

CITY OF KNOXVILLE, TENNESSEE
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For the year ended June 30, 2004

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unqualified opinion on the basic financial statements of the City of Knoxville, Tennessee. Our opinion was based on our audit and the report of other auditors who audited the financial statements of the Knoxville Utilities Board and the Metropolitan Knoxville Airport Authority. Because the auditors of the Metropolitan Knoxville Airport Authority performed a separate single audit, the schedule of financial assistance does not include assistance received by the Authority. The Knoxville Utilities Board received no federal financial assistance during the year ended June 30, 2004.
2. Three reportable conditions (04-1 through 04-3) relating to the audit of the basic financial statements are reported in the auditors' report on compliance and on internal control over financial reporting based on an audit of financial statements performed in accordance with *Government Auditing Standards*. One of those conditions (04-1) is reported as a material weakness.
3. No instances of noncompliance material to the basic financial statements were disclosed during the audit.
4. One reportable condition (04-4) disclosed during the audit of major federal award programs was reported in the auditors' report on compliance with requirements applicable to each major program and internal control over compliance in accordance with OMB Circular A-133.
5. The auditors' report on compliance with requirements applicable to each major program and internal control over compliance in accordance with OMB Circular A-133 for the City of Knoxville, Tennessee expresses an unqualified opinion.
6. Audit findings relative to the major federal award programs for the City of Knoxville, Tennessee are reported in Part C of this schedule.
7. The following programs were tested as a major programs:
 - Community Development Block Grant (CFDA # 14.218)
 - Home Grant (CFDA # 14.239)
 - Empowerment Zone (CFDA # 14.244)
 - COPS Grant (CFDA # 16.710)
 - Formula Grants (CFDA # 20.507)
8. The threshold for distinguishing Type A and Type B programs was \$469,822.
9. The City of Knoxville, Tennessee was not determined to be a low-risk auditee.

CITY OF KNOXVILLE, TENNESSEE
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

For the year ended June 30, 2004

B. FINDINGS - FINANCIAL STATEMENT AUDIT

04-1 Financial Reporting Oversight

Finding: The design and effective operation of internal controls is crucial to the effective operation of city government and for accurate financial reporting. The lack of central oversight has resulted in several reportable conditions that were noted in both the current and prior years. The large number of adjusting journal entries proposed by external auditors highlight the potential for material misstatement of the City's financial reports.

Payroll clearing accounts - The City failed to make entries to transfer withholdings to proper funds. As a result no withholdings were transferred to the City Choice Fund and certain other withholding accounts in the Payroll Clearing Fund were misstated.

Encumbrances - In the City's accounting system, encumbrances are recorded by a debit to encumbrances and a credit to either reserve for encumbrances or reserve for contracts. There are eight funds (100, 401, 506, 220, 230, 705, 507004 and 507006) in which encumbrances do not agree with the reserve balances.

Allocation of Property Tax Voids and Refunds - All property taxes are deposited into the City's General Fund upon receipt. Monthly the City calculates and allocates those receipts between the General Fund and the Debt Service Fund based on the Property Tax Ordinance. During the current year, however, voided and refunded property taxes were not included in the calculation and resulted in Debt Service Fund property tax revenues being overstated by \$93,951. This amount was corrected during the audit of the City's financial statements and refunded to the General Fund.

Capital Assets - There is no monitoring, on a current basis, of the recording of capital assets. The City did not complete its review and recording of capital assets into its records until five months after the end of its fiscal year. The lack of oversight in monitoring the recording of capital assets reduces the effectiveness of internal controls and allows assets to remain untagged and unaccounted for. This increases the possibility that theft of such assets could go undetected.

Budgets - Three legally approved budget amendments were not recorded in the City's general ledger. Because the City makes financial decisions based upon the availability of appropriations, it is important that the general ledger reflect all approved amendments to the budget.

Financial Reporting of Activities of Related Entities - Oversight of recording of operations of the Knoxville Convention Center, properties managed by the Public Building Authority, and the Civic Auditorium and Coliseum appears to need improvement. Unreconciled variances and the number of adjusting entries required to restate the City's records to conform with those provided by related entities indicate the need for enhanced oversight of reporting these activities. These errors and weaknesses in internal control could result in errors going undetected until the annual audit and threaten the ability of elected officials to receive accurate and timely interim financial reports.

Increasing focus on internal control can have the added benefit of changing controls from detective controls, which detect exceptions after they have occurred to preventive controls, which are designed to prevent errors or irregularities from occurring.

CITY OF KNOXVILLE, TENNESSEE
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

For the year ended June 30, 2004

Recommendation: We recommend that the City review its procedures for monitoring controls over recording transactions and its financial reporting. Those procedures should include review of financial information by appropriate management personnel to ensure its accuracy and completeness.

Management response:

Payroll clearing accounts - We concur with the finding. The withholdings from employee payroll checks for the flexible spending accounts are now transferred weekly from the Payroll Clearing Fund to the City Choice Fund.

The Payroll Clearing Fund will be reconciled at least quarterly to determine that withholdings have been transferred to the proper fund and to ensure that withholding accounts are not misstated.

Encumbrances - We agree with this finding. The accounting staff will work to correct this finding, and the balances will be tied on a periodic basis.

Allocation of Property Tax Voids and Refunds - We concur with the finding. Voided and refunded property taxes are now computed in the allocation.

Capital Assets - The recognition and recording of capital assets was being done on a routine basis through February. The individual assigned to this task left employment with the City and a gap did occur. We have reassigned duties, and this function will be performed by various individuals. The reconciliation of most fixed assets will be done on at least a quarterly basis, for most assets. General fixed assets for capital projects will be done on a less frequent basis. We do not believe this to be a control issue as these types of assets are not subject to theft.

Budgets - We disagree with this finding. Budget amendments were recorded for FY 2003/2004.

In the case of the "reorganization" ordinance, we did not physically reclass each new division of the "newly reorganized" department into the new larger department, e.g. the Information Systems division of the newly formed Finance and Accountability Department was still listed as Information Systems. This was done to avoid a major reclassification of accounts and the implementation of major change in the accounting system in mid-year due to a shift from a four digit to five digit department code, a change that was made to coincide with the beginning of the new fiscal year. This did not, however, result in any lack of control, as all departments were still subject to the original divisional budget. In those instances, where a department/division was eliminated or subsumed as part of a completely different organization, the necessary changes were made in the ledger.

We agree that there may have been some issue with reconciliation. We are trying to determine the source of the differences and will correct the problem.

Financial Reporting of Activities of Related Entities - We acknowledge the issues with the Civic Auditorium/Coliseum, and these are addressed in another response. We believe that the issues cited in regard to the Convention Center and Public Building Authority are minor and deal in part with classification issues/concerns. We will change these classifications which should make it easier for the auditors to verify the reconciliations.

CITY OF KNOXVILLE, TENNESSEE
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

For the year ended June 30, 2004

04-2 Coliseum Bank Accounts

Finding: At June 30, 2004 the Coliseum is holding in its bank accounts approximately \$44,000 in funds that cannot be identified with "unsettled shows," deposits, or payables. It is also holding interest earnings (\$2,732) and wire deposits from ticket rebates (\$70,146) and sports promotions (\$163,826) that are due to the City's operating bank account.

Recommendation: We recommend that the Coliseum transfer these funds to the City Treasurer for deposit into the City's operating bank account.

Management response: The funds in question have been transferred to the City accounts. We are in the process of eliminating the separate bank accounts for the Coliseum/Auditorium, and integrating this activity into the City's consolidated bank accounts. This will eliminate the holding of funds by the Coliseum/Auditorium, result in increased interest earnings, and should help with reconciliation. Coliseum staff will still perform the reconciliation of amounts owed to promoters.

04-3 City Court Citations

Finding: Although the Police Department logs the issuance of citation books to police officers, there are no procedures to insure that all citations are issued, properly voided or returned as unused. As a result missing citations cannot be identified.

Recommendation: We recommend that citations be accounted for in a manner that will ensure that all issued citations have been returned to City Court or properly voided.

Management response: Police officers currently check citation books out at Teleserve and through the offices located at Central District and East District. The log sheet contains the date, name, and ticket numbers. Citations may be written for three different courts - Municipal (City), General Sessions (County) or Juvenile Court (County). Voided citations are sent to Records Section, which then enters the citation in the Records Management System under the Citations Module. The date and officer name are inputted and in the narrative, it says void.

In addition, officers may carry a citation book in their vehicle and only occasionally write a citation. This would pertain specifically to officers assigned to divisions and sections other than Patrol. For instance, an investigator may carry a book of citations but only write one occasionally. He may keep that book for months or longer and still have it in the vehicle.

Status of Prior year Findings

Findings 03-1, 03-2, 03-3 and 03-5 have been corrected. Finding 03-4 has been repeated as part of current year finding 04-1.

CITY OF KNOXVILLE, TENNESSEE
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

For the year ended June 30, 2004

C. FINDINGS AND QUESTIONED COSTS - MAJOR FEDERAL AWARD PROGRAMS AUDIT

04-4 Grant Accounting

Finding: The City receives large amounts of federal and state financial assistance. The City has not designated anyone to overseeing the accounting for the grants and contracts.

The lack of a designated individual who is familiar with grants allows program costs and revenues to be recorded in incorrect funds or programs. In some instances entries for quarterly billings to grantors have been duplicated. In others, quarterly billings have not been recorded. Grant expenditures are balanced at year-end by adjusting revenue through accounts receivable or deferred revenue without regard to the validity of the entries. As a result the following errors in grant accounting occurred:

- KAT reimbursement claims are not reconciled to the City's general ledger. This understates receivables due from grantors and grant revenues until such time allowable costs are included in subsequent reimbursement requests.
- Fourth quarter police grant activity was not recorded until after the audit began.
- The Youth Mentoring Grant (Fund 250053) duplicated expenditures totaling \$19,873 on its reimbursement requests. The Offender Reintegration Grant (Fund 250056) duplicated expenditures totaling \$9,592 on its reimbursement requests.
- Emergency Management Grant reimbursement requests are prepared from a listing of invoices maintained on an electronic spreadsheet. The spreadsheet does not link the invoices to amounts paid, nor is the spreadsheet and the related grant reimbursement requests reconciled to the City's general ledger.

Recommendation: We recommend that the City designate an individual to reconcile its accounting records to grant requests prepared by departments administering the grants.

Management response: KAT grants have been reconciled at the time of reimbursement requests being filed. If a reimbursement request did not include a receivable then it has not been recorded. Going forward we will book the receivable at the time cash is disbursed by the City.

We agree that the fourth quarter Police grant activity was not recorded before July 30 because that information was not received from KPD due to the senior KPD grant person being in training in July. We consider this to be an anomaly and will work to correct in the future.

We agree that duplicative reimbursement requests were filed. These have been refunded.

It is correct that Emergency Management grant reimbursement requests are prepared from a listing of invoices maintained on an electronic spreadsheet. We have requested that this spreadsheet include purchase order and invoice information. This will be reconciled to the City's general ledger.

CITY OF KNOXVILLE, TENNESSEE
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

For the year ended June 30, 2004

If staffing is available, we will consider assigning one individual to oversee grant management. However, it is more efficient to divide the accounting work among several individuals assigned to the various departments. Additional oversight will be provided to try and correct any reconciliation issues. We have no plans to hire a centralized grant coordinator and, are uncertain, given the wide variety of activities that the City performs, that one individual could handle all the work efficiently. We believe that it be may be better to have individuals with functional expertise to be responsible for the appropriate grants as is now the case.

Status of Prior year Findings

Portions of Finding 03-6 relating to grant management were corrected during the year ended June 30, 2004. Portions of Finding 03-6 relating to accounting for grant activities have been repeated as current year finding 04-4.