

## **PART II, FINDINGS RELATING TO THE FINANCIAL STATEMENTS**

Findings and recommendations as a result of our examination are presented below. We reviewed these findings and recommendations with management to provide an opportunity for their response. The county executive's written responses are paraphrased in this report. Other officials offered oral responses to certain findings and recommendations; however, these oral responses have not been included in this report.

### **OFFICE OF COUNTY EXECUTIVE**

**FINDING 02.01**      **THE OFFICE DID NOT PROPERLY MAINTAIN INVENTORY RECORDS AND CONTROLS OVER ASSETS**  
(Internal Control – Reportable Condition Under Government Auditing Standards)

Our audit revealed the following deficiencies in records of and controls over assets owned by the general county government:

- A.      Assets were not tagged or otherwise clearly marked as county property.
- B.      No procedures were in place to ensure that newly acquired assets were added to the inventory. Also, the inventory did not include the serial numbers of all equipment.
- C.      The office did not have procedures to ensure that persons independent of inventory recordkeeping verified the inventory.

Generally accepted accounting principles require accountability for all county-owned assets.

### **RECOMMENDATION**

The County Executive's Office should improve controls over assets by establishing policies and procedures for tagging or labeling all assets as county property, recording newly acquired assets in the records, and ensuring that personnel independent of recordkeeping verify the inventory.

### **MANAGEMENT'S RESPONSE – COUNTY EXECUTIVE**

Assets of the County Executive's Office are clearly marked and recorded on the inventory records. I have requested inventory lists from the other offices and departments; however, I cannot force other elected officials to mark and list county property. They should be totally responsible for items under their control. Also, I am not aware of any state law that requires me to check the inventory of any other elected official. The county executive is responsible only for assets of that office and not assets in the custody of other officers.

## REBUTTAL

Section 5-6-108, Tennessee Code Annotated, requires that the county executive serve as the accounting officer and general agent for the county and ensure “the care and custody of all the county property, except such as is by law placed in the custody of other officers ...” The “other officers” referred to in this section are the School and Highway Departments. The County Executive’s Office is required to maintain an inventory of all assets owned by the general county government and should establish policies and procedures to safeguard these assets.

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## OFFICE OF HIGHWAY SUPERINTENDENT

FINDING 02.02      **THE OFFICE HAD DEFICIENCIES IN PURCHASING PROCEDURES**  
(Internal Control – Reportable Condition Under Government Auditing Standards)

Our examination of the office’s purchasing procedures revealed the following deficiencies:

- A. Purchase orders were not issued properly in all applicable instances. In several instances, purchase orders were issued after goods or services were purchased. This practice defeats the purpose of the purchase orders and makes them approval of payments rather than approval of purchases. Also, our examination disclosed a few instances in which purchase orders were not issued for purchases.
- B. In several instances, invoices were paid without documentation that goods and services had been received. This practice weakens controls over the purchasing process. We extended our audit procedures and determined that these goods and services were received.

## RECOMMENDATION

Purchase orders should be issued properly for all applicable purchases. Also, documentation should be obtained indicating goods and services have been received before invoices are paid.

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FINDING 02.03      **THE OFFICE DID NOT PROPERLY MAINTAIN INVENTORY RECORDS AND CONTROLS OVER ASSETS**  
(Internal Control – Reportable Condition Under Government Auditing Standards)

Our audit revealed the following deficiencies in records of and controls over assets owned by the Highway Department:

- A. All assets were not tagged or otherwise clearly marked as county property.
- B. The inventory did not contain serial numbers for all items listed. Also, listed serial numbers and descriptions were incorrect in a few instances. We determined that these items were on hand and furnished the Highway Department with the correct information.
- C. Some assets were not included on the inventory. Our examination revealed a trackhoe, two salt spreaders, and a small loader that were not included on the inventory records.
- D. The county did not have procedures to ensure that persons independent of inventory recordkeeping verified the inventory.

Generally accepted accounting principles require accountability for all county-owned assets.

### RECOMMENDATION

The Highway Department should improve controls over assets by establishing policies and procedures for tagging or labeling all assets of the Highway Department as county property. These records should include all assets of the department and the correct serial numbers. Also, the department should ensure that personnel independent of recordkeeping verify the inventory.

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### OFFICE OF DIRECTOR OF SCHOOLS

FINDING 02.04      **DEFICIENCIES WERE NOTED INVOLVING CONTRACTS FOR THE CONSTRUCTION OF A NEW ELEMENTARY SCHOOL**  
 (A. and C. Noncompliance Under Government Auditing Standards; B. Internal Control – Reportable Condition Under Government Auditing Standards)

The following deficiencies were noted involving contracts for the construction of a new elementary school:

- A. The School Department entered into a contract with a construction company to act as the construction manager of a new elementary school construction project. This contract provided for the construction manager to oversee construction of the new school facility and allowed the company to enter into contracts directly with subcontractors. The contract also provided for the construction manager to make payments directly to the subcontractors. We know of no statutory authority that would allow a School Department to authorize a construction manager to enter into contracts and make payments to a third party on the county's behalf.

- B. The director of schools did not require sufficient documentation for disbursements made by the construction manager to subcontractors. The department received only summary payment requests on a monthly basis from the construction manager. The payment requests only listed the total dollar value of work finished by the subcontractor and payment amount due to each subcontractor. The director of schools then paid the construction manager these amounts, and the construction manager was then responsible for paying the subcontractors.
- C. The department's accounting records for the construction project reflected only the cash transactions (cash disbursements and cash balances). Records were not maintained to document the status of the project and the amount of funds the construction manager obligated through contracts with subcontractors and vendors for supplies and materials. The construction manager provided us this information, and accordingly, we have posted adjustments to reflect commitments (contracts entered into by the construction manager for the project prior to June 30, 2002) of \$5,348,691 in the financial statements of this report. Due to our posting of these obligations, the Other Education Capital Project Fund reflects a fund deficit of \$5,022,563 at June 30, 2002. This deficit should be liquidated when additional loan proceeds are received from the Montgomery County Public Building Authority.

## RECOMMENDATION

The department should not enter into contracts that allow construction managers to make payments to third parties on behalf of the School Department and, for the existing contract, should require itemized statements from the construction manager for payments made to subcontractors. Also, the accounting records of the Other Education Capital Projects Fund should be maintained in accordance with generally accepted accounting principles, including properly reflecting contract obligations in the financial statements.

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## OFFICE OF TRUSTEE

### FINDING 02.05      **THE TRUSTEE DID NOT ADEQUATELY COLLATERALIZE FUNDS EXCEEDING FDIC COVERAGE** (Noncompliance Under Government Auditing Standards)

The trustee did not have adequate escrow coverage to collateralize funds exceeding Federal Deposit Insurance Corporation (FDIC) coverage. At June 30, 2002, funds on deposit exceeded FDIC coverage and pledged securities by \$1,784,734. Section 5-8-201, Tennessee Code Annotated, provides for county officials to require any bank that is a depository of county funds to deposit in an escrow account in a second bank collateral security equal to 105 percent of county funds.

RECOMMENDATION

The trustee should require depositories to pledge securities in sufficient amounts to fully protect county funds exceeding FDIC coverage, as required by state statute.

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**OFFICE OF CIRCUIT AND GENERAL SESSIONS COURTS CLERK**

**FINDING 02.06      BANK STATEMENTS FOR GENERAL SESSIONS COURT WERE NOT RECONCILED WITH CASH JOURNAL ACCOUNTS  
(Internal Control – Reportable Condition Under Government Auditing Standards)**

Bank statements for General Sessions Court were not reconciled with cash journal accounts for the year examined. As a result, errors made in posting bank transactions to the cash journal were not discovered and corrected.

RECOMMENDATION

Bank statements should be reconciled with cash journal accounts monthly, and errors discovered in the reconciliation process should be investigated and corrected promptly.

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**FINDING 02.07      THE OFFICE OF CIRCUIT AND GENERAL SESSIONS COURTS HAD DEFICIENCIES IN RECEIPTING AND DEPOSITING COLLECTIONS  
(A., B. Noncompliance Under Government Auditing Standards;  
C. Internal Control – Reportable Condition Under Government Auditing Standards)**

We noted the following deficiencies involving the courts' receipt and deposit of collections:

- A. The clerk did not deposit funds collected in General Sessions Court to the court's bank account within three days of collection. Section 5-8-207, Tennessee Code Annotated (TCA), requires county officials to deposit office funds within three days of collection.
- B. Official, prenumbered receipts were not issued for General Sessions Court traffic school collections, as required by Section 9-2-103, TCA.
- C. The clerk did not deposit collections of Circuit and General Sessions Courts intact to the courts' bank accounts. Employees were allowed to cash personal checks from collections of both courts, and the funds of both courts were commingled.

## RECOMMENDATION

All funds should be receipted with official, prenumbered receipts and deposited to the bank account within three days of collection, as required by state statutes. Employees should not be allowed to cash checks from office collections, and collections of each court should be deposited intact to that court's bank account.

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### FINDING 02.08      **THE EXECUTION DOCKET TRIAL BALANCE FOR GENERAL SESSIONS COURT DID NOT RECONCILE WITH CASH JOURNAL ACCOUNTS** (Noncompliance Under Government Auditing Standards)

As of June 30, 2002, the clerk prepared a trial balance of execution docket balances for General Sessions Court, as required by Section 18-2-103, Tennessee Code Annotated (TCA). However, this trial balance did not reconcile with cash journal accounts by a material amount. We were unable to determine if the clerk had complied with provisions of the Unclaimed Property Act, Section 66-29-110, TCA. This statute provides that any funds held by the courts for more than one year and unclaimed by the owner are considered abandoned. Section 66-29-113, TCA, further requires these funds to be reported and paid to the state Treasurer's Office.

## RECOMMENDATION

The execution docket trial balance for General Session Court should be reconciled with cash journal accounts. Any funds held by the court for more than one year and unclaimed by the owner are considered abandoned and should be reported and paid to the state Treasurer's Office in compliance with state statute.

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## OTHER FINDINGS AND RECOMMENDATIONS

### FINDING 02.09      **QUESTIONABLE PRACTICES SURROUND THE PURCHASE OF A USED FIRE TRUCK FROM THE COUNTY'S AGENT** (Material Noncompliance Under Government Auditing Standards)

On September 28, 2000, county executive David Beaty signed a letter that stated "Charles Kerns is acting as an agent for Fentress County Government to procure fire equipment or other articles as needed by Fentress County." After his appointment, Mr. Kerns assisted Fentress County in purchasing various items of fire department equipment and was

reimbursed for his travel expenses. These purchases of equipment were made by a county warrant payable directly to the vendors. However, the following deficiencies were noted concerning the county's purchase of a used fire engine:

- A. Fentress County purchased a used fire truck from Charles Kerns, the county's agent, for \$20,000 on August 13, 2002. Title documents on file disclose that Mr. Kerns purchased the fire truck in question for \$10,000 shortly before selling it to the county for \$20,000. Because Mr. Kerns was acting as the county's agent for the procurement of fire equipment at the time of this sale, we question the legality of this sale.
- B. The fire truck was not purchased on the basis of competitive bids solicited through public advertisement, as required by the county's purchasing law. Sections 5-14-201 to 5-14-206, TCA, require all purchases exceeding \$5,000 to be based on competitive bids solicited through public advertisement. Exceptions to bidding requirements are made for purchases made from sole suppliers and for emergency purchases.
- C. The County Commission voted to purchase the fire truck from Mr. Kerns as an emergency purchase in its August 12, 2002, meeting. However, no reasons were given to explain why the purchase was considered an emergency.

We have discussed this matter with a representative of the District Attorney General's Office.

#### RECOMMENDATION

County officials should seek legal advice to determine if the county is due a refund of \$10,000 on the purchase of the fire truck. All county purchases should be made in compliance with the county's purchasing statutes. If a purchase is deemed an emergency, documentation should be provided clearly explaining the emergency and the reason why proper purchasing procedures cannot be followed.

#### MANAGEMENT'S RESPONSE – COUNTY EXECUTIVE

I strongly disagree with the finding. I appointed Mr. Kerns as "acting" agent for Fentress County on a temporary basis two years ago. The appointment was not intended to be permanent. The letter of appointment was necessary for Mr. Kerns to receive, on behalf of Fentress County, much needed equipment from Virginia fire departments. The purchase of the fire truck was requested by a county commissioner. Mr. Kerns and the truck were present in the courthouse parking lot before and after the commission meeting. The members of the County Commission inspected the fire truck and then voted to purchase it for \$20,000 as an emergency purchase. The County Commission had the authority to declare the situation an emergency. I had nothing to do with the purchase of the truck except to pay for it.

## REBUTTAL

Mr. Kerns was appointed as “acting” agent in September 2000 and continued to serve in that capacity through the end of Mr. Beaty’s term that ended on August 31, 2002. Mr. Kerns was then reappointed an “acting” agent for the county by the new county executive, John Mullinix. Although Mr. Kerns was not a paid employee of the county, he considered himself a representative of the county, evidenced by payments he received for travel expenses and procurement of equipment for Fentress County. In addition, on grant applications Mr. Kerns submitted on behalf of Fentress County during this time he listed himself as the contact person. Therefore, it does appear that Mr. Kerns was “acting” as an agent for the county at the time this fire truck was purchased from him.

Also certain provisions in state statutes must be followed before a purchase can be considered an emergency purchase. One of these provisions in Section 5-14-204(3)(A), TCA, states that “a record of any emergency purchase shall be made by the person or body authorizing such purchase, and shall specify the amount paid, the items purchased, from whom the purchase was made and the nature of the emergency.” The records of the County Commission meeting authorizing the purchase of this fire truck do not provide any reason why this purchase is an emergency. Therefore, we question if this purchase was indeed an emergency purchase and not subject to the county’s bidding requirements.

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### FINDING 02.10      **RECORDS WERE NOT MAINTAINED FOR GENERAL FIXED ASSETS** (Internal Control – Material Weakness Under Government Auditing Standards)

Fentress County did not inventory, value, and record its general fixed assets (buildings, equipment, etc.), as required by generally accepted accounting principles. The Governmental Accounting Standards Board has adopted Statement 34, which will become effective for Fentress County for the year ending June 30, 2004. Statement 34 places an even greater emphasis on the need to maintain general fixed asset records.

### RECOMMENDATION

Fentress County should inventory, value, and record its general fixed assets in accordance with generally accepted accounting principles.

### MANAGEMENT’S RESPONSE – COUNTY EXECUTIVE

The County Executive’s Office has compiled the first-ever complete inventory list of all Fentress County fixed assets with the assistance of the State Planning Office, the Fentress

County Planning Commission, and the County Commission. The only thing unfinished was placing a value on some of the properties. The Governmental Accounting Standards Board adopted Statement 34 effective for Fentress County for the 2004 year, not the 2002 year. Also, GASB 34 is not a law.

### REBUTTAL

A self-balancing group of accounts for all general fixed assets is currently required by generally accepted accounting principles. The absence of fixed asset records requires us to issue a qualified opinion on the county's financial statements.

The Governmental Accounting Standards Board (GASB) is the standard-setting body for the accounting principles that must be followed by state and local governments. While the standards issued by the GASB are not laws, a state or local government must follow them to be in compliance with generally accepted accounting principles. If a county decides not to implement the requirements of GASB Statement 34, we will be forced to issue an adverse opinion on the county's financial statements. An adverse opinion means that the county's financial statements are not fairly presented in accordance with generally accepted accounting principles. As noted in the finding, GASB Statement 34 becomes effective for Fentress County for the year ending June 30, 2004.

**FINDING 02.11**      **A SYSTEM OF CENTRAL ACCOUNTING, BUDGETING, AND PURCHASING HAD NOT BEEN ADOPTED**  
(Internal Control – Reportable Condition Under Government Auditing Standards)

Fentress County officials had not adopted a system of central accounting, budgeting, and purchasing. Establishing a central system would significantly improve internal controls over the accounting, budgeting, and purchasing processes.

### RECOMMENDATION

Fentress County officials should consider adopting the County Financial Management System of 1981 or a private act which would provide for a system of central accounting, budgeting, and purchasing covering all county departments.

### MANAGEMENT'S RESPONSE – COUNTY EXECUTIVE

I have recommended that the County Commission adopt a system of central accounting, budgeting, and purchasing. However, they have chosen not to adopt such a system.

FINDING 02.12

**DUTIES WERE NOT SEGREGATED ADEQUATELY IN THE OFFICES OF COUNTY EXECUTIVE, HIGHWAY SUPERINTENDENT, DIRECTOR OF SCHOOLS, TRUSTEE, COUNTY CLERK, CIRCUIT AND GENERAL SESSIONS COURTS CLERK, CLERK AND MASTER, REGISTER, AND SHERIFF**  
(Internal Control – Reportable Condition Under Government Auditing Standards)

Duties were not segregated adequately among officials and employees in the Offices of County Executive, Highway Superintendent, Director of Schools, Trustee, County Clerk, Circuit and General Sessions Courts Clerk, Clerk and Master, Register, and Sheriff. Officials and employees responsible for maintaining the accounting records in these offices were also involved in receipting, depositing, and/or disbursing funds. We realize that due to limited resources and personnel, management may not be able to properly segregate duties among employees. However, our professional standards require that we bring this matter to the reader's attention in this report.