion and analysis of the Department's financial performance during the fiscal year ended June 30, 2006. Please read and review this information in conjunction with the Department's transmittal letter at the front of this report and the Department's financial statements and note disclosures.

OVERVIEW OF FINANCIAL STATEMENTS:

The basic financial statements of the Virginia Department of Mental Health, Mental Retardation and Substance Abuse Services (the Department) are presented in a proprietary fund format in accordance with the principles of an enterprise fund. Enterprise funds may be used to report any activity for which a fee is charged to external users for goods or services. There are numerous sections of the Code of Virginia that require the Department to maximize efforts to recover the costs of services rendered at our sixteen inpatient facilities. Due to this, a fee is applicable to every service provided. The Department is required by law to maximize its efforts to collect such fees from individual patients, legally liable parties, and third party coverage such as Medicaid, Medicare and private insurance.

In addition to the operation of inpatient facilities, the Department funds community programs operated by the Commonwealth's forty community services boards. Funding is also provided to a number of private not-for-profit organizations providing mental health, mental retardation and substance abuse services in a community setting. This funding consists of state general funds from the Commonwealth of Virginia and Federal grant subsidies. These financial activities, along with those attributable to capital maintenance and restricted donations, are presented in the financial statements as non-operating financial activities. The financial statements and information presented include the following:

Statement of Net Assets: This financial statement displays the Department's assets and liabilities and the difference between them (net assets). Changes in net assets (increases and decreases) represent one mechanism to measure the financial health of the Department and whether it's financial position is improving or deteriorating.

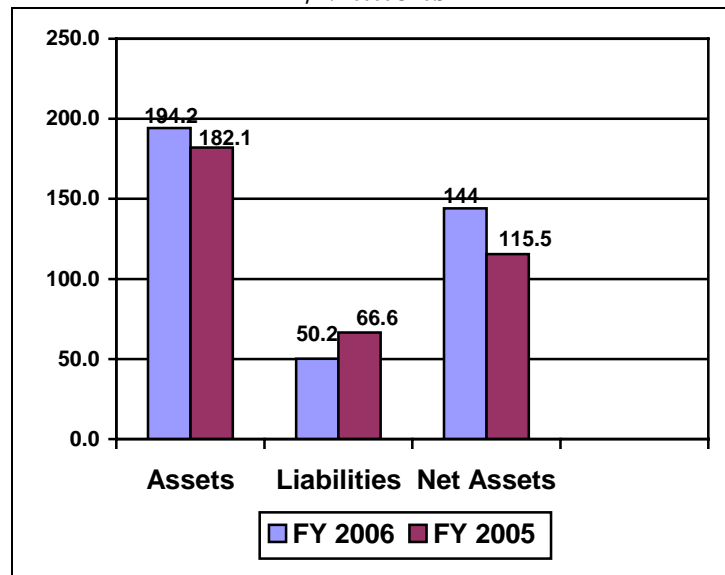
The Department's net assets increased by approximately \$28.5 million (25%) from \$115.5 million to \$144 million). This increase in net assets was attributable to numerous factors. The major factors resulting in the increase in net assets were increases in Cash with the Treasurer of Virginia, Inventories, and Prepaid Expenses and decreases in Capital Outlay Funds and Property, Plant and Equipment. Total liabilities decreased \$16.3 million primarily due to decreases in Accrued Payroll.

Note: The user should refer to the Financial Statement Section for additional information.

Statement of Net Assets

Description	2006	2005	% Change
Current Assets	\$101,006,269	\$80,446,958	25.6
Non-current Assets	10,175,497	12,003,570	(15.2)
Property and Equipment	83,019,578	89,620,746	(7.4)
Total Assets	\$194,201,344	\$182,071,274	6.7
Current Liabilities	11,726,330	29,869,454	(60.7)
Non-current Liabilities	38,506,761	36,731,645	4.8
Total Liabilities	\$50,233,091	\$66,601,099	(24.6)
Invested in Capital Assets	83,019,578	89,620,746	(7.4)
Unrestricted Net Assets	53,636,747	15,725,641	241.1
Restricted Net Assets	7,028,467	9,843,459	(28.6)
Retained Earnings	283,461	280,329	1.1
Total Net Assets	\$143,968,253	\$115,470,175	24.7

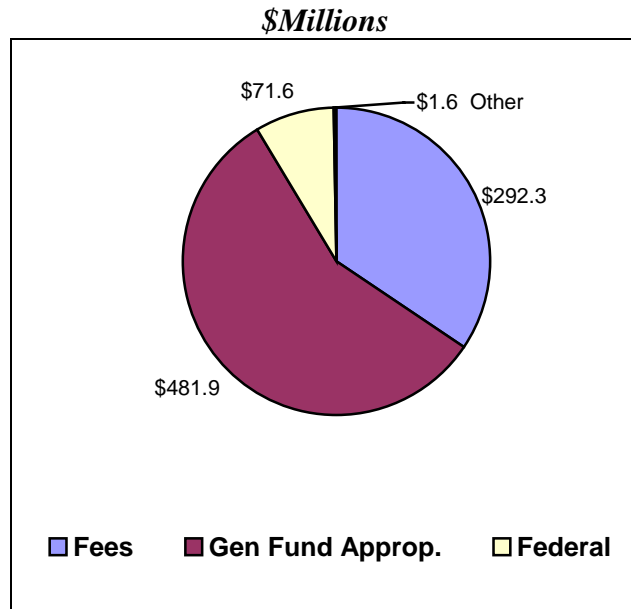
ASSETS, LIABILITIES, NET ASSETS
\$Millions



Statement of Revenues, Expenses and Changes in Net Assets: This financial statement presents the operating results of the Department for the fiscal year ended June 30, 2006. The Department uses the accrual basis of accounting whereby revenues are recognized when earned as opposed to received and expenses are recognized when incurred as opposed to when paid.

Total revenues increased \$23.6 million (2.8%) to \$847.4 million. Net Patient Service Revenue decreased \$.4 million and Appropriations from the Commonwealth increased \$23.9 million. Federal revenues increased \$.1 million. The decrease in Net Patient Service Revenue is attributed to several factors including changes in gross charges, third party cost settlement receivables, charity allowances, and contractual adjustments. These are fully presented in Note 9.

FY 2006 TOTAL REVENUES (GAAP BASIS)
(Operating & Non-Operating)
\$847.4 Million Total



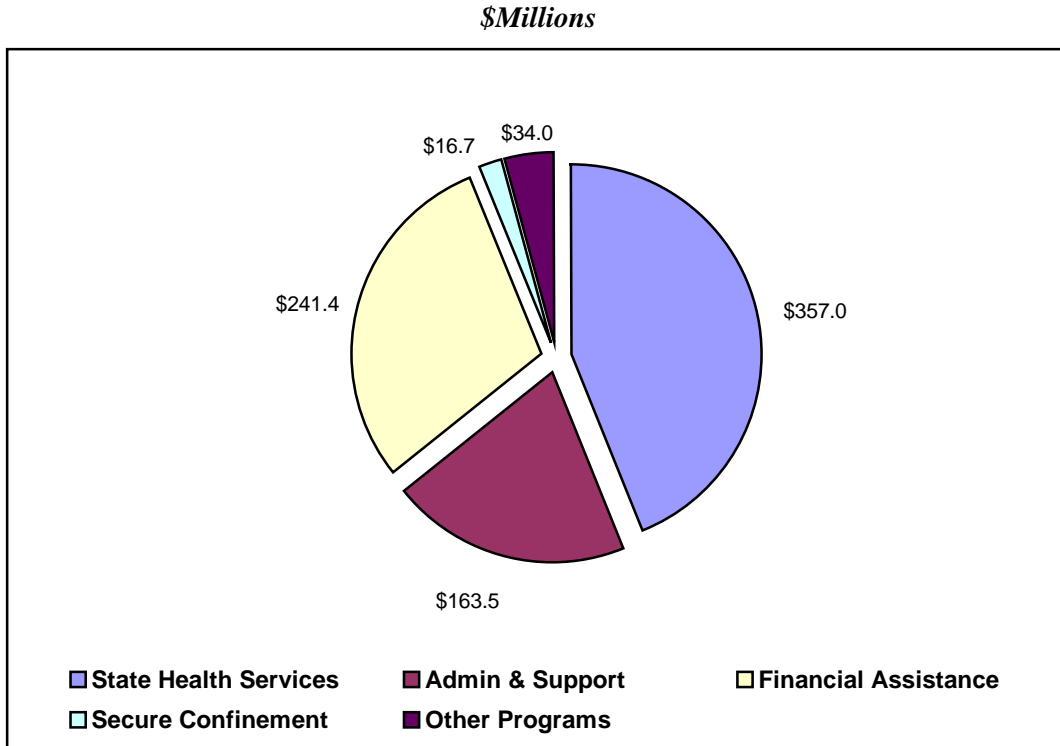
Revenues (in Millions)	2006	2005
Net Patient Service (Fees)	\$292.3	\$292.7
Gen Fund Appropriation	481.9	458.0
Federal	71.6	71.5
Other	1.6	1.6
Total Revenues	\$847.4	\$823.8

Expenses (operating expenses only) for the fiscal year were charged to a number of programs. These expenses are presented on the accrual basis of accounting whereby expenses are recognized when incurred. The Department's accrual basis expenses for fiscal years 2006 and 2005 were as follows (in millions).

Expense Program	2006	%	2005	%
State Health Services	\$357.0	44	\$341.0	43
Financial Assistance for Health Services	241.4	30	245.1	31
Administrative & Support Services	163.5	20	159.0	20
Secure Confinement	16.7	2	15.0	2
Instruction	6.4	1	6.0	1
Community Health Services	5.5	0	3.7	0
Depreciation Expenses	7.8	1	10.6	1
Other Program Expenses	14.3	2	15.2	2
Total Expenses	\$812.6	100	\$795.6	100

Total expenses increased \$17 million (2 %) to \$812.6 million. The increase is primarily due to salary increases to state employees and additional expenses for secure confinement and community health services.

FY 2006 EXPENSES (GAAP BASIS)
\$812.6 Million Total Expenses



Expense Program Descriptions: See Notes to Financial Statements (Note 16).

Statement of Cash Flows: This financial statement provides relevant information regarding the Department's sources of cash receipts and purposes of cash disbursements. The purpose of this statement is to demonstrate the Department's capacity to generate cash flows and its ability to pay routine obligations.

Overall, cash increased \$6.3 million for the year. This was a result of changes in cash flows in operating activities, non-capital financing activities, and capital financing activities.

The department used \$259.9 million in net cash to conduct its operating activities for fiscal year 2006. Receipts from Patient Services amounted to \$291.4 million of cash inflow and Payments to Employees of \$442 million and Payments to Suppliers of \$110 million comprised the balance of the cash outflow.

The net cash from Non-capital Financing Activities amounted to \$269.1 million. General Fund appropriations were \$481.9 million and federal grant subsidies were \$65.9 million. Payments to Community Programs resulted in a cash outflow of \$241.4 million. The remaining net outflows were primarily for restricted expenditures.

The net cash used by Financing Activities amounted to \$2.8 million. This included \$6.5 million in revenue bond proceeds and \$9.3 million in capital outlay expenses.

BUDGETARY HIGHLIGHTS

The Department's budget consists of the following sources of funds:

Budget (in Millions)	2006	2005
State General Funds	\$482.0	\$458.1
Special Revenue Funds	282.5	270.5
Federal Funds	81.9	73.0
Final Operating Appropriation	846.4	\$801.6

State General Funds consist of the appropriation of general tax revenues from the Commonwealth of Virginia. These funds subsidize the Department's sixteen inpatient facilities, finance the majority of the Central Office oversight functions, and fund community programs operated by Virginia's community services boards and private not for profit organizations.

Special Revenue Funds are derived predominantly from the collection of fees related to the provision of services in the Department's inpatient facilities. These revenues consist of Medicaid reimbursement, Medicare reimbursement, private insurance reimbursement, private payments and Federal entitlement programs.

Federal funds consist of numerous grants from the Federal government. The majority of the Department's federal subsidies consist of the Substance Abuse Prevention Treatment (SAPT) Block Grant and the Community Mental Health Services (CMHS) Block Grant. These grants are passed through to community programs by the Department's Office of Grants Management. With the exception of the National School Lunch, National School Breakfast, Education of Handicapped Children, and the Virginia Department of Agriculture and Consumer Services Federal Food Distribution Program, all grants are passed through to community programs. Those not passed through are administered by some of the Department's sixteen inpatient facilities. In fiscal year 2006, the Department expended \$68.4 million in Federal funds.

Of the Department's consolidated operating budget of \$846.4 million, \$830.6 million was expended. On a budgetary basis of accounting whereby expenses are recognized when paid as opposed to incurred, the Department expended its appropriated resources for the following programs during fiscal years 2006 and 2005 (in millions):

Budgetary Expenditures (In Millions)	2006	2005
State Health Services	\$371.2	\$347.8
Financial Assistance for Health Services (CSB funding)	241.4	245.1
Administration and Support Services	179.7	163.0
Community Health Services	11.7	9.5
Secure Confinement	16.6	16.1
Other Programs	10.0	8.4
Total Budgetary Expenditures	\$830.6	\$789.9

Of these expenditures, \$397.8 million were expended for direct inpatient care, \$241.4 million were transferred to communities for community programs, and \$191.4 million were expended for administration and support services for the Department's facilities and central office. Direct inpatient care consists of state health services and secure confinement. Administration and support services for patients include food services, housekeeping, laundry services, buildings and grounds maintenance, security services, general management and direction, and central office general management and direction.

CAPITAL ASSETS AND CAPITAL OUTLAY BUDGET

The Department's net capital assets (net of accumulated depreciation) totaled \$83 million. This amount represents a decline of 7 % from the previous fiscal year. The information below details the composition of the Department's capital assets (in millions).

Description	FY 2006	FY 2005
Land	\$14.6	\$14.8
Infrastructure	9.4	9.4
Equipment	43.4	43.0
Buildings	238.5	238.8
Accumulated Depreciation	(222.9)	(216.4)
Net Capital Assets	\$83.0	\$89.6

A capital outlay budget is appropriated to the Department on a biennial basis. During a budget biennium (2 year cycle) capital appropriations may be brought forward with the approval of the Department of Planning and Budget. The capital budget is intended to provide capital maintenance, needed modifications to building structures, improvements to facility boiler operations, and life safety code modifications. For fiscal year 2006 the Department's capital outlay budget was \$91.7 million of which \$9.3 million was expended.

ECONOMIC FACTORS AFFECTING THE DEPARTMENT

The Virginia General Assembly approved new community initiatives in the mental health, mental retardation and substance abuse areas. Although Virginia's economy continues to be robust, the continuing debate regarding the funding of the Commonwealth's transportation needs could impact the Department. If the General Assembly prefers financing these needs through savings generated from other state agencies, the Department could be negatively impacted. If the preference is funding through debt financing or additional taxes and user funds, limited or no impact on the Department's operations can be expected.

System Characteristics

SYSTEM CHARACTERISTICS OF THE DEPARTMENT

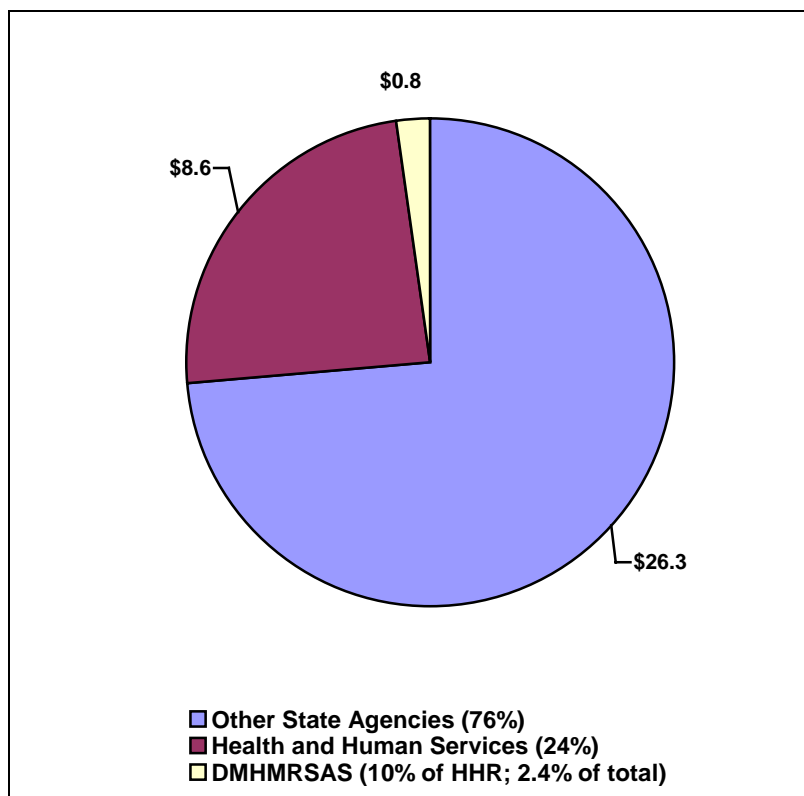
The Virginia Department of Mental Health, Mental Retardation and Substance Abuse Services (the "Department" or DMHMRSAS) consists of ten mental health facilities, five training centers for the mentally retarded, one medical center, and a Central Office. The Department also funds forty community services boards.

This section of the Annual Financial Report presents budgetary information for FY 2006 and overall systems funding information for FY 2006 to provide the reader with an overall perspective of the size of the service delivery system in which the Department operates.

The Department is organized under the Secretary of Health and Human Resources. Appropriations for the Secretary of Health and Human Resources represented approximately 24% of the Commonwealth of Virginia's \$35.7 billion final operating appropriation for FY 2006. The Department was allocated approximately 10% of the total appropriations available to the Secretary of Health and Human Resources. For the fiscal year, the Department's final operating appropriation was \$846.4 million (excluding capital outlays) and final budgetary operating expenditures were \$830.6 million.

FY 2006 BUDGET

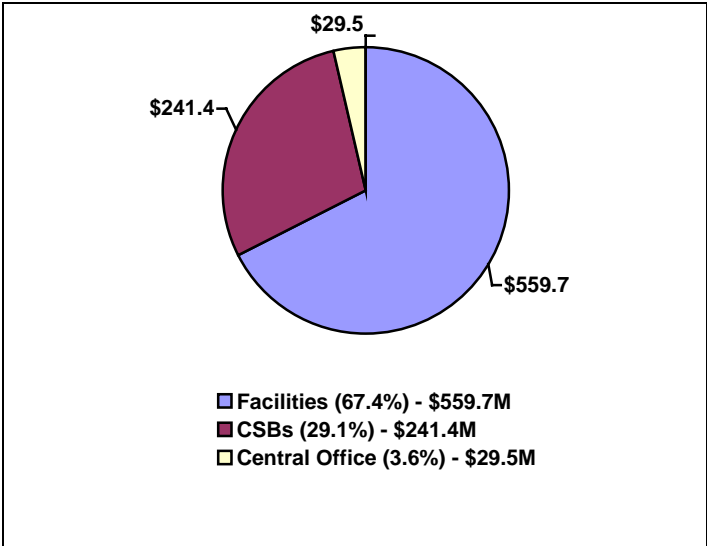
**COMMONWEALTH OF VIRGINIA
\$35.7 Billion (Final Operating Appropriation)**



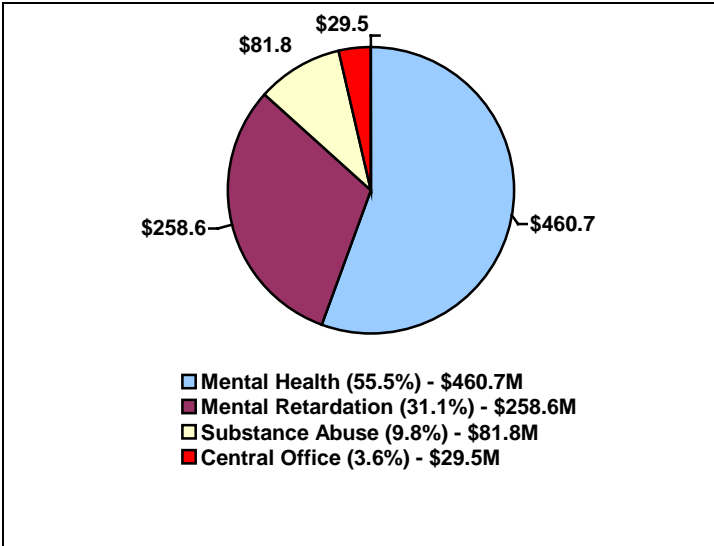
The following charts present FY 2006 final budgetary expenditures for all facilities, CSBs, and the Central Office. Also presented are expenditures by program area: Mental Health, Mental Retardation, Substance Abuse, Administration and Support, and the Central Office.

FY 2006 BUDGETARY EXPENDITURES

FACILITIES, CSBs, CENTRAL OFFICE
\$830.6 Million Total Expenditures



BY PROGRAM
\$830.6 Million Total Expenditures

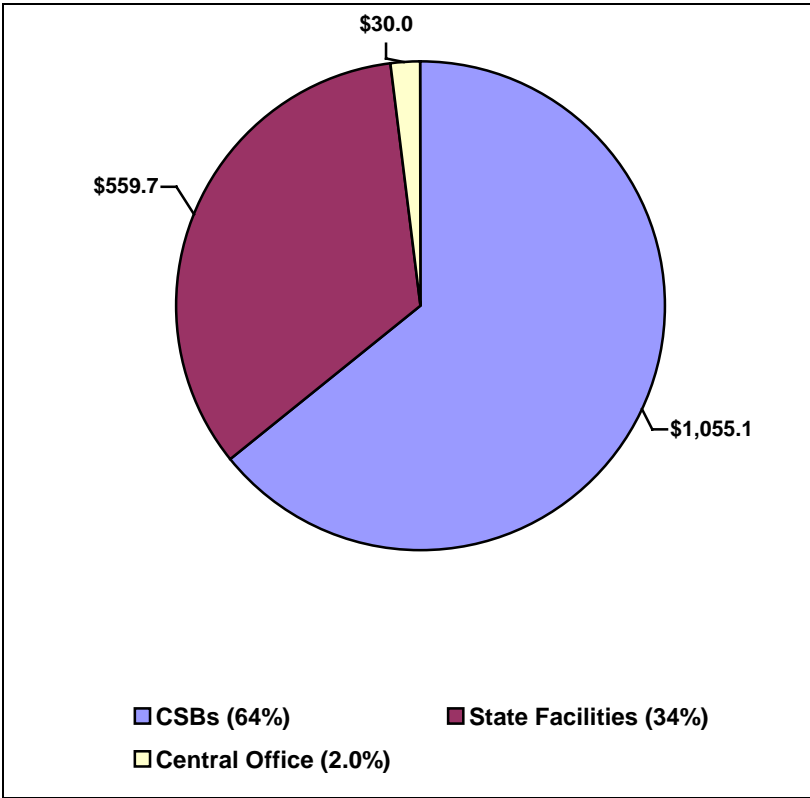


BUDGETARY EXPENDITURES (\$830.6M) vs. GAAP EXPENSES (\$812.6M): As noted in the Introduction, budgetary expenditures differ from GAAP expenses due to accounting estimates of revenues earned but not yet received and expenses incurred but not yet paid on the GAAP basis versus cash received and paid on the budgetary basis.

The following chart is provided to present a total services systems funding overview for FY 2006 that includes the total funding available for publicly funded mental health, mental retardation and substance abuse services within the Commonwealth. Total Services Systems Funding is defined as appropriated amounts for the operation of DMHMRSAS Facilities and Central Office and CSBs. CSB funding includes amounts provided by the federal, state, and local governments, and includes Medicaid, Medicare, and other fees.

***FY 2006 – TOTAL SERVICES SYSTEMS FUNDING
CSBs, Facilities, Central Office***

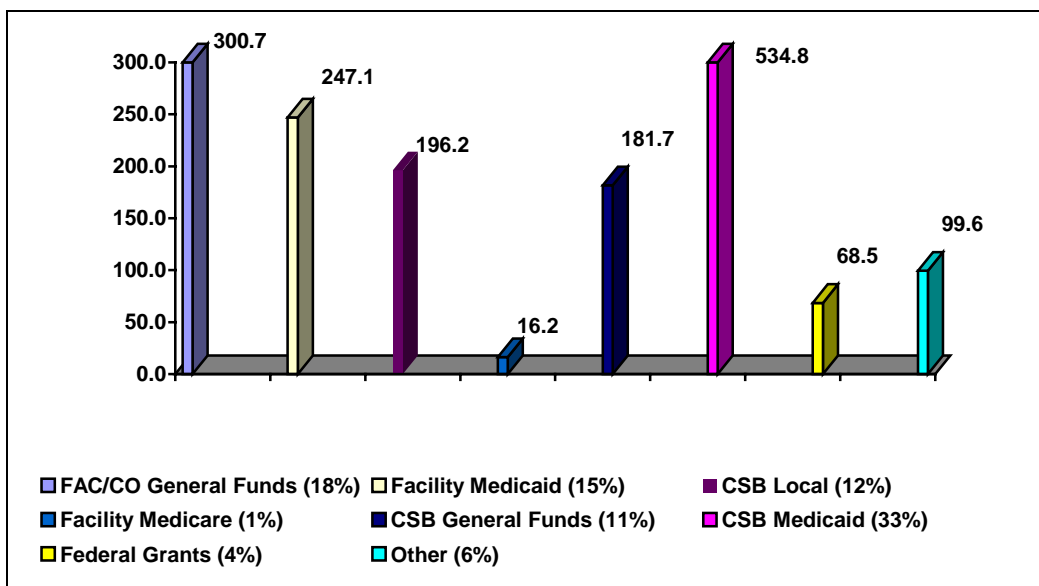
Grand Total \$1.644 Billion



The following chart presents total services systems funding for FY 2006 by funding source for Community Services Boards (CSBs), State Facilities, and the DMHMRSAS Central Office.

TOTAL SERVICES SYSTEM FUNDING – FY 2006
GENERAL FUND, MEDICAID SOURCES, FEDERAL, LOCAL

GRAND TOTAL \$1.644 BILLION



Funding Source	\$ Millions	%
CSB Medicaid	\$534.8	33
Facility/CO General Fund	300.7	18
Facility Medicaid	247.1	15
CSB General Fund	181.7	11
CSB Local Govt.	196.2	12
Other (Fees, Insurance)	99.6	6
Federal Grants	68.5	4
Facility Medicare	16.2	1
Total	\$1,644.8	100

Source: DMHMRSAS' Office of Budget and Financial Reporting

COMMUNITY SERVICES BOARDS

Community services boards were established through legislation passed by the General Assembly in 1968 (Chapter 10, Title 37.2 of the Code of Virginia). Local governments were directed to establish and maintain community mental health, mental retardation and substance abuse programs. These programs were to be administered in the most accessible and least restrictive settings. Community services boards serve as providers of services, client advocates, community educators, program developers, and planners on issues related to the provision of services. Listed below are the forty community services boards serving Virginia residents.

Virginia Community Services Boards

Alexandria	Highlands
Alleghany Highlands	Loudoun County
Arlington	Middle Peninsula-Northern Neck
Blue Ridge Behavioral Healthcare	Mount Rogers
Central Virginia	New River Valley
Chesapeake	Norfolk
Chesterfield	Northwestern
Colonial	Piedmont
Crossroads	Planning District One Behavioral Health Services
Cumberland Mountain	Portsmouth Dept. of Behavioral Healthcare Services
Danville-Pittsylvania	Prince William County
Dickenson County Behavioral Healthcare	Rappahannock Area
District 19	Rappahannock-Rapidan
Eastern Shore	Region Ten
Fairfax-Falls Church	Richmond Behavioral Health Authority
Goochland-Powhatan	Rockbridge Area
Hampton-Newport News	Southside
Hanover County	Valley
Harrisonburg-Rockingham	Virginia Beach Dept. of MH/MR/SAS
Henrico Area	Western Tidewater

Twelve community services boards serve a single county or city while twenty-eight serve multiple jurisdictions. Board members are appointed by their locality and represent the interests of those individuals with mental disabilities or substance abuse problems within their locality. More than 8,000 direct and contract agency staff work within the community services board system serving more than 200,000 clients.

CENTRAL OFFICE

The Department's Central Office has oversight responsibility for the programmatic, financial and administrative activities occurring within the state facilities and community services boards. This office promulgates and enforces policy and provides technical assistance to facilities and community services boards. The Department also licenses and regulates public and private programs and facilities. Joy Yeh, CPA, Ph.D., is the Assistant Commissioner for Finance and Administration.

STATE FACILITIES

The Department operates ten inpatient mental health facilities. These mental health facilities consist of one adolescent facility, two geriatric facilities, and seven adult facilities. The Department also operates five training centers for people with mental retardation and one medical center. Overall, the Department has more than 400 buildings with a value in excess of \$225 million. As of June 30, 2006, the Department consisted of 8,727 employees and the facility daily average patient census was 3,033. The daily average patient census for each facility is presented below. Employee and census information are also presented for a period spanning 36 years in the charts that follow.

Virginia's State Hospitals

<u>Facility</u>	<u>Description</u>
<p>Catawba Hospital Director: Jack L. Wood, MBA, VCO Facility Administrator: Charles C. Law, MHA Finance Director: James F. Campbell, CPA</p>	<p>Located in Catawba, Virginia, this facility provides care to patients and short-term care to adults from nearby communities. The FY 2006 daily average patient census was 102.</p>
<p>Central State Hospital Director: Charles Davis, MD Facility Administrator: David Chu Finance Director: William Hawkins</p>	<p>Located in Petersburg, Virginia, this facility provides inpatient adult psychiatric services as well as forensic and adolescent psychiatric services. The FY 2006 daily average patient census was 240.</p>
<p>Eastern State Hospital Director: John M. Favret Facility Administrator: Martin S. Kline Finance Director: Cliff Love</p>	<p>Located in Williamsburg, Virginia, this hospital provides adult, geriatric, acute and chronic psychiatric, behavioral and dual diagnosis to individuals with mental illness and chemical dependency. The FY 2006 daily average patient census was 419.</p>
<p>Commonwealth Center for Children and Adolescents Director: William J. Tuell, RN, MSN Facility Administrator: Vickie Falls Finance Director: Vickie Falls</p>	<p>Located in Staunton, Virginia, this new facility provides highly specialized intensive diagnostic, evaluation and psychiatric treatment services to children between the ages of four and eighteen. The FY 2006 daily average patient census was 31.</p>
<p>Northern Virginia Mental Health Institute Director: Lynn DeLacy, Ph.D, RN Facility Administrator: Richard Lopez, MBA Finance Director: Anne Baxter</p>	<p>Located in Falls Church, Virginia, this facility provides acute psychiatric care. The FY 2006 daily average patient census was 120.</p>
<p>Piedmont Geriatric Hospital Director: Stephen M. Herrick, Ph.D. Fac. Administrator: H. Eugene Overton, CPA Finance Director: Lynne Inge</p>	<p>Located in Burkeville, Virginia, this hospital provides care for geriatric patients. The FY 2006 daily average patient census was 119.</p>
<p>Southern Virginia Mental Health Institute Director: David M. Lyon, MBA Facility Administrator: A. Wade Hopkins, CPA Finance Director: A. Wade Hopkins, CPA</p>	<p>Located in Danville, Virginia, this facility provides short-term acute psychiatric care. The FY 2006 daily average patient census was 68.</p>
<p>Southwestern Virginia Mental Health Institute Director: Cynthia McClaskey, Ph.D. Facility Administrator: Roy G. Layne Finance Director: Lonzo Lester, Jr.</p>	<p>Located in Marion, Virginia, this facility provides acute and long-term care for adolescents, adults, and geriatrics. The FY 2006 daily average patient census was 149.</p>
<p>Western State Hospital Director: Jack Barber, MD Facility Administrator: David Mawyer Finance Director: Jon Chapman</p>	<p>Located in Staunton, Virginia, this hospital provides inpatient adult psychiatric services. The FY 2006 daily average patient census was 243.</p>

Virginia Center for Behavioral Rehabilitation

Director: Clarence C. Murphy
Assistant Director: Eric Aldridge
Finance Director: Edwina Camden

Located in Petersburg, Virginia, this facility was established July 1, 2003. Its purpose is to provide treatment to individuals deemed to be sexually violent. Patients at this facility have completed their prison terms associated with sexually violent behavior and are receiving inpatient treatment for their disorders. The FY 2006 daily average patient census was 28.

Virginia's Training Centers

The Department's training centers provide residential care and training in such areas as language, self-care, independent living, socialization, academic skills and motor development. Each training center is described below.

<u>Facility</u>	<u>Description</u>
Central Virginia Training Center Director: Denise D. Micheletti, MSA, RN Facility Administrator: Charles Felmlee Finance Director: Charles Felmlee	Located in Lynchburg, Virginia, this center provides inpatient services to residents who are severely and profoundly retarded. The FY 2006 daily average patient census was 540.
Northern Virginia Training Center Director: Mark Diorio, Ph.D. Facility Administrator: none Finance Director: Sobra Ewald	Located in Fairfax, Virginia, this center serves residents with moderate to profound mental retardation. The FY 2006 daily average patient census was 176.
Southeastern Virginia Training Center Director: Robert D. Shrewsberry, Ph.D. Facility Administrator: Brian Whitesell Finance Director: Maureen Doggett	Located in Chesapeake, Virginia, this center serves individuals with severe to profound mental retardation. The FY 2006 daily average patient census was 189.
Southwestern Virginia Training Center Director: Dale Woods, Ed.D. Facility Administrator: John W. Jones, Jr. Finance Director: Frances Vaught, CGFM	Located in Hillsville, Virginia, this center serves persons with severe to profound mental retardation and multiple disabilities. The FY 2006 daily average patient census was 211.
Southside Virginia Training Center Director: John A. Holland, M.D. Facility Administrator: William Hawkins Finance Director: Bob Kaufman	Located in Petersburg, Virginia, center serves individuals with severe to profound mental retardation and varying physical disabilities. The FY 2006 daily average patient census was 336. This facility provides administrative and operational support to Central State Hospital and Hiram Davis Medical Center.

Medical Center

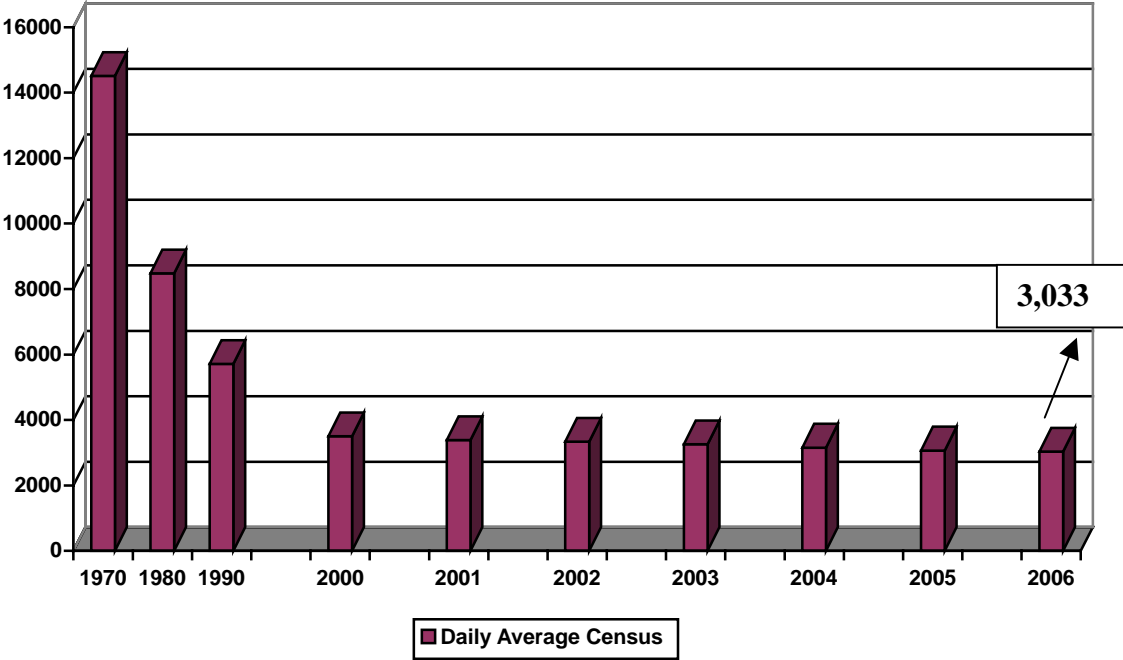
Hiram Davis Medical Center
Director: David A. Rosenquist
Facility Administrator: William Hawkins
Finance Director: Bob Kaufman

Located in Petersburg, Virginia, the Department operates this center, which serves the medical needs of patients and residents of Central State Hospital, and Southside Virginia Training Center, respectively. The medical center also operates an aftercare pharmacy, which provides medications to the patients and residents of the Petersburg Complex and clients of the forty community services boards. The FY 2006 daily average patient census was 62.

STATE FACILITIES STATISTICS

The following chart presents selected patient census levels over the past 36 years. As can be noted, the Daily Average Census levels have been steadily declining since 1970 with a gradual leveling since 2000. In 1970, the Daily Average Census was 14,514 and in 2006 the Daily Average Census was 3,033.

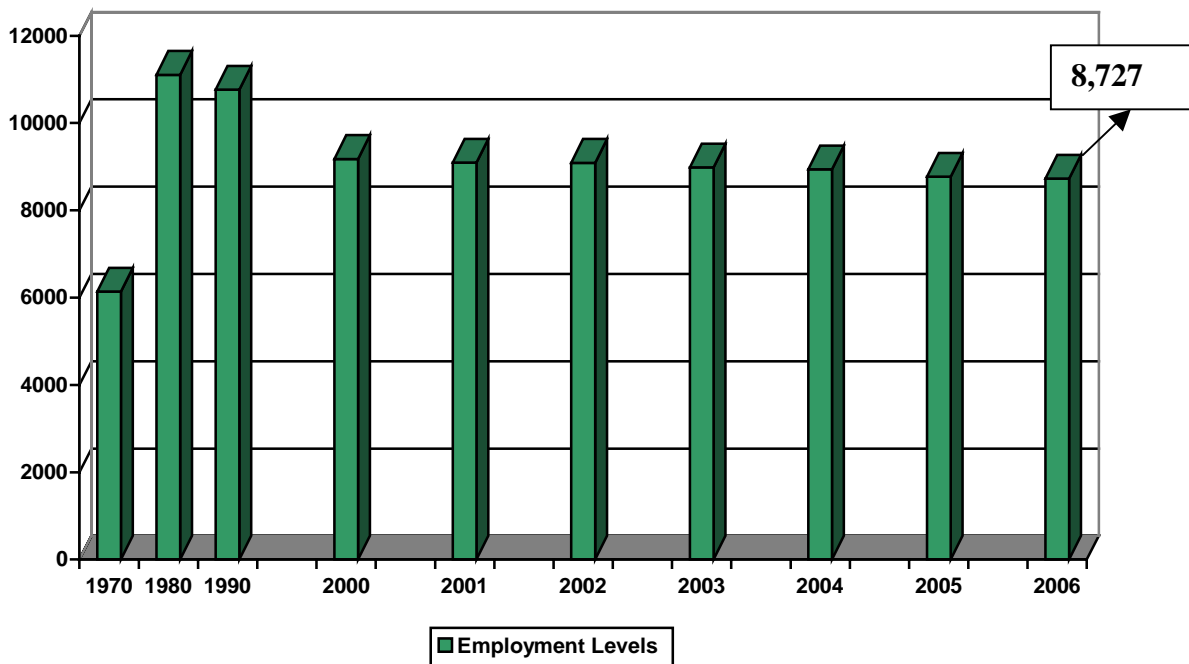
PATIENT CENSUS



Source: "Comparative Analysis-Operating Statistics and Costs" and "Ten Year Expenditure Analyses." DMHMRSAS Office of Budget and Financial Reporting

The following chart presents selected employment levels over the past 36 years. Employment levels have been declining since 1980. The 1980 level was 11,106 and the 2006 level was 8,727. These employment levels include all DMHMRSAS operations (facilities and central office).

EMPLOYMENT LEVELS



Source: DMHMRSAS Office of Budget and Financial Reporting “Comparative Analysis-Operating Statistics and Cost” and “Ten Year Expenditure Analyses.”

Note: Employment levels are employees on payroll at the end of the fiscal year. The average number of employees for FY 2006 was 8,768. Employment levels were low in the 1970's due to the operation of fewer facilities by DMHMRSAS. In 1970, DMHMRSAS operated 9 facilities. In 1980 there were 17 facilities and from 1990-2003 there were 15 facilities. Since 2004, DMHMRSAS has operated 16 facilities. This reflects the addition of a new facility, the Virginia Center for Behavioral Rehabilitation, for the treatment of sexually violent predators in 2004.

Financial Statements

**Virginia Department of Mental Health, Mental Retardation
and Substance Abuse Services
Statement of Net Assets
For Fiscal Year Ended June 30, 2006
With Comparative Figures for 2005**

	<u>2006</u>	<u>2005</u>
Assets		
Current Assets:		
Cash, Cash Equivalents and Investments	\$2,363,014	\$2,233,013
Cash with Treasurer of Virginia	22,089,640	14,057,564
Cash Advances	60,150	67,150
Patient Accounts Receivable (Net of Allowance for Doubtful Accounts of \$13,798,820 for 2006 and \$14,894,128 for 2005)	32,011,191	32,105,554
Cost Settlements Receivable	24,154,547	23,123,397
Other Accounts Receivable	84,726	33,044
Inventories	8,586,992	5,834,336
Prepaid Expenses	11,656,009	2,992,900
Total Current Assets	<u>101,006,269</u>	<u>80,446,958</u>
Noncurrent Assets		
Capital Outlay Funds	6,723,210	9,613,495
Patient/Resident Funds Held by Trustee	3,452,287	2,390,075
Property, Plant, & Equipment (Net of Accumulated Depreciation)	83,019,578	89,620,746
Total Noncurrent Assets	<u>93,195,075</u>	<u>101,624,316</u>
Total Assets	<u>\$194,201,344</u>	<u>\$182,071,274</u>
Liabilities		
Current Liabilities:		
Accrued Payroll	\$6,905,592	\$24,385,242
Accounts Payable	3,311,936	3,878,837
Compensated Absences	123,749	165,273
Retainage Payable	55,119	50,317
Deferred Revenue	1,151,095	1,211,253
Other Liabilities	178,839	178,532
Total Current Liabilities	<u>11,726,330</u>	<u>29,869,454</u>
Noncurrent Liabilities		
Compensated Absences	35,045,887	34,325,623
Patient/Resident Funds Held by Trustee	3,452,287	2,390,075
Other Liabilities	8,587	15,947
Total Noncurrent Liabilities	<u>38,506,761</u>	<u>36,731,645</u>
Total Liabilities	<u>50,233,091</u>	<u>66,601,099</u>
Net Assets		
Invested in Capital Assets	83,019,578	89,620,746
Retained Earnings	283,461	280,329
Unrestricted	53,636,747	15,725,641
Restricted	7,028,467	9,843,459
Total Net Assets	<u>\$143,968,253</u>	<u>\$115,470,175</u>

See accompanying notes to financial statements.

**Virginia Department of Mental Health, Mental Retardation
and Substance Abuse Services
Statement of Revenues, Expenses and Changes in Net Assets
For Fiscal Year Ended June 30, 2006
With Comparative Figures for 2005**

	<u>2006</u>	<u>2005</u>
Operating Revenues		
Net Patient Service Revenue	\$292,375,017	\$292,769,146
Other Operating Revenue	1,188,744	885,083
Total Operating Revenue	<u>293,563,761</u>	<u>293,654,229</u>
Expenses		
State Health Services	356,709,221	340,972,155
Administration and Support Services	163,550,976	158,921,455
Secure Confinement	16,753,531	14,988,870
Community Health Services	5,540,849	3,724,095
Depreciation Expense	7,861,046	10,659,380
Instruction	6,390,966	6,011,132
Regulation of Public Facilities	1,510,322	1,121,206
Health Research and Planning	(1,026,220)	1,608,778
Loss on Disposal of Equipment	733,109	4,310,030
Vending Facilities	152,076	149,518
Total Operating Expenses	<u>558,175,876</u>	<u>542,466,619</u>
Operating Income (Loss)	<u>(\$264,612,115)</u>	<u>(\$248,812,390)</u>
Nonoperating Income (Loss)		
Appropriations from the Commonwealth	\$481,934,174	\$458,005,753
Federal Grant Revenues	71,572,097	71,471,588
Restricted Donations	375,754	563,927
Surplus Property Sales	24,119	8,298
Insurance Recovery Proceeds	3,177	107,050
Interest Income	8,691	4,373
Financial Assistance for Health Services	(241,436,053)	(245,122,630)
Capital Outlay Expenses	(9,361,050)	(5,160,280)
Other Nonoperating Expenses	(12,984,429)	(8,025,516)
Total Nonoperating Income (Loss)	<u>290,136,480</u>	<u>271,852,563</u>
Income (Loss) Before Contributions and Transfers	<u>25,524,365</u>	<u>23,040,173</u>
Capital Appropriations from the Commonwealth	-	11,041,601
Capital Revenue Bond Proceeds	6,545,431	4,833,472
Reversions to the Commonwealth	(1,585,330)	(129,838)
Net Operating Transfers	<u>(1,986,388)</u>	<u>(1,864,994)</u>
Change in Net Assets	28,498,078	36,920,414
Net Assets, Beginning of Year	<u>115,470,175</u>	<u>78,549,761</u>
Net Assets, End of year	<u>\$143,968,253</u>	<u>\$115,470,175</u>

See accompanying notes to financial statements.

**Virginia Department of Mental Health, Mental Retardation
and Substance Abuse Services
Statement of Cash Flows
For Fiscal Year Ended June 30, 2006**

Cash Flows from Operating Activities:

Receipts from Patient Services	\$291,438,230
Other Operating Receipts	1,137,062
Payments to Employees	(442,461,253)
Payments to Suppliers	<u>(110,095,773)</u>
Net Cash Used by Operating Activities	<u>(259,981,734)</u>

Cash Flows from Noncapital Financing Activities:

Operating Subsidies-General Fund Appropriations	481,934,174
Federal Grant Subsidies	65,901,980
Payments to Community Programs	(241,436,053)
Net Operating Transfers and Reversions	6,046
Restricted Donations	375,754
Restricted Expenditures	(37,689,545)
Endowment Expenditures	(8,787)
Nonoperating Revenues	27,296
Interest Income from Endowment Funds	<u>8,691</u>
Net Cash Flows from Noncapital Financing Activities	<u>269,119,556</u>

Cash Flows from Capital and Related Financing:

Revenue Bond Proceeds	6,545,431
Capital Outlay Expenditures	(9,356,249)
Capital Outlay Appropriations	<u>-0-</u>
Net Cash Flows Used By Capital and Related Financing	<u>(2,810,818)</u>

Net increase (Decrease) in Cash and Cash Equivalents	6,545,431
Balance – Beginning of Year	<u>28,361,297</u>
Balance – End of Year	<u>\$34,688,301</u>

Reconciliation of Operating Loss to Net Cash Used by Operations:

Operating Loss	(\$264,612,115)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operations:	
Depreciation Expense	7,861,046
Loss on Disposal of Property	733,109

Net Changes in Assets and Liabilities:

Accounts Receivable	1,082,832
Inventories	2,752,656
Prepaid Assets	8,663,109
Accrued Payroll	(17,479,650)
Accounts Payable	(566,901)
Compensated Absences – Current	(41,524)
Retainage Payable	4,802
Deferred Revenue	(60,158)
Other Current Liabilities	307
Compensated Absences – Long Term	720,264
Funds Held in Custody for Others	1,062,212
Third Party Settlements Payable	<u>-0-</u>
Other Liabilities	<u>(7,360)</u>

Net Cash Used by Operating Activities	<u>(259,981,734)</u>
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See accompanying notes to financial statements.

Notes to Financial Statements

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The accompanying financial statements represent the activities of the Virginia Department of Mental Health, Mental Retardation and Substance Abuse Services (DMHMRSAS) for the fiscal year ended June 30, 2006. DMHMRSAS is an agency of the Commonwealth of Virginia and is included in the basic financial statements of the Commonwealth. The financial statements presented include the sixteen state operated facilities and funding for forty community services boards. The state facilities are listed below as follows:

<u>Facility</u>	<u>Location</u>	<u>Facility</u>	<u>Location</u>
Central State Hospital	Petersburg	Catawba Hospital	Catawba
Eastern State Hospital	Williamsburg	Northern VA Training Center	Fairfax
Southwestern VA MH Institute	Marion	Southside VA Training Center	Petersburg
Western State Hospital	Staunton	Northern VA MH Institute	Falls Church
Central VA Training Center	Lynchburg	Piedmont Geriatric Hospital	Burkeville
Commonwealth Center for Children and Adolescents	Staunton	Southwestern VA Training Center	Hillsville
Southeastern VA Tng. Center	Chesapeake	Southern VA MH Institute	Danville
VA Center for Behavioral Rehabilitation	Petersburg	Hiram Davis Medical Center	Petersburg

B. Basis of Accounting

DMHMRSAS has adopted the economic resources measurement focus and full accrual basis of accounting in accordance with Generally Accepted Accounting Principles (GAAP) as prescribed by the Government Accounting Standards Board (GASB) for providers of healthcare services. Revenues are recorded when earned and expenses are recorded when incurred and measurable, regardless of when the related cash flows take place.

Pursuant to GASB Statement 20, Accounting and Financial Reporting for Proprietary funds and Other Governmental Entities That Use Proprietary Fund Accounting, DMHMRSAS has elected not to apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989.

The financial statements have been prepared in accordance with GASB Statement 34, Basic Financial Statements-and Management Discussion and Analysis-for State and Local Governments.

C. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts could differ from those estimates.

D. Net Patient Service Revenue

Patient service revenue is recorded at scheduled rates when services are rendered. Allowances and provisions for uncollectible accounts and contractual adjustments are deducted to arrive at net patient service revenue, as are charges for charity services.

E. Indigent Care and Uncollectible Accounts

DMHMRSAS accepts all patients regardless of their ability to pay. A patient is classified as indigent by reference to established Commonwealth policies. The criteria for identifying indigent patients are based on asset and income guidelines that are updated annually in accordance with the federal poverty income guidelines as provided by the federal Office of Management and Budget. Net Patient Service Revenue includes the gross charges for indigent care less allowances for uncollectible amounts.

F. Settlements Due To/From Third-Party Programs and Contractual Adjustments

A significant portion of the Department's services are rendered to patients covered by Medicare, Medicaid, or Anthem. These third-party payers have entered into contractual arrangements with the Department for reimbursement of services provided to patients in specific certified components of the Department's individual facilities. Generally, the Department is reimbursed for patient services by these third-party payers at the lower of cost or charges or at prospectively determined rates in the case of certified components that provide inpatient services. Throughout the year, the third-party payers reimburse the Department at a prearranged tentative payment amount. In accordance with the third-party payor agreements, the difference between covered charges, whether based upon allowable costs of services or prospectively determined rates, and the Department's standard billing rates results in contractual adjustments. Contractual adjustments are recorded as deductions from patient service revenue in the period in which the related services are rendered. The annual settlements for reimbursement of patient services covered by third-party programs are determined through cost reports, which are subject to audit and retroactive adjustments by these third parties. The settlements receivable or payable from third-party programs are recorded in the accompanying financial statements.

G. Investments

Investments are valued at cost or fair market value when received if donated.

H. Inventory

Inventory is generally valued at average cost. DMHMRSAS inventory consists of the following: drugs, medical supplies, materials, food supplies, petroleum/fuel oil, housekeeping and laundry supplies, personal care items and clothing, and office supplies. Adjustments have been made in order to report inventory amounts in accordance with the consumption method.

I. Compensated Absences

Compensated absences reflected in the accompanying financial statements represent the amounts of vacation, sick and compensatory leave earned by employees of the Department, but not taken at June 30, 2006. The amount reflects all earned vacation, sick and compensatory leave payable under the Commonwealth of Virginia's leave policies.

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS

GASB Statement 40, *Deposit and Investment Risk Disclosures*, effective for fiscal periods beginning after June 15, 2004, amends GASB Statement 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreement), and Reverse Repurchase Agreements*. GASB Statement 40 eliminates the custodial credit risk disclosures required for Categories 1 and 2 deposits and investments, but maintains disclosures for category 3. The following risk disclosures are required by GASB Statement 40:

Custodial Credit Risk (Category 3 deposits and investments) - The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. DMHMRSAS has no Category 3 deposits or investments for 2006. At the end of the year, the carrying amount of Cash Not With the Treasurer of Virginia was \$1,877,381 and the bank balance was \$4,200,864. The bank balances exceeding those covered by Federal Deposit Insurance are protected under the provisions of the Virginia Security for Public Deposits Act.

Credit Risk - The risk that an issuer or other counterparty to an investment will not fulfill its obligations. GASB Statement Number 40 requires the disclosure of the credit quality rating on any investments subject to credit risk.

Concentration of Credit Risk - The risk of loss attributed to the magnitude of a government's investment in a single issuer. GASB Statement 40 requires disclosure of any issuer with more than five percent of DMHMRSAS's investments. The Mutual and Money Market Funds and Local Government Investment Pool represent 3 and 97 percent, respectively, of total investments.

Interest Rate Risk - The risk that changes in interest rates will adversely affect the fair value of an investment. GASB Statement 40 requires disclosure of maturities for any investments subject to interest rate risk. DMHMRSAS does not have an interest rate risk policy.

Foreign Currency Risk - The risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. DMHMRSAS has no foreign investments or deposits for 2006.

The following information is provided with respect to the risks associated with the DMHMRSAS' cash, cash equivalents, and investments at June 30, 2006.

Cash and Cash Equivalents

Pursuant to Section 2.2-1800, et seq., Code of Virginia, all state funds of DMHMRSAS are maintained by the Treasurer of Virginia who is responsible for the collection, disbursement, custody, and investment of state funds. Cash deposits held by DMHMRSAS are maintained in accounts collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2- 4400, et seq., Code of Virginia. The Virginia Security for Public Deposits Act eliminates any custodial credit risk for DMHMRSAS' deposits. Cash and cash equivalents represent cash with the Treasurer, cash on hand, certificates of deposit and temporary investments with original maturities of 90 days or less, and cash equivalents with the Virginia State Non-Arbitrage Program (SNAP). SNAP is an open-end management investment company registered with the Securities and Exchange Commission (SEC). Cash and cash equivalents reporting requirements are defined by GASB Statement 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities that Use Proprietary Fund Accounting*. Additional disclosures required for cash equivalents under GASB Statement 40 are presented with the investments in the following tables.

Investments

Authorized investments are set forth in the Investment of Public Funds Act of the Code of Virginia, Sections 2.2-4500 through 2.2-4516. Authorized investments include: U.S. Treasury and agency securities, corporate debt securities of domestic corporations, asset-backed securities, mortgage-backed securities, AAA rated obligations of foreign governments, bankers acceptances and bank notes, negotiable certificates of deposit, repurchase agreements, and money market funds. Investments fall into two groups: short- and long-term. Short-term investments have an original maturity of over 90 days, but less than or equal to one year. Long-term investments have an original maturity greater than one year.

Credit and Concentration of Credit Risks

	Fair Value	Credit Rating	Concentration of Risk Per- cent
Cash Equivalents:			
U.S. government securities:			
Short-term investment fund	\$15,500	AAA	
Other	95,328		
	<u>110, 828</u>		
Total Cash Equivalents			
Investments:			
Mutual and money market funds	81,275		3%
Local government investment pool	2,710,544	AAA	97%
	<u>2,791,819</u>		
Total investments			
	<u>2,791,819</u>		
Total Cash Equivalents and Investments			
	<u><u>\$2,902,647</u></u>		

Interest Rate Risk –Maturities

	Less than 1 year	1-5 years	Total
Investments:			
Mutual and money market funds	\$ 81,275		\$ 81,275
Local government investment pool		2,710,544	2,710,544
	<u>\$81,275</u>	<u>\$2,710,544</u>	<u>\$2,791,819</u>
Total Investments			

Securities Lending Transactions

Investments and cash equivalents held by the Treasury of Virginia represent DMHMRSAS' allocated share of cash collateral received and reinvested and securities received for the State Treasury's securities lending program. Information related to the credit risk of these investments and the State Treasury's securities lending program is available on a statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report.

3. NONCURRENT ASSETS

Noncurrent Assets are for two primary purposes. The first purpose is for capital maintenance and construction. These funds are held with the Treasurer of Virginia. The second purpose is for discretionary use by DMHMRSAS patient/residents. These funds are held in trust in local bank accounts throughout the State.

4. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost or estimated historical cost. The Department capitalizes expenditures for equipment if the equipment is separate, has a multi-year life and has a value or unit acquisition cost in excess of \$5,000 at the date of acquisition (for State Hospitals and Training Centers).

Depreciation on property, plant and equipment is computed over the estimated useful lives of the assets based upon the straight-line method of depreciation. The general range of estimated useful lives is fifteen to forty years for buildings and fixtures and three to fifteen years for equipment. A summary of changes in fixed assets is presented below:

	Balance at July 1, 2005	Additions	Deletions	Balance at June 30, 2006
Land	\$14,773,386	-	132,697	\$14,640,689
Infrastructure	9,418,012	-	-	9,418,012
Equipment	42,978,051	1,990,787	1,588,635	43,380,203
Buildings	238,824,612	2,200	356,305	238,470,507
Construction in Progress	-	-	-	-
Accumulated Depr.	<u>(216,373,315)</u>	<u>(7,861,046)</u>	<u>(1,344,528)</u>	<u>(222,889,833)</u>
Total	<u>\$89,620,746</u>	<u>(5,868,059)</u>	<u>733,109</u>	<u>\$83,019,578</u>

5. RETAINAGE PAYABLE

At June 30, 2006, \$55,119 was held by DMHMRSAS as retainage on various contracts for work that had been performed. The retainage will be remitted to the various contractors upon satisfactory completion of the various contracts.

6. OPERATING AND CAPITAL LEASES

The Department is also committed under various operating leases for equipment. In general, these leases are short term in nature. The Department was the lessee of capital equipment under capital leases expiring in various years through 2009. The assets under capital leases are recorded as fixed assets at the lower of the net present value of the minimum lease payments during the lease term or the fair market value of the asset. As of June 30, 2006, the Department has the following total future minimum rental payments for operating and capital leases and the present value of the net minimum lease payments for capital leases:

<u>Year</u>	<u>Operating Leases</u>	<u>Capital Leases</u>
2007	\$178,308	\$37,696
2008	35,991	14,923
2009	11,855	6,392
2010	4,055	
2011		
2012		
Later Years	-	
Total Minimum Lease Payments	230,209	59,011
Less: Executory Costs	<u>60,119</u>	
Net Minimum Rental Payments	<u>\$170,090</u>	<u>\$59,011</u>
Less: Interest		3,587
Present Value of Minimum Lease Payments		<u>\$55,424</u>
Current Portion	\$132,066	\$37,696
Long-term Portion	<u>38,024</u>	<u>17,728</u>
Total	<u>\$170,090</u>	<u>\$55,424</u>

Interest rates on capitalized leases vary and are based on negotiations between each Facility Administrator and the lessor and range between 4% to 7.5%.

7. CONTINGENCIES

Medicare cost reports submitted to the Medicare program together with the related statistics that support cost allocations to the program for the fiscal year ended June 30, 2006 have not been reviewed by the fiscal intermediary. Acceptance and review of these cost reports could result in adjustments to settlements and a liability of the Department to the Medicare program. The effects of these reviews cannot be determined at this time. Medicaid cost reports submitted for final settlement for the fiscal year ended June 30, 2006 have not been reviewed by the intermediary. Acceptance and review of these cost reports could result in adjustments to the settlements and a liability of the Department to the Medicaid program. It is the opinion that adjustments, if any, resulting from this review will not be material.

The Department is involved in several lawsuits arising in the ordinary course of operations. It is the Department's opinion that any losses incurred as a result of known claims existing as of June 30, 2006 will not be material.

8. APPROPRIATIONS FROM THE COMMONWEALTH

The Appropriations Act specifies that unexpended appropriations from the General Fund of the Commonwealth shall revert, except as specifically provided by the General Assembly, at the end of a biennium. For years ending at the middle of the biennium, unexpended appropriations that have not been approved for reappropriation in the next year by the Governor become part of the General Fund of the Commonwealth and are, therefore, no longer available to the Department's facilities or Central Office for expenditure.

The original appropriation from the General Fund of the Commonwealth for fiscal year 2006 has been adjusted as follows:

FY 2006, Original Appropriation, as of July 1, 2005		445,005,639
Reduce 2 nd year appropriation		-245,766
Transfer to Dept of Rehabilitative Services		-1,452,006
Transfer to set up Office of the Inspector General		-529,761
Continue FY 2005 general fund regrade		11,903,317
FY 2006 general fund regrade		10,019,209
Health insurance premium increase		9,500,427
Group life insurance premium holiday		-1,069,259
Retiree health insurance adjustments		-668,154
Covernet rate increases		2,030
Rent plan cost increase		37,324
General fund carry forward balance		1,491,562
Transfer from Dept. of Social Services		18,025
Locality share of Special Education for facilities		26,271
VITA salary increase per caboose bill		81,489
Funding for 3 rd June payroll		7,813,827
Final (Adjusted) Appropriation, June 30, 2006		481,934,174

9. NET PATIENT SERVICE REVENUE (FEES)

The Department's mental health and mental retardation facilities provide a significant amount of services, which are deemed charitable and are subsidized by state General Fund appropriations. Of the total charges of \$529,238,333 for fiscal year 2006, \$257,538,353 was deemed to be charitable services. Charitable write-offs occur when no third party resources are available and investigation of client resources indicate the client is unable to pay full rate charges or reduced charges determined in accordance with a sliding fee scale. This amount has been deducted from gross patient service revenue. The following chart presents the detail calculations of net patient service revenue (Fees) for FY 2006 and FY 2005, respectively. It is useful to note that the majority of DMHMRSAS revenue consists of Medicaid reimbursements.

**Net Patient Service Revenue (FEES)
FY 2006 and FY 2005**

Description	FY 2006	FY 2005	Change
Gross Patient/Resident Charges	\$529,238,333	\$501,582,397	\$27,655,936
Less: Charity Allowance	(257,538,353)	(273,467,280)	15,928,927
Plus: Third Party Cost Settlements Receivable	24,154,547	23,123,397	1,031,150
Less: Contractual Adjustments	(3,479,510)	41,530,632	(45,010,142)
Net Patient Service Revenue	\$292,375,017	\$292,769,146	(\$394,129)

10. RISK MANAGEMENT AND SELF-INSURANCE

DMHMRSAS is a participant in the Commonwealth of Virginia's self-insurance program administered by the Department of Treasury, Division of Risk Management (DRM) and the Department of Human Resource Management (DHRM). The two types of plans offered include a health care plan for state employees administered by DHRM and a Risk Management Plan and Workers Compensation Plan offered by DRM and DHRM, respectively. Risk management insurance includes property, boiler and machinery, crime, employee dishonesty bond, general (tort) liability, professional liability, and automobile liability. These self-insurance plans are accounted for by the Commonwealth of Virginia in an Internal Service Fund. Detailed information relating to these plans is available at the statewide level only in the Commonwealth's Comprehensive Annual Financial Report for FY 2006.

In the opinion of management, such coverage is adequate to provide for the ultimate liability, if any, which might result from the settlement of claims currently asserted against DMHMRSAS, as well as the potential liability for incidents of which DMHMRSAS has knowledge, but for which claims have not yet been asserted against DMHMRSAS. Accordingly, no provision is included in the financial statements for such potential liabilities. Sufficient information has not been developed by DMHMRSAS to provide a reasonable basis for estimation of the potential liability for incurred incidents, which have not been reported to DMHMRSAS; however, in the opinion of management, any potential liability for unreported incidents is not expected to have a material effect on the financial position of DMHMRSAS.

DMHMRSAS is self-insured for the first \$100,000 of each risk management loss, subject to any limitations indicated in the Code of Virginia. The Commonwealth of Virginia has not had any insurance settlements exceed the coverage during the past three years.

11. RETIREMENT PLAN

Employees of DMHMRSAS are employees of the Commonwealth. Substantially all full-time classified salaried employees participate in a defined benefit pension plan administered by the Virginia Retirement System (VRS). Information relating to this plan is available at the statewide level only in the Commonwealth of Virginia's Comprehensive Annual Financial Report. The Commonwealth, not DMHMRSAS, has overall responsibility for contributions to this plan. Total pension costs under the plan were \$29,525,740 for the year ended June 30, 2006.

12. POST-EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

The Commonwealth participates in the VRS-administered statewide group life insurance program that provides post-employment life insurance benefits to eligible retired and terminated employees. The Commonwealth also provides healthcare credits against the monthly health insurance premiums of its retirees who have at least 15 years of state service and participate in the state health plan. Information related to these plans is available at the statewide level in the Commonwealth's Comprehensive Annual Financial Report.

13. DEFERRED COMPENSATION PLANS

DMHMRSAS through the Commonwealth offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The Virginia Retirement System (VRS) administers the deferred compensation plan, pursuant to the Government Employees Deferred Compensation Plan Act, Section 51.1, Chapter 6 et seq. of the *Code of Virginia*. The VRS contracts with private corporations or institutions subject to the standards set forth in the *Code* to provide investment products as well as any other goods and services related to the administration of the deferred compensation plan. The Commonwealth's Department of Accounts is responsible for the accounting, reconciliation, and record keeping associated with State employees' enrollment, payment to the plan through payroll deductions, and timely transfer of withheld funds to the trustee designated by the VRS for investment. The plan provides a number of investment options and is designed so that each participant retains investment control of his/her individual account. The plan, available to all State employees, permits them to defer a portion of their salary until future years. The deferred compensation is held in trust for the exclusive benefit of plan participants and their beneficiaries and is not available to employees until termination, retirement, death, or unforeseeable emergency. Since the VRS has no fiduciary relationship with plan participants, plan assets are not included in the financial statements. In addition, the Commonwealth provides a cash match under Internal Revenue Code Section 401(a) for employees participating in the deferred compensation plan who have been employed at least one year. During the current fiscal year, the maximum match was \$20 per pay period or \$40 per month. The fair value of assets in the cash match savings plan at June 30, 2006, is also excluded from the financial statements. Further information related to these plans is available at the statewide level in the Commonwealth's Comprehensive Annual Financial Report.

14. ENDOWMENTS

Donor restricted endowments reside within DMHMRSAS facilities. The net appreciation available for expenditure is \$248,093, and of this amount, \$247,996 is reported as restricted net assets. The *Code of Virginia* authorizes acceptance of donations. Facility management and the donor agreements determine whether net appreciation can be spent and the accepted spending rate. These policies may vary with each institution.

15. PRIVATE-PUBLIC EDUCATIONAL FACILITIES AND INFRASTRUCTURE (PPEA)

PPEA resulted from legislation that permitted an alternative tool that allows public entities to more efficiently develop infrastructure and achieve better value for the taxpayer. The PPEA allows for solicited and unsolicited proposals to develop or operate a qualifying project. Using the PPEA process, DMHMRSAS entered into comprehensive agreements with Gilbane Development Companies on December 20, 2005 for the building of an initial 100 bed facility to treat sexually violent predators and to replace the geriatric wing of Eastern State Hospital with a new 150 bed geriatric facility. These facilities are known as Virginia Center for Behavioral Rehabilitation (VCBR) and Hancock Geriatric Treatment Center (HGTC), respectively. As of June 30, 2006, the department paid \$1.2 million towards the \$31.5 million cost for VCBR and \$1million towards the \$22.5 million cost for HGTC. On July 26, 2006 a change order was executed to expand VCBR to a 300- bed facility. The cost of the expanded 300-bed facility is \$58.8 million. DMHMRSAS will be operating these facilities once construction is complete.

16. EXPENSE PROGRAM DESCRIPTIONS

The Department reports expenses under various state programs. These programs are briefly described below. This categorization will be changed in our FY 2007 Annual Financial Report to line up with the new service area categories advanced by the Department of Planning and Budget.

State Health Services (430):

Efforts to provide direct health care services to individuals and families through state-operated facilities.

Administration and Support Services (449):

Efforts to provide overall administrative and logistical support services. This includes general management, computer services, food services, housekeeping, laundry, physical and power plant, and training.

Financial Assistance for Health Services (445):

Efforts to provide financial aid to localities for the provision of local health services. This includes CSB funding for mental health, mental retardation, substance abuse, and administrative services.

Secure Confinement (357):

Efforts to hold patients in secure confinement until such time as they can be returned to the community. These include the forensic unit at Central State Hospital and the Virginia Center for Behavioral Rehabilitation.

Instruction (197):

Efforts to provide academic elementary and secondary education. This includes basic skills and knowledge instruction as well as occupational-vocational instruction.

Community Health Services (440):

Efforts to provide health care services to individuals and families through community-based services.

Regulation of Public Facilities (561):

Efforts to inspect, certify, and regulate public facilities and services, both publicly and privately operated.

Health, Research, and Planning (406):

Efforts to promote the public health through research planning, and coordination of services and activities.

Vending Facilities (806):

Efforts to provide food services.

**Virginia Department of Mental Health, Mental Retardation and Substance Abuse Services
Schedule of Expenditures of Federal Awards
For Fiscal Year Ended June 30, 2006**

Federal Sponsor/Program	CFDA#	Balance 7/1/05	Receipts	Disb.	Balance 6/30/06
<u>MONETARY ASSISTANCE</u>					
<u>U.S. DEPT. OF HEALTH & HUMAN SERVICES:</u>					
Direct Payments:					
PATH Grant	93.150	-	\$1,151,496	\$1,151,496	-
Consolidated Knowledge Grant	93.230	-	242,898	242,898	-
Traumatic Brain Injury	93.234	-	35,629	35,629	-
SA and MH Regional Projects	93.243	-	1,143,143	1,143,143	-
CMS Research	93.779	-	76,424	76,424	-
Community MH Block Grant	93.958	-	10,210,735	10,210,735	-
SAPT Block Grant	93.959	-	43,647,307	43,646,342	965
State Homeland Security Program	97.067	-	85,000	85,000	-
<u>U.S. DEPT. OF EDUCATION:</u>					
Direct Payments:					
Grants for Infants and Families with Disabilities	84.181	-	9,394,348	9,394,346	2
<u>PASS THROUGH GRANTS:</u>					
VA Dept. of Health: Emergency Preparedness Grants	93.889	-	528,229	528,229	-
VA Dept. of Health: Universal Newborn Hearing Screening	93.251	-	20,000	12,784	7,216
VA Dept. of Social Services: Child Care Block Grant	93.575	-	274,434	274,434	-
VA Dept. of Social Services: Title IV E	93.658	-	77,014	77,014	-
VA Dept. of Criminal Justice Services: JABIG	16.523	-	375,119	375,119	-
VA Board for People w/ Disabilities: Improving Comm. Living	93.230	-	7,029	7,029	-
VA Dept. of Transportation: Improving Outcome for DUI	20.000	-	10,910	10,910	-
VA Dept of Med. Asst. Svcs: Medical Assistance Program	93.778	-	1,089,400	1,089,400	-
Total Monetary Assistance Central Office		-	68,369,115	68,360,932	8,183
<u>FACILITY FEDERAL ASSISTANCE</u>					
National School Lunch	10.555	38,043	37,710	59,872	15,881
Education of Handicapped Children	84.027	(716)	67,325	70,198	(3,589)
Internet Grant	N/A	16,697	-	-	16,697
National School Breakfast	10.553	22,402	17,078	10,960	28,520
FEMA Grants	97.036	77,743	112,317	1,554	188,506
State Homeland Security Program	97.067	-	85,000	254,917	(169,917)
Total Facility Assistance		154,169	319,430	397,501	76,098
Total Monetary Assistance		154,169	68,688,545	68,758,433	84,281
<u>NONMONETARY ASSISTANCE</u>					
<u>U.S. DEPT OF AGRICULTURE</u>					
Pass Through Assistance: Federal Surplus Food Program	10.550	15,101	7,373	16,168	6,306
Total Federal Assistance		\$169,270	\$68,695,918	\$68,774,601	\$90,587

This Schedule is presented on the cash basis of accounting

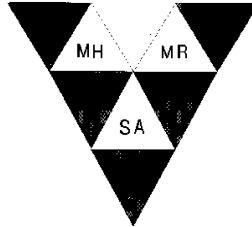
Chronological History

***CHRONOLOGICAL HISTORY OF THE VIRGINIA
DEPARTMENT OF MENTAL HEALTH, MENTAL RETARDATION AND
SUBSTANCE ABUSE SERVICES***

- 1773 Public Hospital for Persons of Insane and Disordered Minds (currently known as Eastern State Hospital) is established in Williamsburg. This facility is the first in the new world designed exclusively for treatment of people with mental disabilities.
- 1825 Western State Hospital is established in Staunton.
- 1841 Public Hospital for Persons of Insane and Disordered Minds changes its name to Eastern Lunatic Asylum.
- 1869 Central State Hospital is established in Howards Grove.
- 1885 Central State Hospital is moved to Petersburg.
- 1886 Southwestern State Hospital (currently known as Southwestern Virginia Mental Health Institute) is established in Marion.
- 1894 Eastern Lunatic Asylum changes its name to Eastern State Hospital.
- 1909 Catawba Hospital is established near Salem.
- 1910 The Virginia State Colony for the Epileptic and Feeble-minded (currently known as Central Virginia Training Center) is established in Lynchburg to serve people with mental retardation.
- 1911 Individual boards are created to govern each state hospital and the state colony in Lynchburg.
- 1918 Piedmont Hospital (currently Piedmont Geriatric Hospital) is established near Burkeville.
- 1929 DeJarnette Center is established in Staunton.
- 1936 The first state hospital board (currently known as the State Mental Health, Mental Retardation and Substance Abuse Services Board) is established.
- 1939 Petersburg Colony (currently known as Southside Virginia Training Center) is established to serve people with mental retardation.
- 1940 The Virginia State Colony for the Epileptic and Feeble-minded changes its name to the Lynchburg State Colony.
- 1942 The Department of Mental Hygiene and Hospitals is established in Richmond (currently known as the Department of Mental Health, Mental Retardation and Substance Abuse Services). Hugh C. Henry, MD is appointed the first Commissioner. Daily average patient census is 14,189.
- 1946 Joseph E. Barrett, MD is appointed second Commissioner. Daily average patient census is 13,656.
- 1954 The Lynchburg State Colony changes its name to the Lynchburg Training School and Hospital.
- 1957 Hiram W. Davis, MD is appointed as third Commissioner. Daily average patient census is 13,706.
- 1968 The General Assembly passes legislation (Chapter 10 of Title 37.1) allowing the establishment of community services boards. Northern Virginia Mental Health Institute is established in Falls Church.
- 1969 William Allerton, MD is appointed as fourth Commissioner. Daily average patient census is 14,501.

- 1971 The name of the Petersburg Colony is changed to the Petersburg Training School and Hospital.
- 1973 Northern Virginia Training Center and Southwestern Virginia Training Center are established in Fairfax and Hillsville, respectively. The Department of Mental Hygiene and Hospitals changes its name to the Department of Mental Health and Mental Retardation.
- 1974 The name of the Petersburg Training School and Hospital is changed to Southside Virginia Training Center.
- 1975 Southeastern Virginia Training Center is established in Chesapeake.
- 1976 By act of the General Assembly, the Division of Drug Abuse Control is merged with the Bureau of Drug Rehabilitation in the Department of Mental Health and Mental Retardation to form the Division of Substance Abuse. Leo Kirven, MD is appointed as fifth Commissioner. Daily average patient census is 10,227.
- 1977 Southern Virginia Mental Health Institute is established in Danville.
- 1979 Hiram Davis Medical Center is established in Petersburg.
- 1980 The General Assembly amends Chapter 10 to require all cities and counties to join or establish a community services board by July 1, 1983.
- 1981 Joseph Bevilacqua, Ph.D. is appointed as sixth Commissioner. Daily average patient census is 8,024.
- 1983 Statewide coverage of community services boards is achieved.
- 1985 The Lynchburg Training School and Hospital changes its name to Central Virginia Training Center.
- 1986 Howard M. Cullum is appointed as seventh Commissioner. Daily average patient census is 6,154.
- 1987 The Department of Mental Health and Mental Retardation becomes the Department of Mental Health, Mental Retardation and Substance Abuse Services.
- 1988 The General Assembly enacts a \$68 million community services initiative, the single largest infusion of state funding for community services. The Southside MHMR Support Unit is merged with Southside Virginia Training Center.
- 1990 King E. Davis, Ph.D. is appointed as eighth Commissioner. The geriatric unit at Western State Hospital and the adolescent unit at Eastern State Hospital are closed and patients transferred. Daily average patient census is 5,714.
- 1991 The Department implements Medicaid State Plan Option and mental retardation waiver with community services boards. The Virginia Treatment Center for Children is transferred to the Medical College of Virginia to more adequately serve the hospital's research needs.
- 1994 Timothy A. Kelly, Ph.D. is appointed as ninth Commissioner. Daily average patient census is 4,924.
- 1997 Richard E. Kellogg is appointed acting Commissioner. Daily average patient census is 4,176.

- 1998 Richard E. Kellogg is appointed as tenth Commissioner. The Hall-Gartlan Commission completes its work and makes significant recommendations for change in the system of publicly funded mental health, mental retardation, and substance abuse services. This leads to a major rewrite of portions of the Code of Virginia dealing with community mental health, mental retardation, and substance abuse services. Daily average patient census is 4,048.
- 1999 Admissions to state hospitals continue to decline as medications used in community settings become more effective. Total admissions to state hospitals declined by 1,193 or 19% to 6,316. Daily average patient census is 3,799.
- 2000 Admissions to state hospitals continue to decline. Total admissions to state hospitals declined by 1,146 or 18.1% to 5,170. The daily average patient census is 3,505.
- 2001 Admissions to state hospitals increased moderately. Total admissions to state hospitals increased by 154 or 3% to 5,324. The daily average patient census is 3,191. DeJarnette Center changes its name to Commonwealth Center for Children and Adolescents.
- 2002 James S. Reinhard, MD is appointed as eleventh Commissioner. Total admissions to state hospitals increased by 734 or 13% to 6,058. The daily average patient census is 3,342. Due to severe state budget and economic conditions, the Department is required to reduce expenses by \$33.4 million in fiscal year 2003 and \$37.3 million in fiscal year 2004. These reductions apply to the Department's facilities, Central Office, and Community Program (CSB) funding.
- 2003 The patient/resident average continued to decline. Average census was 3,263. Due to recessionary times experienced by the Commonwealth as well as the nation, the Department was forced to reduce its workforce. Total full time staff employed by the Department at June 30 was 8,967, down from 9,090 the previous year. State funding to community programs was reduced by 10%. The Department, in partnership with community services boards and state hospitals, began a series of regional reinvestment projects. These projects involve the reallocation of current state hospital resources to community programs. Legislation creating the Virginia Center for Behavioral Rehabilitation (VCBR) is enacted and Dinwiddie County is selected as the initial site. VCBR is established to treat sexually violent predators.
- 2004 The patient/resident average census continued to decline and amounted to 3,157 at the close of the year. Regional reinvestment projects, initially started in fiscal year 2003, continued as the Department moved forward in making efforts to maximize resources in community settings. Although not officially transitioned until early fiscal year 2005, fourteen information technology services staff are transferred from the Department to the newly formed Virginia Information Technology Agency (VITA).
- 2005 Patient/resident census declined to 3,069. The Department submitted its 2006-2008 biennium budget in the summer and fall of 2005. Governor Warner included \$170 million in new spending attributable to community-based services and \$290 million in capital money to replace Eastern State Hospital, Western State Hospital, Central Virginia Training Center and Southeastern Virginia Training Center. The Governor's budget proposal is to be discussed and debated during the 2006 legislative session. The Department employed 8,770 full-time employees including 4,520 at its mental health facilities, 3,996 at its training centers for the mentally retarded and 254 in its Central Office.
- 2006 Patient/resident census continued to decline. The average census was to 3,033. New funding initiatives in the community along with approval to replace four facilities (Eastern State, Western State, Southeastern Virginia Training Center and Central Virginia Training Center) were approved by the General Assembly. The new initiatives will become effective during the 2006-2008 biennium.



ACKNOWLEDGEMENTS

This annual report was prepared under the direction of Joy Yeh, CPA, Ph.D., Assistant Commissioner, Finance and Administration and Kenneth M. Gunn, Jr., CPA, CGFM, Director, Office of Budget and Financial Reporting. Annual financial statement preparation is very much a team effort and could not have been possible without the diligent efforts of facility financial management staff and those offices in the Division of Finance and Administration at the Central Office.

The team involved in preparing this report includes: Nauri D. Ahmed, CPA, CGFM; Danielle Y. Claiborne; and Gerald M. Spivey, CGFM, CFE (Financial Management Analysts within the Office of Budget and Financial Reporting). Assistance was also provided by: Jimmy Hodges, CGFM; Cynthia Hatch; and Ben Saunders (Budget Managers within the Office of Budget and Financial Reporting). Brenda Mantlo, Executive Secretary to Dr. Yeh, was also instrumental in the production of this report.

The Auditor of Public Accounts (APA) has audited previous years' operations of the Department. These audits have been favorable. The Department has been committed to cooperating, within its resources, to comply and implement all APA recommendations. Copies for prior years' audit reports may be obtained by writing or contacting the APA. The address is:

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