



**METROPOLITAN GOVERNMENT OF NASHVILLE
AND DAVIDSON COUNTY**

Management Letter

June 30, 2002



1900 Nashville City Center
511 Union Street
Nashville, TN 37219-1735

October 31, 2002

The Honorable Mayor and Members of Council
The Metropolitan Government of Nashville and Davidson County
Nashville, Tennessee

Ladies and Gentlemen:

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Metropolitan Government of Nashville and Davidson County, Tennessee (the Government) as of and for the year ended June 30, 2002, which collectively comprise the Government's basic financial statements and have issued our report thereon dated October 31, 2002. We also have audited the Sports Authority, General Hospital, and Bordeaux Hospital, discretely presented component units of the Government, as of and for the year ended June 30, 2002 as displayed in the Government's basic financial statements. We also have audited the financial statements of each of the Government's nonmajor governmental, nonmajor enterprise, internal service, and fiduciary funds presented as supplementary information in the accompanying combining financial statements as of and for the year ended June 30, 2002.

In planning and performing our audit of the aforementioned financial statements, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. The maintenance of adequate control designed to fulfill control objectives is the responsibility of management. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, controls found to be functioning at a point in time may later be found deficient because of the performance of those responsible for applying them, and there can be no assurance that controls currently in existence will prove to be adequate in the future as changes take place in the organization. Furthermore, reportable conditions do not include potential future internal control problems; that is, control problems coming to our attention that do not affect the preparation of financial statements for the period under audit.

However, we noted certain matters involving internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions are matters coming to our attention that, in our judgment, relate to significant deficiencies in the design or operation of internal control and could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions. The reportable conditions noted during our audit, which have been discussed with the appropriate members of management, is summarized in Appendix I.





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A material weakness is a reportable condition in which the design or operation of one or more internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, the reportable conditions described above are not believed to be material weaknesses.

Although not considered to be reportable conditions, we also noted other certain matters involving internal control and other operational matters that are presented for your consideration in Appendix II.

We also noted matters involving the Government's internal control and its operation used to administer federal financial assistance programs which we will report to management of the Government in a separate report dated October 31, 2002.

These conditions were considered in determining the nature, timing, and extent of the audit tests applied in our audit of the 2002 financial statements, and this report does not affect our report on these financial statements dated October 31, 2002. We have not considered internal control since the date of our report.

This report is intended solely for the information and use of the audit committee, management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

REPORTABLE CONDITIONS

METROPOLITAN NASHVILLE PUBLIC SCHOOLS IMPROVE FIXED ASSETS RECORDS AND CONTROLS

Observation

For fiscal years 2000 and 2001, significant deficiencies in the controls and accountability for fixed asset record keeping were noted as a reportable condition in internal controls. Actions taken by Metropolitan Nashville Public Schools (MNPS) management during fiscal 2002 included assignment of the internal auditor as the official primarily responsible for this function, and establishment of depreciable lives and other information necessary to implement Statement of Governmental Accounting Standards No. 34 *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*. However, there continue to be numerous control deficiencies in this area that merit significant attention by management. Many of the control deficiencies occur in areas where coordination between separate operational units within MNPS is required. There does not appear to be a functional coordination or accountability mechanism to ensure that areas coordinate effectively to address weaknesses and develop reporting tools, reconciliation processes and other accountability measures.

Ongoing significant deficiencies noted include:

- Periodic physical inventories of fixed assets have not been performed. Capital assets are simply deleted from inventory without investigation when a school reports that it no longer has an asset in its inventory.
- The Construction Office appears to have primary responsibility for record keeping tasks related to land transactions and building construction. The Construction Office submits invoices and requisitions to the Accounting Department for purchasing approval and payment process; however the Construction Office is the primary source of information regarding these expenditures - the Accounting Department typically only records the disbursement information they are given. In addition, current procedures do not properly capture classification information, and as a result, computed depreciation could be inaccurate. For the year ended June 30, 2002, all land balances needed to be identified and reclassified to ensure there was no depreciation calculated on those balances. These construction related expenditures account for millions of dollars annually and should be primarily the responsibility of MNPS’ Accounting Department.
- The warehouse, the Construction Office and the Accounting Department function independently of each other when tracking and recording fixed assets. While the Capital Asset Ledger, the MICS Tracking System and the General Ledger all contain information regarding the capital assets maintained by MNPS, these records are not reconciled. Due to the large volume and dollar amount of activity in these accounts, a formal reconciliation process should be developed. Lack of such reconciliations results in untimely recording of finished projects on the Capital Asset Ledger and the untimely identification of discrepancies between these systems. Furthermore, the current situation could result in inaccurate depreciation expense.
- Assets are not subject to a consistent central tagging process. Major purchases are tagged centrally; however, items purchased directly by schools (primarily from school activity funds) are not tracked or capitalized. Individual schools may engrave their name on the asset, but there is no system wide policy regarding this type of activity.

Recommendation

Sound financial administration in safeguarding MNPS' investment in capital assets is of utmost importance in the exercise of stewardship responsibilities. These responsibilities can be effectively discharged only through adequate systems and coordination between affected operating units. Establishing accurate capital asset records can be a difficult and time-consuming task. Several recommendations in this regard follow:

- Strengthen the authority of the central point of responsibility for all aspects of capital assets accounting, including financial statement disclosure and risk management.
- Develop a formal reconciliation process between the MICS Tracking System and the Capital Asset Ledger, which will be performed quarterly. Once reconciled with the MICS Tracking System, the Capital Asset Ledger should be reconciled to the General Ledger. Appropriate adjustments to each set of records should be made to complete the reconciliation process.
- Establish written procedures to control the proper input into the records for all capital asset additions, sales, abandonments, and transfers.
- Develop written procedures to ensure that donations from Parent/Teacher Organizations, businesses, fundraisers, and other sources are recorded on the Capital Asset Ledger for tracking and depreciation purposes.
- Clearly define the location of physical assets and accounting control over capital assets.
- Plan and perform a complete inventory of all capital assets. In adding assets to the Capital Asset Ledger, obtain relevant information such as asset description, location, vendor or manufacturer, acquisition date, and cost. Any missing capital assets identification tags should be affixed at the time the physical inventory is taken.
- Once the complete inventory of capital assets has been performed, follow up with periodic inventories of capital assets by location, with appropriate investigation of discrepancies.
- Ensure the timely utilization of the central tagging process.

By maintaining accurate fixed asset records, MNPS will realize several benefits:

- Responsibility for custody and effective use of capital assets will be clearly established;
- Capital assets can be inventoried periodically to ensure that they are properly controlled;
- Information regarding sources of supply, prices, and useful lives will be readily available; and
- Records will be readily available to substantiate the amount of grants used to finance expenditures for capital assets, and, furthermore, the determination of costs for building or equipment use would be facilitated.

Management Response

We concur. The Metro Finance Department will bring in outside assistance to resolve the situation and train MNPS personnel. Metro Finance will monitor the situation throughout the fiscal year to ensure implementation of corrective action..

**METROPOLITAN NASHVILLE PUBLIC SCHOOLS
RETIREMENT FUND TRUSTEE RECONCILIATIONS**

Observation

MNPS maintains a significant volume and dollar amount of investments for three retirement funds. While investment activity for funds invested in the Metropolitan Investment Pool (MIP) was recorded throughout the year, activity for funds held by the third party trustee was not recorded until adjustments were proposed as a result of the annual audit. The large volume of activity and high dollar amount of investments indicate a need for a formal monthly reconciliation process. Lack of such reconciliations leaves such assets at risk and potentially creates the opportunity for untimely identification of errors. This same condition existed for fiscal 2001, and no notable progress was made during fiscal 2002.

Subsequent to June 30, 2002, the Government's Office of Treasury assigned personnel to work with MNPS personnel to establish procedures for reconciliation of this information.

Recommendation

A coordinated effort between the MNPS Accounting Department, the MNPS Pension Department and the Office of Treasury should be established. A formal monthly reconciliation and review process should be implemented to ensure that amounts reported by investment custodians are accurate and that the underlying activity is properly recorded on the general ledger of MNPS.

Management Response

We concur. The Metro Treasurer is reviewing the current process and has assumed the custodial duties for the MNPS Retirement Fund.

**METROPOLITAN NASHVILLE PUBLIC SCHOOLS
INFORMATION SYSTEMS
PAYROLL PROCESSING**

Observation

MNPS' payroll system has been utilized for more than 20 years and processes checks for approximately 9,800 employees bi-weekly. The payroll application is a highly customized system that requires a specialized skill set to maintain, and there are limited personnel at MNPS who are completely familiar with this system. In practice, the payroll supervisor is the most knowledgeable person regarding the functionality of this system. However, this results in an inappropriate level of reliance on the payroll supervisor to initiate, process and record transactions and changes to the database. This lack of segregation of duties results in an environment where unauthorized transactions could occur and not be detected timely by responsible officials. The payroll supervisor could change payroll amounts without detection.

Another weakness is that Group ID's are issued to all staff with access to the payroll system, which results in minimal accountability for changes made to the system and the payroll application. Additionally, Operator ID's are only 3 digits, require no password, and are not required to change periodically. Thus, it is possible that someone can execute a transaction using someone else's ID with little monitoring of the user activity in the payroll system.

The payroll system also does not prevent any users from looking at specific employee information, only from making unauthorized changes. The information technology (IT) department has initiated some discussion with Human Resources regarding efforts to prevent users from viewing employee data unless authorized.

Recommendation

We understand that MNPS has made the decision to implement the payroll module of FASTnet as part of the overall FASTnet implementation, with a target implementation date of July 2004. Until such time as FASTnet payroll is functional, MNPS should develop a secondary resource that is fully capable of processing payroll in order to ensure functionality of the system in the case of employee absence and to provide better overall segregation of duties. As part of the FASTnet implementation project, methods for automation of the time entry process should be investigated.

To improve the access controls over the payroll processing system, IT should produce and review audit trails and reports that show all activity on the system. The MNPS Finance Director or his designee should review reports. Logical security controls should be enhanced by use of individual ID's, with stronger authentication controls, and user access levels should be periodically reviewed and old accounts eliminated. We also recommend that the IT department continue its efforts with Human Resources to limit access to employee information only to authorized personnel.

Management Response

We concur. The Metro Finance Department is currently working with MNPS to ensure that MNPS successfully implements Metro's Central Payroll System (FASTnet). The Metro Finance Department is also working with MNPS to hire a qualified payroll supervisor for MNPS.

OTHER RECOMMENDATIONS

METROPOLITAN NASHVILLE PUBLIC SCHOOLS COORDINATION OF ACCOUNTING AND CONTROL ACTIVITIES

Observation

The management and control structure of MNPS is highly decentralized between various operating units, such as accounting, payroll, benefits, pension, information services, employee relations, construction, warehouse, etc. Each area has responsibility for maintaining its own supporting information, and for forwarding information to the accounting department, which is responsible for recording transactions. To effectively manage, record and report the activities of this large organization, close coordination between the operational units is required. However, the culture and resource constraints of the organization currently inhibit timely and successful coordination between operating units. As discussed in earlier observations, KPMG noted three separate instances where lack of effective coordination between units resulted in reportable conditions in internal control.

Recommendation

In an effort to address the need for a higher level of ownership and accountability for various reconciliation processes, KPMG recommends establishing a leadership team at MNPS who will be responsible for the design and implementation of reconciliation and communication processes to overcome the barriers that currently exist between operational units. By establishing this leadership team and granting the appropriate level of authority to effect change, MNPS management should be better able to correct many of the internal control weaknesses noted and instill a greater sense of ownership and accountability for cross-functional areas with general ledger impact.

Management Response

We Concur. Management will address this recommendation during the upcoming budget process in determining methods, including staffing issues, to improve overall coordination and management within the Business/Human Resources/Information Technology/Employee Benefits/Facilities/Construction areas.

**METROPOLITAN NASHVILLE PUBLIC SCHOOLS
INFORMATION TECHNOLOGY SECURITY**

Observation

At the Metropolitan Nashville Public Schools' offices, access to the computer room is not restricted to authorized personnel only.

Recommendation

Restrict access to the MNPS computer room to authorized personnel.

Management Response

We Concur. Computer room security has been strengthened. Effective February 3, 2003, the code key has been changed; and only essential personnel within the Information Technology Department know this code, or are allowed into the computer operations area. We appreciate the auditors for bringing this to our attention.

**METROPOLITAN NASHVILLE PUBLIC SCHOOLS
POSITION CONTROL RECORDS**

Observation

Periodically throughout the year, the central human resources department circulates a position control listing to principals to verify the numbers and classification of payroll positions. These control listings are returned to the central human resources department but are not retained.

Recommendation

The verification procedure performed by the principals is a good control over existence of employees. KPMG recommends that the principals document their approval of the listings as accurate before returning them to the central human resources department, and that the human resources department retains the “confirmations” for a period of one year.

Management Response

We Concur. For the future, we will require the signature of the principal for verification of the data, and the data will be retained for a period of one year. Furthermore, we plan to conduct the verification procedure at both the outset of the school year [September] and again at mid-year [January].

**METROPOLITAN NASHVILLE PUBLIC SCHOOLS
CHARITABLE GIVING CAMPAIGN**

Observation

Each year, MNPS encourages its employees to contribute to charitable organizations through several methods, including payroll deduction and direct donations of cash or personal checks. Each school has a coordinator who collects these contributions and records the totals on the “Metro Schools Employee Giving Campaign Report Form. (Campaign Report Form)” Since only one person is responsible for collecting, recording and delivering these contributions to the central payroll department, a high risk of misappropriation is present.

In addition, at the central payroll office, one individual is responsible for collecting the contributions from the schools and forwarding them to the appropriate charities. KPMG noted instances where the Campaign Report Form had been altered, and because of the lack of segregation of duties in this process, it is difficult to ascertain whether such changes were due to error or misappropriation of the related contribution. Finally, KPMG noted two instances where checks received from employees had not been forwarded to the appropriate charity, but were held in the file storage room, which is not a secure location for receipts.

Recommendation

To improve controls in the area of charitable contributions, we recommend the following:

- Implement a multi-person process under which different persons would be responsible for the collection and recording functions. A third person should forward the contributions to the MNPS central office. This would better segregate the collecting, recording and delivery functions and would better safeguard the contributions received.
- Designate someone within the MNPS payroll office to maintain a spreadsheet of individual contributors and amounts as the contributions are delivered to the MNPS central office. Receipts should be placed in the safe or other secured location until delivery or pick up by the charities. Upon release of the contribution to the charity, agree the total amount on the spreadsheet to the amount delivered, investigating any discrepancies.
- Deliver contributions to the charities on a timely basis. Make multiple deliveries/mailings if the contributions are received over an extended period. This will better safeguard the contributions, and will better ensure timely receipt by the designated charities.

Management Response

We Concur. Management will consider these recommendations within available resources and make changes as necessary. Prior to next year’s campaign, the Employee Giving Campaign lead agencies will be queried and a collections process developed to balance the needs of collecting and receipt by charities with limited internal resources for handling these contributions.

**METROPOLITAN NASHVILLE PUBLIC SCHOOLS
IMPROVE ORGANIZATION AND FILING OF PAYROLL DEDUCTION AUTHORIZATIONS**

Observation

MNPS' payroll department is responsible for maintaining original supporting documentation of employees' payroll deductions for garnishments such as child support payment and Chapter 13 bankruptcy payments, as well as employee optional deductions for 12 month option pay, union dues, charitable contributions, credit union deductions, etc. There is currently no central location or documented procedures for filing such documentation, and as a result, it is not well organized to facilitate verification of information.

Recommendation

Sound establishment of an organized and safeguarded document filing system is critical to maintaining sufficient supporting documentation for employee deductions. To improve this function, KPMG recommends establishment of a central location for filing supporting documentation for employee payroll deductions. The files should be organized by type of deduction or by employee ID. In addition, supporting documentation should be filed immediately after entry into the computer system, keeping most recent documents on top.

Management Response

We Concur. This will be reviewed and determined by the new Payroll Coordinator. Files for efficient retrieval of documentation will be paramount in creating this file scheme.

**METROPOLITAN NASHVILLE PUBLIC SCHOOLS
FILING OF PAYROLL REGISTER BOOKS**

Observation

MNPS maintains payroll register books/registers that document the detail payroll activity by pay cycle. Under current procedures, these registers are accessible by any employee within the accounting office. They are currently kept in the storage closet with no formal organization or process to check out registers as needed. Changes are written into the registers with no formal procedures for how to document an approved change. There also is no formal policy on retention of information to support any changes to the registers.

Recommendation

The storage closet should be organized by year, month and type of school. One employee should be in charge of maintaining the vault, and all registers checked out should be documented in order to ensure that registers are removed only for authorized purposes. Formal procedures should be implemented to ensure a consistent process for changes, including maintenance of documentation for any changes. These changes will better ensure accountability for changes and will improve document retention and maintenance procedures.

Management Response

We Concur. The new Payroll Coordinator will be charged with the responsibility of maintaining registers for efficient storage and retrieval to include a sign out system.

**METROPOLITAN NASHVILLE PUBLIC SCHOOLS
RECONCILIATION OF ACTUARIAL VALUATION**

Observation

Under existing procedures, MNPS does not reconcile its payroll census data to the actuarial valuation report provided by the consulting actuary to ensure the accuracy of the data, which is used as the basis for computing the pension obligation and related information. This limits MNPS' ability to prevent, detect and correct potential errors in the calculation of the pension obligation.

Recommendation

The Benefits Office should coordinate with the payroll and human resources offices to develop a procedure to ensure the accuracy of the census data provided to the consulting actuary. Such a control would better ensure accuracy in the calculation of the pension obligation.

Management Response

We concur. The Employee Benefits Department will be responsible for testing data provided to the actuary prior to the commencement of the actuarial calculations.

**EMPLOYEE BENEFIT BOARD
RECONCILIATIONS**

Observation

The Government is in the process of implementing a formal reconciliation process between deductions for medical insurance withheld from employees to amounts submitted to insurance carriers. A reconciliation was performed for the year-ended June 30, 2002, but there were outstanding issues with the insurance carriers that were not resolved as of year-end. The large volume of activity and the high dollar amount of withholdings should require formal reconciliation processes for this function throughout the year. Lack of such reconciliation processes creates the opportunity for overpayments to vendors.

Recommendation

The Government should expedite the process underway to ensure complete and timely reconciliation between amounts paid to insurance carriers and amounts collected from employees. Once the process has been established, these reconciliations should be reviewed by management to ensure the accuracy and completeness of amounts paid and collected.

Management Response

We concur. Reconciliations will be completed by June 30, 2003.

**GENERAL GOVERNMENT
CAPITAL ASSET INVENTORY**

Observation

During fiscal 2000, in connection with the implementation of the capital asset module of FASTnet, each department of the Government completed a review of all capital assets for the purposes of ensuring accuracy of information input to FASTnet. Further, at the end of fiscal 2000, the responsibility for maintenance of the capital asset records transferred to the Division of Accounts. During fiscal 2001, the Division of Accounts began drafting formal policies on the continuing review of capitalized/fixed assets. To date, the detailed procedures to implement the policies adopted have not been fully developed and implemented.

Recommendation

We recommend that the Division of Accounts formalize its procedures for implementing the policies surrounding the record keeping and periodic physical inspection of capital assets.

Management Response

We concur. Procedures are in process under which Departments will be responsible for annual inventories and the Division of Accounts will test a sample of the results on a rotating basis. Procedures will be in place by June 30, 2003.

**GENERAL GOVERNMENT
FIXED ASSET RECONCILIATION**

Observation

The Division of Accounts currently performs a monthly reconciliation between the fixed asset module and the general ledger, and discrepancies are researched and resolved. However, no formal management review of this reconciliation is currently performed.

Recommendation

We recommend Division of Accounts implement a formal periodic review of the reconciliation performed between the fixed assets module and the general ledger to help ensure that discrepancies are resolved accurately and in a timely manner.

Management Response

We concur. A Fixed Asset Supervisor will review this reconciliation beginning in fiscal year 2003.

**GENERAL GOVERNMENT
PROPERTY TAX SYSTEM**

Observation

Three types of taxes exist: Real Property, Personal Property, and Public Utility. These revenues, which represent the Government's largest revenue stream, are maintained on a separate mainframe in an outdated software package. This is one of the last systems to be processed on the mainframe. As such, the expenses related to maintaining the mainframe for fewer and fewer purposes become relatively more expensive per application. Further, no interface exists between the Tax Accounting System and FASTnet. Rather, FASTnet is updated manually from reports generated by the Tax Accounting System.

Recommendation

In order to enhance the efficiency of the tax accounting process, reduce overall expenses (related to maintaining the mainframe), and to reduce the risk of errors, we recommend that the Government investigate the purchase of a complete tax compilation system which would interface with both the general ledger system and the other necessary systems (Land Information System, etc). This will provide for more timely updates of financial reporting and reduce the risk of human error in the process. Once all applications have been transferred from the mainframe environment, the Government will achieve cost savings from discontinuance of the mainframe operations.

We understand that the Metro IS Department is currently selecting new software packages to replace the mainframe software packages. The software should be selected and implemented as soon as possible to mitigate the risk that data updated manually between systems is incomplete or inaccurate. Management should also consider implementing edits and validations for data fields in the new software to reduce the risk of data entry errors.

Management Response

We concur. A Request for Proposal is in process and should be issued before June 30, 2003 to select the new software package to replace the mainframe software package.

**GENERAL GOVERNMENT
DELINQUENT TAX ACCOUNT RECONCILIATIONS**

Observation

Payments for delinquent tax accounts are reconciled at the detailed level only once annually at the time the new tax roll is updated in the Trustee system. Discrepancies usually arise between the summary and detailed delinquent account data due to adjustments made in the system.

Recommendation

We recommend a reconciliation of delinquent tax years be completed on a quarterly basis to help increase the accuracy of both the detail and summary accounts on an interim basis. Also, if new software is selected to replace the mainframe Assessor and Trustee systems, we recommend the new system have the functionality to account for special exceptions (i.e. bounced checks, updating past delinquent accounts, etc) that currently require IS and the Trustee's office to make manual adjustments to the system. This could help minimize discrepancies discovered in the delinquent tax accounts during the year-end reconciliation process.

Management Response

We concur. A Request for Proposal is in process and should be issued before June 30, 2003 to select the new software package to replace the mainframe software package

**GENERAL GOVERNMENT
PAYROLL DEDUCTION INPUT**

Observation

Payroll receives a variety of forms for all new employees who are selecting medical, dental, and other benefits. They also receive information for non-voluntary deductions. Currently, there are several individuals who enter these voluntary and non-voluntary options into FASTnet for payroll deductions. However, there does not appear to be a review of the information entered into the system to ensure that the options were input correctly. The mitigating control is that the employee should complain if the wrong options were entered. However, this reliance on a detective control may cause a customer service issue.

Recommendation

We recommend that voluntary and non-voluntary deductions input into FASTnet be reviewed by a supervisor or third party at least on a test basis.

Management Response

We concur. A review process will be in process by June 30, 2003 to review voluntary and non-voluntary deductions input into FASTnet.

**DEPARTMENT OF WATER & SEWERAGE SERVICES
INFORMATION TECHNOLOGY SECURITY**

Observation

The following security issues were noted at the Department of Water & Sewerage Services:

- After a user is granted access to the system, the request for security that is sent to the Security Administrator is not kept on file. If a user were to make an unauthorized change in the system, the Security Administrator would have no supporting documentation to indicate the supervisory authorization for the access granted.
- Users may have more access rights in the Customer Information System (CIS) than their job responsibilities may require. KPMG noted that management requested wide access be granted to users so that they can access data from other areas in the event an employee is on leave or is absent. Generic accounts with update access are also set up in the system. Results of AS/400 security scans revealed that there are multiple logical access security vulnerabilities that could be the result of weak logical access standards.
- While there are fire extinguishers in the computer room, KPMG noted there are no appropriate fire suppression systems installed.

Recommendation

KPMG recommends the following actions to improve security of the IT system:

- The Security Administrator should retain documentation of all requests for security access in order to provide evidence that appropriate supervisory personnel authorize access rights.
- Management should assess the needs of users with high levels of access to CIS that are not directly related to their job functions on a regular basis. If high-level access is deemed necessary for these individuals, then management should document the reason and implement regular periodic reviews of all activity of individuals with these high levels of access. Management should also consider disabling generic accounts and assigning these functions to individual user accounts so that activity can be tracked and to increase the level of accountability.
- Management should continue their efforts to establish a disaster recovery plan, and in the interim, additional physical safeguards should be implemented to protect the computer room in the event of fire.

Management Response

- We concur. CSC Supervisory personnel request user security changes by way of email, these requests are logged into the MWS DP Umbrella HelpDesk system and the appropriate system administrator's MS ACCESS Database (CAST) for an infinite amount of time. Documentation of approvals will be maintained.
- CSC has various employees that perform cross-functional duties. To ensure that CIS security access matches job functionality, beginning in fiscal year 2003, MWS has instituted a policy to annually review the job functions of all CIS users and change the security access accordingly. In addition, monthly CIS journal reports are generated to review the changes made to customer records.

Appendix II

- A generic sign-on for scheduling the nightly process has been established to streamline the viewing and copying of reports. This generic sign-on has limited access to CIS and can only be used for scheduling the update and cannot perform any other changes/updates in the system. It should be noted that only a system administrator can alter the billing process jobs.
- The computer is in compliance with local Fire Marshal standards. MWS is also working with the Metro ITS department to establish a disaster recovery plan that will incorporate two mirroring AS400's housed at separate facilities. This disaster recovery plan will also consider the need for additional fire suppression mechanisms.

**DEPARTMENT OF WATER AND SEWERAGE SERVICES
WATER CUT-OFF AND COLLECTION ACTIVITIES**

Observation

The Department's current policies state that water services will be cut off after 30 days of delinquent non-payment. It is the responsibility of the meter readers to perform the cut-off procedure. During fiscal 2002, there was a shortage in meter reading personnel, and management instructed the readers to place priority on the meter readings, and to defer cut-off procedures. As a result, the Department of Water & Sewerage Services incurred approximately \$1.2 million in additional bad debt expense for the year ended June 30, 2002.

Recommendation

We recommend that the Department follow its approved cut-off and collection procedures in order to minimize write-off of uncollectable amounts from customers.

Management's Response

We Concur. MWS did not have an adequate number of personnel dedicated to the collection process during FY 2002. Four employees have been assigned to discontinue service to delinquent accounts. In addition, MWS recently submitted an RFP to outsource the field collections process to ensure that delinquent accounts are addressed in a more timely manner and help stabilize our bad debt expenses.

**HOSPITAL AUTHORITY
HEALTH INSURANCE PORTABILITY AND ACCOUNTABILITY ACT OF 1996**

Observation

The Health Insurance Portability and Accountability Act of 1996 (HIPAA), among other things, established standards for the privacy and protection of patient-specific health information, as well as overarching security and privacy requirements. The Authority has established a HIPAA implementation process with specific accountabilities defined to address the entity-wide requirements under the legislation. Based on our review of the current status of the Authority's efforts, we offer the following commentary regarding HIPAA.

The Authority will have until October 16, 2003 to comply with the requirements articulated in the Transactions and Code Sets segment of the Final Rule. This section of the Final Rule requires specific data formats and transaction code sets be used in most electronic transactions. The Authority requested and received an extension of compliance with the Transactions and Code Sets segment. The mandatory test date for Transactions and Code Sets of April 16, 2003 remains in place.

Standards regarding privacy were published in the December 28, 2000 Federal Register and became effective on April 14, 2001. The Authority will have until April 14, 2003 to comply with the requirements of the Privacy Rule. While acknowledging that the Authority must, at a minimum, strictly comply with regulatory mandate, we believe that HIPAA may also form a critical foundation for an independent review of the Authority's policies and procedures with respect to privacy. We believe that best-of-class privacy procedures represent a significant business asset as health care organizations increasingly compete based on the quality of medical and non-medical services available to the health care consumer. Given the significant opportunity to create unique competitive advantage, the Authority might wish to consider how its ongoing HIPAA efforts can go beyond pure regulatory compliance in the important area of privacy.

Further, the final draft of the Security Regulations has been submitted to the Office of Management and Budget. Once accepted and finalized, standards are required to be implemented generally within two years of the effective date of the final rule. (The effective date of the final rule will be 60 days after its publication.) This rule will likely involve changes to existing information sharing and related protective mechanisms for patient data transferred between covered entities and their business associates, as well as enhancements to existing information security procedures and supporting software, technology, and devices.

Management Response

Both hospitals conducted a thorough assessment of their HIPAA readiness in the spring, summer, and fall of 2002. The HIPAA Steering Committee was assigned responsibility for the oversight of this assessment. Flow charts reflecting how Protected Health Information moves through all departments and units were developed by this Committee and an outside accounting firm. Walkthroughs of both facilities and interviews with all department heads were conducted. The result of this study was a complete assessment of HIPAA readiness of each hospital as required by the regulations. Recommendations on how to resolve identified issues of HIPAA non-compliance were made and discussed, and initial HIPAA education and training took place with management and the Hospital Authority Board. This overall assessment included readiness for the privacy, security, and transactions and codes regulations.

In August 2002 both facilities asked for and received an extension of compliance with the Transactions and Codes regulations until October 2003. From January 2003 to March 2003, privacy policies and procedures will be developed and implemented, and all staff will be trained as required by the Privacy Regulations which are effective April 14, 2003. All necessary Business Associate contracts will also be signed.

**GENERAL HOSPITAL
ESCHEAT LAW POLICY**

Observation

Under Title 66, *Uniform Disposition of Unclaimed Property Act*, of the Constitution of the State of Tennessee, all property of another person held in a fiduciary capacity for a period greater than five years shall be remitted to the State of Tennessee. KPMG noted General Hospital does not have a policy and procedures in place to track and remit these amounts to the State of Tennessee.

Recommendation

We recommend that General Hospital establish a policy to identify and track patient accounts with a credit balance over five years old and remit balances to the State, as appropriate.

Management Response

We Concur. While General Hospital does not have the recommended policy, we are and have been in compliance with the State escheat law policy. We will develop the recommended policy.

**GENERAL HOSPITAL
INTERIM ESTIMATION OF THIRD-PARTY SETTLEMENTS**

Observation

General Hospital has not routinely prepared interim analyses of expected third-party cost report settlements. The Hospital has the ability to prepare and reconcile third-party payor log information to Provider Statistical and Reimbursement Reports (PS&Rs). During fiscal 2002, General Hospital activated the Medicare payor logs; however, the PS&Rs were not provided by the Medicare intermediary to allow for the reconciliation. Maintenance of accurate and complete logs for Medicare is important in determining current year estimated settlements.

Recommendation

General Hospital should develop and implement procedures to estimate current year settlements at least once each quarter. Templates can be developed and utilized to provide reasonable estimates. Also, to improve the documentation and estimation process, we recommend that third-party logs be reconciled to the PS&Rs on a regular basis. Implementation will ensure that interim financial information used by management to make operating and financial decisions is more accurate and can help identify potential Medicare interim overpayments and underpayments at a time when management may be able to take corrective action by requesting payment changes from Medicare.

Management Response

We agree that the ability to estimate current year settlements could only have a positive effect on operations and decision-making. The Medicare payer logs are now functional and reconciliation to the Medicare PS&Rs will start as soon as the Medicare intermediary (Mutual of Omaha) corrects their problem which has led to the PS&Rs not being available since early 2001. By June 30, 2003, we will have the recommended templates in place to estimate third-party settlements.

**GENERAL HOSPITAL
THIRD-PARTY ACCOUNTING AND BILLING PROCEDURES**

Observation

In fiscal 2002, General Hospital's average time for issuing bills was approximately 14 days. This was a slight improvement from the average drop time of 15 days for fiscal 2001. We noted that the billing department does not have an automated contract management system to load fee schedules and approved amounts for each payor. Currently, when a payment is posted, the Hospital does not have automated controls in place to identify underpayments.

Recommendation

We recommend that the Hospital continue to train physicians and department personnel to decrease billing time to the industry standard of 5-7 days. Such improvements will enhance collections and cash flow. We also suggest that the Hospital install a contract management system to assist patient accounting in the collections process. A contract management system would allow underpayments to be identified quickly and increase the efficiency of the patient accounting department by eliminating the monthly manual review of each payor's payments.

Management Response

We concur that the existing 14-day average for bills to drop is too high and have established a goal of 10 days, which we believe would compare well with other similar public and teaching hospitals. Given the significant reductions in overall net revenues in fiscal 2002, the budgeted contract management system had to be pushed back to at least fiscal 2003. We have recently identified an alternative to a contract management system which will provide the same benefits but at a significantly reduced capital outlay. This enhancement should be operational by March 2003.

**GENERAL HOSPITAL
GENERAL LEDGER ACCOUNTING SYSTEM**

Observation

Currently most operating units of the Government utilize the primary Government's general ledger accounting system (FASTnet). However, General Hospital does not use FASTnet as its primary accounting system. We recognize that General Hospital uses several modules of FASTnet. However, the duplication of effort and the inefficiencies resulting from having to "reconcile" two sets of general ledgers suggests that the full utilization of FASTnet may be appropriate.

Recommendation

We recommend that General Hospital convert to FASTnet, except for the use of its current accounts receivable/billing system. This will allow management to discontinue reconciling "two sets of general ledgers".

Management Response

We Concur. MNGH places a premium value on monthly detailed departmental financial statements including current month and YTD comparison to both budget and prior year. We will continue to assess FASTnet's ability to meet the Hospital Authority's reporting needs both currently and in the future. Until that occurs, management believes the value added to the organization of having detailed departmental financial statements far exceeds the cost of reconciling two general ledgers.