

PART II, FINDINGS RELATING TO THE FINANCIAL STATEMENTS AND FEDERAL AWARDS

Findings and recommendations as a result of our examination are presented below. We have reviewed these findings and recommendations with management to provide an opportunity for their response. Excerpts from the written response of the director of schools are quoted directly in this report. The director of accounts and budgets also prepared a written corrective action plan for finding 02.03 dealing with a reportable condition under OMB Circular A-133. That corrective action plan is presented following Part III. Other officials offered oral responses to certain findings and recommendations; however, these oral responses have not been included in this report.

OFFICE OF DIRECTOR OF ACCOUNTS AND BUDGETS

FINDING 02.01 THE DOCUMENTATION OF BUDGET AMOUNTS APPROVED BY THE COUNTY COMMISSION HAD DEFICIENCIES
(Internal Control – Material Weakness Under Government Auditing Standards)

Appropriations reflected in this report were taken directly from records maintained in the Office of Accounts and Budgets. Some budget amendments posted to the accounting records could not be traced to the County Commission minutes. Also, the appropriation resolution printed in the minutes only reflected a total appropriation figure for each fund and did not present appropriations at the major category levels. Therefore, our opinion on the financial statements is qualified because we were unable to determine if all budgets and budget amendments reflected on the financial statements were properly approved by the County Commission.

RECOMMENDATION

All budget entries posted to the accounting records should be documented with copies of County Commission approvals. Also, the appropriation resolution printed in the minutes should include appropriations at major category levels.

FINDING 02.02 AN UNAUTHORIZED INTERFUND LOAN OF \$290,000 WAS MADE DURING THE YEAR AND REMAINS OUTSTANDING
(Material Noncompliance Under Government Auditing Standards)

An interfund loan of \$290,000 was made from the General Purpose School Fund to the School Federal Projects Fund during the year. This loan had not been approved by the County Commission or by the state director of Local Finance, as required by Section 9-21-408, Tennessee Code Annotated. Also, the loan had not been repaid as of the date of this report.

RECOMMENDATION

The \$290,000 interfund loan should be repaid immediately. All interfund loans should be approved by the County Commission and the state director of Local Finance, as required by state statute.

FINDING 02.03 **GRANT ACTIVITY WAS NOT INCLUDED ON THE COUNTY'S ACCOUNTING RECORDS** (Internal Control—Reportable Condition Under OMB Circular A-133 and Under Government Auditing Standards)

Loudon County applied for and was awarded a grant of \$316,250 from the Appalachian Regional Commission. This grant was passed through the Tennessee Valley Authority (TVA) and was used to provide partial funding of improvements and extensions to waterlines owned by the Loudon Utilities District (LUD). Loudon County management directed TVA to remit the grant proceeds directly to the LUD. Therefore, the proceeds of the grant were not recorded on the county's accounting records. The failure to channel these funds through the county and the failure to record these proceeds on the accounting records materially misstates the county's financial statements and the schedule of federal financial assistance. We have recorded these transactions in the financial statements and schedule of federal financial assistance.

RECOMMENDATION

All grant proceeds should be channeled through the county and included in the county's accounting records.

FINDING 02.04 **THE GENERAL CAPITAL PROJECTS FUND AND THE INDUSTRIAL/ECONOMIC DEVELOPMENT FUND HAD FUND DEFICITS** (Internal Control – Reportable Condition Under Government Auditing Standards)

The following funds had fund deficits at June 30, 2002:

- A. The General Capital Projects Fund had a fund deficit of \$1,771,933 at June 30, 2002. This fund deficit resulted from the unperformed portions of construction projects of \$3,312,008 being reserved as encumbrances. Funding for these future expenditures is expected to be received from local revenue and future debt issuance. However, as of the date of this report, the county has not approved any debt issues for the project.

- B. The Industrial/Economic Development Fund (a Special Revenue Fund) had a fund deficit of \$16,859 at June 30, 2002, that resulted from building construction contracts of \$192,005 being reserved as encumbrances in the financial statements. This fund deficit should be liquidated when grant proceeds and funds from the city of Loudon are received subsequent to June 30, 2002.

Generally accepted accounting principles require unperformed contracts to be reflected as a reservation (encumbrance) of fund balance. If unperformed portions of the building construction had not been reserved as an encumbrance of the fund balance in the financial statements, the Industrial/Economic Development Fund would have reflected a fund balance of \$175,146. The following statement presents the condition of the Industrial/Economic Development Fund at June 30, 2002, if the unperformed portion of the contracts had not been reflected as a reservation of the fund balance:

Industrial/Economic Development Fund
Fund Equity - Restated
June 30, 2002

Fund Balance

Unreserved:

| | |
|-----------------------------|-------------------|
| Undesignated | \$ 175,146 |
| Fund Balance, June 30, 2002 | |
| Restated | <u>\$ 175,146</u> |

RECOMMENDATION

County officials should take appropriate steps to liquidate the fund deficits in the General Capital Projects Fund and the Industrial/Economic Development Fund.

FINDING 02.05 **ACCOUNTING FUNCTIONS FOR THE HIGHWAY DEPARTMENT WERE NOT PERFORMED IN ACCORDANCE WITH THE FISCAL CONTROL ACTS OF 1957**
(Noncompliance Under Government Auditing Standards)

Loudon County operates under the provisions of the Fiscal Control Acts of 1957, Section 5-13-101, et seq., Tennessee Code Annotated, which provides for the director of the Office of Accounts and Budgets to maintain accounting records for all funds administered by the county executive, highway superintendent, and director of schools. Accounting records for the Highway Department were maintained by personnel of that department under the supervision of the highway superintendent, rather than by the director of accounts and budgets.

RECOMMENDATION

The director of the Office of Accounts and Budgets should maintain the accounting records for the Highway Department in compliance with provisions of the Fiscal Control Acts of 1957.

FINDING 02.06 **BANK ACCOUNTS WERE NOT MAINTAINED PROPERLY** (Internal Control – Reportable Condition Under Government Auditing Standards)

The office had the following deficiencies in the maintenance of bank accounts:

- A. The office did not reconcile bank statements for the school payroll account with the general ledger balance. Without monthly reconciliations, errors may not be detected and corrected promptly. This account had a cash overdraft of \$4,870 as of June 30, 2002.
- B. The bank account maintained for the purpose of paying claims through the Employee Dental Insurance Fund was not reconciled on a monthly basis. In addition, the office failed to remit employee deductions and county matching amounts from other funds on a timely basis. These deficiencies resulted in a cash overdraft of \$11,414 in this account as of June 30, 2002.

RECOMMENDATION

Bank statements should be reconciled with the general ledger balances on a monthly basis, and any differences should be resolved immediately. Employee deductions and county matching amounts should be remitted to the Dental Insurance Fund on a timely basis.

FINDING 02.07 **THE COUNTY DID NOT FILE THE FINAL COST SETTLEMENT REPORT ON A TIMELY BASIS** (Noncompliance Under Government Auditing Standards)

During a prior year, Loudon County entered into an agreement with the Tennessee Department of Correction to house state prisoners on a cost-reimbursement basis. The reimbursement rate is based on the annual operating costs of the county jail. The county is required to document this cost by filing a final cost settlement report by September 30 of each year. The county failed to submit this report on a timely basis for the 2001 and 2002 years and only recently filed the final cost settlement report for the year ended June 30, 2001. As of the date of this report, the county had not filed the report for the year ended June 30, 2002. Because of the county's failure to file the final cost settlement reports, the Department of Correction has reduced the county's daily reimbursement rate from \$27.64 per state inmate to a flat rate of \$18 per state inmate starting in September 2001. This reduced rate has resulted in a loss of revenue to the county.

RECOMMENDATION

Management should ensure that the final cost settlement report is filed on a timely basis.

OFFICE OF DIRECTOR OF SCHOOLS

FINDING 02.08 **PURCHASES WERE NOT MADE THROUGH THE COUNTY PURCHASING AGENT** (Noncompliance Under Government Auditing Standards)

During the year, the School Department disbursed funds to the various individual schools' activity accounts and allowed the individual schools to make purchases of equipment and various other items. This practice does not comply with the County Purchasing Law of 1957, Section 5-14-101 et seq., Tennessee Code Annotated, which requires the county purchasing agent to make all purchases for the various county departments.

RECOMMENDATION

All School Department purchases should be made in compliance with state statute.

MANAGEMENT'S RESPONSE – DIRECTOR OF SCHOOLS

These funds are distributed to each school at the beginning of each school year and are subject to regular audit by a firm hired to perform a school audit. This firm verifies that the funds sent to schools are spent under proper financial purchasing and expenditure guidelines, and match with funds that have been sent to schools.

We feel strongly that the site-based policy, which we have in place, allows for a more efficient use of funds. This policy allows for an equal distribution of funds and better management of funds, based on student needs.

We feel that to centrally purchase all school supplies and materials would seriously affect the efficiency of this process.

REBUTTAL

This method of channeling funds to the individual schools is not provided for in state statutes. As stated in the finding, the County Purchasing Law of 1957 requires the purchasing agent to make all purchases for the various county departments.

OTHER FINDINGS AND RECOMMENDATIONS

FINDING 02.09 **DUTIES WERE NOT SEGREGATED ADEQUATELY IN THE OFFICES OF CIRCUIT AND GENERAL SESSIONS COURTS CLERK, CLERK AND MASTER, AND SHERIFF**
(Internal Control – Reportable Condition Under Government Auditing Standards)

Duties were not segregated adequately among the officials and employees in the Offices of Circuit and General Sessions Courts Clerk, Clerk and Master, 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.

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

Loudon County and the discretely presented Loudon County School Department did not inventory, value, and record their 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 in Loudon County for the year ending June 30, 2003. Statement 34 places an even greater emphasis on the need to maintain general fixed asset records.

RECOMMENDATION

Loudon County and the discretely presented Loudon County School Department should inventory, value, and record their general fixed assets in accordance with generally accepted accounting principles.