

**THE METROPOLITAN GOVERNMENT OF NASHVILLE
AND DAVIDSON COUNTY, TENNESSEE**

Letter of Recommendations to Management

June 30, 2011



October 31, 2011

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

Ladies and Gentlemen:

We have audited the basic 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, 2011, which collectively comprise the Government's basic financial statements. We have also audited the financial statements of the Sports Authority Fund and the Industrial Development Board Fund, which are discretely presented component units of the Government, and the financial statements of each of the Government's nonmajor governmental, nonmajor enterprise, internal service and fiduciary funds, and have issued our report thereon dated October 31, 2011. Under professional standards, we are providing you with the accompanying information related to the conduct of our audit. We have also audited and reported on separately the financial statements of the following discretely presented component units: Metropolitan Nashville General Hospital and Bordeaux Long-Term Care and Knowles Home (funds of the Hospital Authority), the Metropolitan Transit Authority, and the Metropolitan Nashville Airport Authority. We did not audit the financial statements of the following discretely presented component units: the Nashville District Management Corporation, the Gulch Business Improvement District, Inc., the Metropolitan Development and Housing Agency, the Electric Power Board, the Emergency Communications District and the Convention Center Authority. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the reports of the other auditors.

Management of the Government is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit of the aforementioned financial statements, in accordance with auditing standards generally accepted in the United States of America, we considered the Government's internal control over financial reporting ("internal control") as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Government's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Government's internal control over financial reporting.



Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

We consider the following deficiencies in internal control to be material weaknesses:

CENTRAL GOVERNMENT FUND FINANCIAL STATEMENTS

Accounts Receivable Accrual

Observation

Our audit procedures identified a duplicate entry to record revenue and a related receivable for \$400,000 in the Solid Waste Operations fund. As such, an adjustment, which was material to the fund, was proposed by us and recorded by management to correct the error.

Recommendation

We recommend that management more closely adhere to its existing annual closing procedures to prevent and detect and correct significant errors for all reporting units.

Management's Response

We agree with the observation and the recommendation. This occurred because a department submitted an accrual journal entry for revenue received after year end that was also included in Finance's central accounts receivable accrual. The approval of the department's journal entry was an isolated reviewer error and should not have occurred. Additional supervisory review procedures will be established for June 30, 2012.



CLERK AND MASTER AND COUNTY REGISTER

Lack of Segregation of Duties with Financial Transactions

Observation

During our audit procedures over cash receipts and cash disbursements at these offices, we noted either one or several clerks are responsible for multiple duties which involve financial transactions, such as handling incoming cash receipts, processing these cash receipts, making physical deposits to the bank, maintaining check stock, processing cash disbursements, signing checks, including checks written to themselves for deputy clerk fees, and posting transactions to the Access database. There was no documentation that these functions were reviewed by another employee. These incompatible accounting functions constitute deficiencies in internal control which could lead to undetected misappropriation of funds as well as undetected material misstatements of the offices' financial information.

Recommendation

We recommend that management design and implement procedures that would more effectively segregate certain duties between employees that handle cash and those that record cash transactions. The following are suggestions for improving controls and segregation of duties:

- (1) An employee independent of posting transactions to the accounting records should be responsible for opening the mail/receiving cash and checks over the counter and making copies of checks received. This person should also prepare a daily cash receipts log indicating the dollar amount, nature of cash receipt, and court case. This person should also prepare and make the daily deposit to the bank.
- (2) The employee responsible for preparing the daily cash receipts log and making the daily deposit should submit the daily cash receipts log, bank deposit slip and copies of the checks to an independent employee for timely posting the daily cash receipts to the accounting records.
- (3) An employee independent of posting transactions to the accounting records and with no check signing authority should maintain the physical check stock for all bank accounts. In addition, this employee should maintain a check log for issuing check stock to the employee responsible for processing cash disbursements. This check log should list the sequence of checks issued, the number of checks issued and be signed and dated by both the employee maintaining the check stock and the employee requesting and receiving issued checks. Any unused or voided checks should be logged back into the check log.
- (4) An employee independent of the duties described in (1)-(3) above should be responsible for posting daily cash receipts and cash disbursement transactions as well as preparing the checks for cash disbursements.



Management's Response

Clerk and Master

Management agrees with this recommendation. Since the June 2011 audit, the Office has hired an additional bookkeeper increasing the bookkeeping staff from two to three. Management has and continues to consult with Metro Finance, EBS and other departments to develop processes that will improve controls and segregate duties. The following processes have been implemented:

- 1. An employee independent of posting transactions to the accounting records opens all the mail and makes copies of all checks. A daily mail check log is kept and reviewed against daily deposits by an employee independent of posting transactions to the accounting records. The daily deposit is also made by an employee independent of posting transactions to the accounting records.*
- 2. A sign has been posted at the accounting desk stating, "If you fail to receive a receipt ask to speak to the Clerk and Master."*
- 3. Employees with check writing authority no longer are signatory on checks made to themselves for special officer fees. This practice ceased prior to the June 2011 audit.*
- 4. An employee independent of posting transactions to the accounting records and who is without check signing authority maintains the physical check stock and a check log for issuing checks for cash disbursements.*

As previously, stated Management will continue to explore and implement options to address noted concerns.

County Register

- 1. At this time the Register of Deeds Office does not have ample staff to accomplish this process. Furthermore, it does seem that we would be duplicating to some degree the process we are currently using.*
- 2. We agree that an independent employee should timely post the daily cash receipts to the accounting records. We do have an independent employee performing this process.*
- 3. Steve Moore, Chief Deputy of Information Technology, will order and maintain all check stock. Checks will be locked in the safe in the Information Technology department. Steve will maintain a spreadsheet for each checking account that will include the date, check numbers, signature of employee requesting check and signature of employee releasing checks.*



4. *Currently, Charles Snyder, Chief Deputy of Finance, is responsible for posting daily cash receipts and cash disbursement transactions as well as preparing checks for cash disbursement. He will continue to do so. He has no involvement in opening and dispersing mail. Also a second employee verifies bank deposits on the bank statement against daily accounting reports from our document recording/retrieval system.*

* * * * *

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in internal control to be significant deficiencies:

CENTRAL GOVERNMENT FUND FINANCIAL STATEMENTS

Accounts Payable Cutoff

Observation

During our audit, we noted several reporting units for which liabilities incurred as of year-end were not properly accrued. Accordingly, certain adjustments were proposed by us and recorded by management to ensure that affected financial statement amounts were presented fairly in all material respects, as follows:

<u>Reporting Unit</u>	<u>Total</u>
GSD Capital Projects	\$ 449,700
Education Capital Projects	352,100
USD Capital Projects	109,900
Other Government Services	722,300
School Self-Insurance	38,300
Technology Revolving	117,000
Metropolitan Employees' Flexible Benefits Plan	29,600

Accounting principles generally accepted in the United States of America require liabilities to be accrued when incurred. Though management performed an evaluation concerning the completeness of such liabilities, it did not do so at a threshold to detect all material omissions.

Recommendation

We recommend that management more closely adhere to its existing annual closing procedures to ensure that obligations are recognized in the proper accounting period for all reporting units.



Management's Response

We agree with the observation and the recommendation. In past years the general ledger closing procedures for unrecorded liabilities had higher dollar thresholds than those used by the auditors in their testing for unrecorded liabilities. Beginning with the June 30, 2012 year, Metro will lower those dollar thresholds in an effort to capture more of the larger unrecorded liabilities related to goods and services invoiced prior to year end.

Property Taxes - Allowance for Doubtful Accounts

Observation

While evaluating the reasonableness of management's estimated allowance for doubtful property taxes, we identified two errors in the formulas used to calculate the estimates. As the correction in the formulas resulted in significant differences from the amounts recorded in the Government's respective budgeted funds, management elected to record adjustments to make the corrections.

Recommendation

We recommend that management ensure year-end closing procedures include detailed reviews to detect and correct any significant errors that affect financial statement amounts.

Management's Response

We agree with the observation and the recommendation and will ensure the formulas are corrected before the June 30, 2012 estimate for the allowance for doubtful accounts is calculated. It should be noted that this allowance does not impact revenues or expenditures – it only impacts the balance sheet.

* * * * *

In addition, during our audit, we noted certain matters involving the internal control and other operational matters that are presented for your consideration. This letter does not affect our report dated October 31, 2011, on the aforementioned financial statements. We will review the status of these comments during our next audit engagement. Our comments and recommendations, all of which have been discussed with appropriate members of management, are intended to improve the internal control or result in other operating efficiencies. We will be pleased to discuss these comments in further detail at your convenience, perform any additional study of these matters, or assist you in implementing the recommendations. Our comments are summarized as follows:



CENTRAL GOVERNMENT

Timely Preparation of Bank Reconciliations

Observation

In testing the Government's internal controls over bank reconciliations, we identified certain bank accounts that were not reconciled timely. Specifically, the primary concentration and operating account, the Water and Sewer customer refunds and Trustee's imprest checking accounts, and the Trustee's unapplied property taxes account were not reconciled timely for several months of the fiscal year. The Government does have certain compensating controls in place to timely detect significant misstatements in the financial statements. Furthermore, additional personnel were assigned to assist in completing the primary concentration and operating account reconciliations and, since then, improvement in timeliness has been made. However, the risk of not identifying cash errors and possible fraud related to cash increases greatly when bank accounts are not reconciled timely.

Recommendation

All bank accounts should be reconciled timely on a monthly basis by the Government and all unusual reconciling items should be promptly investigated, adjusted and documented with adequate explanations. This will reduce the likelihood of cash errors and fraud, provide for more timely and accurate financial information, and assist in the effective management of cash flow.

Management's Response

Finance Department Reconciliations

We agree with the observation and the recommendation. As noted in the observation, an additional staff member was assigned to the bank reconciliation function for the 2011 fiscal year. As a result, the percentage of bank accounts reconciled within established timeframes increased from 61% in fiscal year 2010 to 76% in fiscal year 2011. To date in fiscal year 2012, the percentage of bank accounts reconciled within established timeframes is at 97%.

Metro Water Services

Metro Water Services goal is to have the Customer Refund Account reconciled according to the guidelines of Metro Finance Department. These guidelines are to have the Customer Refund Account reconciled no later than two to three months after the close of the current month. During the past year the reconciliation was not completed on time due to being under staffed in the CSC-Cash section. MWS is in the process of hiring a Finance Officer II for the CSC-Cash section and this will be one of their main responsibilities.



Trustee's Office

We are aware of the untimely reconciliation of the monthly bank statement. Because of loss of staff in this area and because the reconciliation process is very time consuming, we have had difficulty in preparing the reconciliation timely. We are attempting to rectify this issue as soon as we possibly can.

Old Outstanding Items on Bank Reconciliations

Observation

Reconciliations for the Trustee's imprest checking account and the Water and Sewer customer refunds account include excessive quantities of reconciling items that have been outstanding in excess of one year.

Recommendation

Though none of the items identified are significant individually or in the aggregate for the respective bank accounts, the Government should evaluate the propriety of reconciling items over a year old periodically (at least annually) and include adequate explanations for any resultant adjustments.

Management's Response

Trustee's Office

We are aware of this issue with regard to the reconciliation of the monthly bank statement. We are attempting to rectify this issue as soon as we possibly can.

Metro Water Services

Metro Water Services has begun to reconcile the outstanding items that are over a year old. This has been incorporated into the monthly reconciliation of the Customer Refund Account to evaluate the outstanding items.

Deficit Balances in Internal Service Funds

Observation

The Government reported four internal service funds with deficit net asset balances at year-end. The School Self Insurance fund made progress during the year in funding its prior year deficit. However, the School Professional Employees' Insurance, Injured on Duty, and Treasury Management funds increased their prior year deficit balances by incurring additional current year losses.



Recommendation

We recommend that charges to other funds be routinely monitored and adjusted to eliminate the deficits over a reasonable period. Otherwise, transfers will be required from the General and/or General Purpose School funds over the next two to three years until the deficit balances are alleviated.

Management's Response

We agree with the observation and the recommendation. The School Self Insurance Fund and the Treasury Management Fund are currently expected to close the June 30, 2012 year with positive net asset balances. The School Professional Employees' Insurance Fund is being monitored by Metro Schools management, and Finance will ensure that Schools management consider whether supplemental appropriations are needed for fiscal year June 30, 2012 and/or whether additional budgetary funding is needed for the June 30, 2013 fiscal year. The Metro Finance Department is closely monitoring the Injured on Duty Fund and is working with the actuaries to ensure the June 30, 2013 fiscal year budget includes the funding necessary to ensure the financial stability of the Injured on Duty Fund.

Internal Balances

Observation

The Government reported certain interfund balances that have not changed from the prior year. Management asserts that these will be repaid in 2012. As such, there are no adjustments necessary and no instances of noncompliance with state laws and regulations. However, if the interfund balances are not repaid in 2012, they will represent long-term interfund borrowings, which are not permitted unless approved by the State in advance.

Recommendation

We recommend that management ensure all interfund balances are repaid in 2012 or obtain approval from the State authorizing any long-term balances.

Management's Response

We agree with the observation and the recommendation and the interfund balances have been repaid.



Infrastructure Reported Using the Modified Approach

Observation

The Government has adopted the alternative to recording depreciation expense on selected infrastructure assets. Under this method, referred to as the modified approach, the Government expenses certain maintenance and preservation costs and does not report depreciation expense. Roads and bridges are accounted for using the modified approach. The Government's Condition Rating of Transportation Network showed that the percentage of lane miles in fair or better condition declined significantly in 2011. During the year, the actual amount spent on roadway paving and surface treatment was lower than the needed amount because the area assessed was heavily impacted by the May 2010 flood, which was followed by an unusually hard winter with heavy snowfall and heavy road salt usage.

Recommendation

In order to continue using the modified approach for selected infrastructure assets, we recommend that the Government maintain its roads and streets in accordance with its established policy of at least 70 percent of its road and street system at a fair or better condition.

Management's Response

As noted in the observation and in the footnotes to the financial statements, the road assessment was negatively impacted by highly unusual weather conditions. Metro is committed to maintaining road conditions at policy levels, and efforts are underway to improve road conditions.

Other Postemployment Benefit Plans Funding

Observation

The Government is currently funding its other postemployment benefit ("OPEB") plans on a pay-as-you-go basis, which has resulted in an escalating OPEB liability in its Governmental Activities financial statements. If the current funding trend continues, the Governmental Activities will report a net deficit as early as 2014 in the government-wide statement of net assets.

Recommendation

We understand that the Government is not unique in the challenges it faces in funding its OPEB obligations, neither within the state of Tennessee nor across the United States. Further, we understand that the Government is assembling a committee tasked with arriving at best practices for postemployment medical benefits strategy. However, we believe it is important to highlight the matter due to the significance of the exposure and, as such, recommend that the Government continue its efforts to aggressively pursue available means to fund its OPEB obligations.



Management's Response

As noted in the recommendation, the Mayor has convened a Study and Formulating Committee, as required by the Metropolitan Charter, to consider Metro's employee benefits including retiree medical benefits. The Committee is currently considering several recommendations that could reduce Metro's OPEB liability. The Committee is expected to present recommendations to the Employee Benefit Board in the spring of 2012.

CLERK AND MASTER

Deposit Timing for Cash Collections

Observation

During our testing of cash receipts of the Clerk and Master office, we noted that office bookkeepers have no system of tracking when cash receipts arrive in the office to enable personnel to determine if cash collections are deposited within three days of physical receipt. The State of Tennessee mandates in the Audit Manual that cash collections should be deposited within three days.

Recommendation

The Clerk and Master office should implement procedures that assure that the office abides by the State of Tennessee Audit Manual requirement for depositing checks and cash within three days of receipt.

Management's Response

Management agrees and will implement a system to track when cash receipts arrive in the office to assure compliance with the State of Tennessee Audit Manual requirement.

COUNTY REGISTER

Observation

During our testing of cash receipts of the County Register office, we noted cash collections for escrow monies are not routinely deposited within three days of physical receipt. The State of Tennessee mandates in the Audit Manual that cash collections should be deposited within three days.

Recommendation

The County Register office should implement procedures that assure that the office abides by the State of Tennessee Audit Manual requirement for depositing escrow monies within three days of receipt.



Management's Response

The Register of Deeds office agrees and will deposit all escrow monies within three days of receipt.

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Management's responses to the material weaknesses, significant deficiencies, and comments identified in our audit have not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the audit committee, management, and others within the Government, and federal and state awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

Crosslin & Associates, P.C.

CROSSLIN & ASSOCIATES, P.C.