

PART II, FINDINGS RELATING TO THE FINANCIAL STATEMENTS

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. The written responses of the county executive, director of accounts and budgets, and director of schools are quoted directly in this report. Other officials offered oral responses to certain findings and recommendations; however, we did not include these oral responses in this report.

OFFICES OF COUNTY EXECUTIVE, DIRECTOR OF SCHOOLS, AND DIRECTOR OF ACCOUNTS AND BUDGETS

FINDING 03.01 **REVENUE ANTICIPATION NOTES LOANED TO THE SCHOOL DEPARTMENT WERE NOT RETIRED PRIOR TO THE CLOSE OF THE CURRENT FISCAL YEAR** (Material Noncompliance Under Government Auditing Standards)

Revenue anticipation notes borrowed by the School Department from the county's General Fund were not fully retired prior to the close of the current fiscal year, as required by Section 9-21-801, Tennessee Code Annotated. Throughout the fiscal year ended June 30, 2003, the county loaned funds from its General Fund to the School Department's School Renovation Fund (Special Purpose Fund) and General Purpose School Fund. The amount loaned to the Special Purpose Fund (\$450,000) was retired prior to year-end. However, of the amount loaned to the General Purpose School Fund, \$1,644,668 had not been repaid as of June 30, 2003. Total loans to the General Purpose School Fund amounted to \$12,844,668, with varying amounts outstanding during the year. The balance of this loan was paid subsequent to June 30, 2003.

RECOMMENDATION

Revenue anticipation notes the county loaned to the School Department should be retired prior to the close of the fiscal year, as required by state statute.

MANAGEMENT'S RESPONSE – DIRECTOR OF SCHOOLS

The unanticipated cash requirements due to mold issues at Sullivan East High School and unfunded mandates required by the State of Tennessee Fire Marshall's Office led to the inability to pay the tax anticipation note. Our self-funded health insurance run out claims added to our cash needs. We had been assured of sufficient funding at the time the budget was approved. County government did see that we had sufficient funds to meet our immediate cash flow requirements for the year. The revenue anticipation note was retired after June 30, 2003, with 2002-03 revenue receivables.

MANAGEMENT'S RESPONSE – COUNTY EXECUTIVE AND DIRECTOR OF ACCOUNTS AND BUDGETS

In regards to the management's response to audit findings on the repayment of school loans before June 30, 2003, the school funds' failure to repay the interoffice loan before the close of records on June 30, 2003, could be attributed to a number of issues beyond the control of

this office. A reduction in county school attendance during the fiscal year ended June 30, 2003, resulted in an adjustment reducing the county school portion of school revenues by approximately \$700,000 in May of 2003, therefore impacting cash flow by this amount.

In addition, after the School Department budget was passed for the FY 2002-03, the School Board elected to switch health insurance carriers, which impacted cash flow substantially in a negative way. The School Department switched to the state pool of insurance from a self-insured fund, thus resulting in premiums being paid in advance instead of as the claims are presented. The payment of this insurance premium resulted in more than \$800,000 impact on the cash flow needs. As well the run-out of health insurance claims required approximately \$1,600,000 in cash for which no additional funds had been requested in the 2002-03 fiscal year budget.

Two other problems which occurred after the budget was passed included cost for fire marshal inspections of different school sites impacting cash flow by approximately \$200,000. The emergency reaction to a black mold problem in a high school after passage of the budget required approximately \$500,000 of additional funds, further impacting the cash flow. It was the intent that the interoffice loans be repaid by June 30; however, based upon these noted substantial issues negatively impacting cash flow the receivables due the school funds at June 30 had to be utilized to repay the loan after June 30 when the receivables were liquidated. This office continues to assist the commission in searching for ways to support our schools financially.

OFFICE OF DIRECTOR OF SCHOOLS

FINDING 03.02 **THE GENERAL PURPOSE SCHOOL FUND HAD A FUND DEFICIT OF \$1,090,070 AT JUNE 30, 2003** (Internal Control – Material Weakness Under Government Auditing Standards)

The General Purpose School Fund had a fund deficit of \$1,090,070 at June 30, 2003. This fund deficit resulted primarily from budgeted revenues and other sources not materializing. Actual revenues and other sources of the General Purpose School Fund were less than budget estimates by over \$1,500,000 for the year ended June 30, 2003.

As reported in the previous year's audit, revenue estimates of the 2001-02 year exceeded actual revenues by over \$2,000,000. Recommendations regarding the need to correct this budget deficiency were reviewed with School Department officials in September 2002. We recommended at that time that officials review and revise revenue estimates for the 2002-03 year to realistic figures, adjust expenditures to the level of actual funding, and closely monitor budget amounts and make adjustments as soon as significant variances become apparent. However, budgeted estimates of revenue were never reduced from the amounts originally budgeted, nor were spending levels adjusted to the level of actual available funding.

School officials' failure to monitor budgeted amounts and adjust operations accordingly led directly to the fund deficit at June 30, 2003, and the lack of funds necessary to repay the revenue anticipation notes, as noted in the previous finding.

RECOMMENDATION

School Department officials should take immediate steps to liquidate this fund deficit. We again recommend that budgeted revenue estimates and appropriations be reviewed and revised if necessary. These revisions should include adjusting expenditure levels to the level of actual available funding. School Department officials should develop a plan to routinely monitor budgeted amounts and make adjustments as soon as significant variances become apparent. Each year that these conditions persist the already poor financial condition of the Sullivan County School Department becomes more dire.

MANAGEMENT'S RESPONSE – DIRECTOR OF SCHOOLS

The Accounting Department for the Sullivan County Department of Education is constantly monitoring revenues and expenditures in an effort to make recommendation to the Director of Schools and School Board concerning the school funds. Every effort is being made to curtail spending with the intent to liquidate the deficit by June 30, 2004.

FINDING 03.03 **EXPENDITURES AND OTHER USES EXCEEDED APPROPRIATIONS IN SEVERAL MAJOR CATEGORIES OF THE GENERAL PURPOSE SCHOOL FUND**
(Noncompliance Under Government Auditing Standards)

Although expenditures, encumbrances, and other uses of the General Purpose School Fund were held within total appropriations, several major categories of appropriations were overspent, including operation of plant (\$275,512), maintenance of plant (\$212,750), and transfers to other funds (\$1,201,351). Transfers to other funds exceeded appropriations primarily due to payments made to the self-insured health and dental fund that were necessary to pay claims that exceeded premiums charged.

RECOMMENDATION

Major categories of expenditures, encumbrances, and other uses should be held within appropriations approved by the County Commission.

MANAGEMENT'S RESPONSE – DIRECTOR OF SCHOOLS

We concur with this finding, and steps have been taken to avoid overspending budgeted series in the future.

OFFICE OF REGISTER

FINDING 03.04 DUTIES WERE NOT SEGREGATED ADEQUATELY IN THE OFFICE OF REGISTER
(Internal Control – Reportable Condition Under Government Auditing Standards)

Duties were not segregated adequately among the official and employees in the Office of Register. The official and employees responsible for maintaining the accounting records 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.

OTHER FINDINGS AND RECOMMENDATIONS

FINDING 03.05 THE COUNTY DID NOT MEET THE REQUIRED FIVE-YEAR AVERAGE FOR LOCAL REVENUES IN THE HIGHWAY/PUBLIC WORKS FUND
(Material Noncompliance Under Government Auditing Standards)

Because of declining local revenues, Sullivan County did not meet the required five-year average for local revenues allocated to the Highway/Public Works Fund. Section 67-3-901, Tennessee Code Annotated (TCA), requires that counties appropriate and allocate “... funds for road purposes from local revenue sources in an amount not less than the average of the five (5) preceding fiscal years ...” in order to be eligible to receive the gas tax increases imposed by the legislature in 1985.

Revenues of the Highway/Public Works Fund from the 1999-2000 year forward are summarized in the following table:

	1999-2000	2000-01	2001-02	2002-03
	Year	Year	Year	Year
Local Revenues	\$ 4,773,601	\$ 4,600,353	\$ 3,805,702	\$ 3,698,990
State, Federal, & Other Revenues	2,973,360	3,117,243	2,784,672	2,892,388
Total Revenues	<u>\$ 7,746,961</u>	<u>\$ 7,717,596</u>	<u>\$ 6,590,374</u>	<u>\$ 6,591,378</u>

	1999-2000 Year	2000-01 Year	2001-02 Year	2002-03 Year
Average of Local Revenues for Five Preceding Years	\$ 4,762,774	\$ 4,724,099	\$ 4,672,980	\$ 4,479,895
Excess (Deficiency) of Local Revenues Compared to Average of Five Preceding Years	\$ 10,827	\$ (123,746)	\$ (867,278)	\$ (780,905)

Sales tax revenues decreased by \$167,918 in the 2000-01 year, accounting for the deficiency in local revenues that year as compared to the average of the preceding five years.

Local revenues of the 1999-2000 year and the 2000-01 year included actual interest earnings of over \$1,600,000 each year. Budgets for the Highway/Public Works Fund also projected \$1,600,000 in interest revenues for the 2001-02 year and the 2002-03 year. However, these estimated revenues did not materialize. Actual interest revenues for 2001-02 amounted to only \$749,375, and actual interest revenues for 2002-03 amounted to only \$366,794. These shortfalls accounted for nearly all the deficiency of local revenues compared to the required five-year average for those two years.

To replace the dramatically declining interest revenues, the County Commission, in its 2003-04 year budget, lowered its estimate of interest earnings and included estimated new revenues from a proposed local wheel tax (\$1,037,000). However, the wheel tax has never been enacted. Although the budget was adopted by the County Commission during June 2003, debate concerning approving the wheel tax continued until November 2003. At that time, the wheel tax resolution was withdrawn by its sponsor. Therefore, these budgeted wheel tax revenues, which were necessary to meet the five-year average of local funds for the 2003-04 year, will not materialize.

RECOMMENDATION

Sullivan County should comply with local revenue requirements of Section 67-3-901, TCA.

MANAGEMENT'S RESPONSE – COUNTY EXECUTIVE AND DIRECTOR OF ACCOUNTS AND BUDGETS

Regarding the response to the audit finding on the Highway Funding, Sullivan County has not intentionally or negligently reduced funding to the Highway Department.

In 1993 a stream of revenue was established using the county's portion of local option sales tax (\$2,500,000), cable franchise tax (\$172,000), county's portion of wholesale beer tax (\$470,000), and interest earning on idle county funds (\$1,580,000). Those revenues have sustained the local funding of the Highway Fund, at or near the highest rate per road mile of any county in the State of Tennessee. In 1999-2000, a decline in the local economy resulted in a negative impact on sales tax revenue (total county portion applied to highways) to a level below \$2,500,000.

In the 2000-01 fiscal year, the unhealed wounds occurred and the 9-11 catastrophe further impacted the economy, lowering interest earnings rates to a life-time low. The budgeted expected earnings rate of 5% annually going into the 2001-02 fiscal year were reduced to near 1%, thus substantially reducing the interest earning for the Highway Fund. Although interest earnings rates had not recovered six months after 911, it was a reasonable expectancy to see interest earnings rates improve during the 2002-03 fiscal year, which they did not. To enhance the county's funding effort, a Mineral Severance Tax was imposed by the County Commission during this period to improve the funding of the Highway Department.

The maintenance of effort test applied by the University of Tennessee (CTAS) has been met each year.

The county continues to provide more than 50% from local funds for the Highway Fund per road mile, more than most other counties in the State of Tennessee. It is the intent of this office to set forth proposed funding in the 2004-05 fiscal year's budget to equal or exceed the level of funding required to meet the maintenance of effort requirements. The proposed funding source will be an increase in the tax rate for Sullivan County.