TENNESSEE ELK RIVER DEVELOPMENT AGENCY

FOR THE PERIOD
JULY 1, 1995, THROUGH APRIL 26, 1996

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August 29, 1996

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Board of Directors
Tennessee Elk River Development Agency
Fayetteville, Tennessee 37334

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Elk River Development Agency for the period July 1, 1995, through April 26, 1996. You will note from the independent auditor's report that a qualified opinion was given on the fairness of the presentation of the financial statements. The report is qualified because we were unable to verify the land inventory balance since the agency did not maintain a list of acreage included in the land account and since the land sold was removed at an amount other than historical cost.

As further discussed in the Background and Organization section of this report, the Tennessee General Assembly, in Public Chapter No. 816, dissolved the Tennessee Elk River Development Agency. As a result, the agency ceased all activities effective the close of business on April 26, 1996.

Consideration of the internal control structure and tests of compliance disclosed certain deficiencies, which are detailed in the Results of the Audit section of this report.

Very truly yours,

W. R. Snodgrass
Comptroller of the Treasury

WRS/cr
96/147

State of Tennessee

Audit Highlights

Comptroller of the Treasury Division of State Audit

Financial and Compliance Audit
Tennessee Elk River Development Agency
For the Period July 1, 1995, Through April 26, 1996

AUDIT OBJECTIVES

The objectives of the audit were to consider the agency's internal control structure; to determine the fairness of the presentation of the financial statements; and to determine compliance with laws, regulations, contracts, and grants.

BACKGROUND

The Tennessee General Assembly, in Public Chapter No. 816, dissolved the Tennessee Elk River Development Agency. As a result, the agency ceased all activities effective the close of business on April 26, 1996.

INTERNAL CONTROL FINDINGS

Inadequate Agency Land Inventory Records
When the agency acquired land from the Tennessee Valley Authority (TVA), neither established a per-acre cost. As land was developed, the agency sold lots through public auction. The land sold was removed from the agency's land inventory account at an amount determined by TVA; however, this amount was not based on cost or market value. In addition, the agency did not maintain a list of the actual acreage included in the current land inventory account (page 18).

Poor Controls Over Payroll
The agency did not maintain adequate control over certain aspects of the payroll process for the agency's central office and Tims Ford office. Problems noted concerned (a) overpayment of payroll and unused annual leave to the central office employees, (b) noncompliance with tax laws, and (c) inconsistent payroll procedures between the Tims Ford office and the central office (page 19).

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is qualified because we were unable to verify the land inventory balance since the agency did not maintain a list of acreage included in the land account and since the land sold was removed at an amount other than historical cost.

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
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AUDIT REPORT
TENNESSEE ELK RIVER DEVELOPMENT AGENCY
FOR THE PERIOD JULY 1, 1995, THROUGH APRIL 26, 1996

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TENNESSEE ELK RIVER DEVELOPMENT AGENCY
FOR THE PERIOD JULY 1, 1995, THROUGH APRIL 26, 1996

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Elk River Development Agency. The audit was conducted pursuant to Section 64-1-310(d), *Tennessee Code Annotated*, which states:

> The annual report, including financial statements, and all books of account and financial records are subject to annual audit by the comptroller. The agency may, with the prior approval of the comptroller of the treasury, engage licensed independent public accountants to perform the audits.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the agency's internal control structure to determine auditing procedures for the purpose of expressing opinions on the financial statements and on compliance with specific requirements applicable to major federal financial assistance programs;
2. to test controls to evaluate the effectiveness of the design and operation of internal control structure policies and procedures applicable to major federal financial assistance programs;
3. to determine the fairness of the presentation of the financial statements;
4. to determine the fairness of the presentation of the supplementary information, in all material respects, in relation to the agency's financial statements taken as a whole;
5. to determine compliance with laws, regulations, contracts, and grants;
6. to determine compliance with specific requirements applicable to major federal financial assistance programs; and
7. to test compliance with general requirements applicable to federal financial assistance programs.

SCOPE OF THE AUDIT

The audit is limited to the period July 1, 1995, through April 26, 1996, and was conducted in accordance with generally accepted government auditing standards. Financial statements are presented for the ten-month period ended April 26, 1996. The Tennessee General Assembly, in Public Chapter No. 816, dissolved the Tennessee Elk River Development Agency. As a result, the agency ceased all activities effective the close of business on April 26, 1996.

BACKGROUND AND ORGANIZATION

BACKGROUND

The Tennessee Elk River Development Agency was created in 1963 by the Tennessee General Assembly to develop and implement a program of comprehensive resource and economic development for those portions of the Elk River watershed lying in Coffee, Franklin, Giles, Grundy, Lawrence, Lincoln, Marshall, and Moore counties in Tennessee.

In 1971, the Tennessee Valley Authority deeded the agency certain land surrounding the Tims Ford Reservoir for development in exchange for two $3,000,000 obligations (the principal obligation and the area development obligation). The principal obligation was to mature in 30 annual payments beginning January 1, 1981. To satisfy the area development obligation, the agency participated in area development projects, such as the construction of parks and other recreational facilities, and economic development projects.

The Tennessee General Assembly, in Public Chapter No. 816, dissolved the agency as of April 26, 1996. All powers, duties, contractual obligations, and functions of the agency were transferred to the Tennessee Department of Environment and Conservation. In addition, all interests in real property and in water rights held by the agency were transferred to the department.

The department is directed to dispose of all properties except those not deemed suitable for development and maintain the remaining property as natural habitats for the preservation of game, non-game, and endangered wildlife species.

ORGANIZATION

The governing body of the Tennessee Elk River Development Agency was the board of directors. As of April 26, 1996, the board was composed of 18 members.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report issued by Kraft Bros., Esstman, Patton & Harrell Certified Public Accountants.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control Structure

As part of the audit of the agency's financial statements for the ten-month period ended April 26, 1996, we considered the internal control structure to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by generally accepted government auditing standards, and an opinion on compliance with specific requirements applicable to major federal financial assistance programs, as required by the Single Audit Act. In addition, controls were tested to evaluate the effectiveness of the design and operation of internal control structure policies and procedures applicable to major federal financial assistance programs. The reports on the internal control structure are on the following pages. Reportable conditions, including a material weakness, are detailed in the findings, which follow the compliance reports.

Fairness of Presentation of the Financial Statements and Supplementary Information

The Division of State Audit has rendered a qualified opinion on the agency's financial statements. In our opinion, except for the effects of such adjustments, if any, as might have been necessary had we been able to examine evidence regarding the land inventory, the statements in this report present fairly, in all material respects, the financial position of the agency at April 26, 1996, and the results of its operations and cash flows for the ten-month period then ended.

In our opinion, the supplementary information in this report is fairly presented, in all material respects, in relation to the financial statements of the agency taken as a whole. The independent auditor's report follows the compliance reports.

Compliance with Laws and Regulations

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under generally accepted government auditing standards.

In our opinion, the agency complied, in all material respects, with the specific requirements applicable to its major federal financial assistance program for the ten-month period ended April 26, 1996.

All identified instances of noncompliance with laws, regulations, contracts, and grants connected with the federal financial assistance program are reported in the Schedule of Noncompliance and Questioned Costs in this report. The compliance reports follow the reports on the internal control structure.

Report on the Internal Control Structure Based on an Audit of the Financial Statements Performed in Accordance With *Government Auditing Standards*

July 19, 1996

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the financial statements of the Tennessee Elk River Development Agency as of and for the ten-month period ended April 26, 1996, and have issued our report thereon dated July 19, 1996. The report is qualified because we were unable to verify the land inventory balance since the agency did not maintain a list of acreage included in the land account and since the land sold was removed at an amount other than historical cost. As described in Note 1 to the financial statements, the Tennessee General Assembly, in Public Chapter No. 816, dissolved the Tennessee Elk River Development Agency. As a result, the agency ceased all activities effective the close of business on April 26, 1996.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The agency's management is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the agency's financial statements for the ten-month period ended April 26, 1996, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

The following reportable conditions were noted:

- Inadequate agency land inventory records
- Poor controls over payroll

These conditions are described in the Results of the Audit section of this report.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities 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 the internal control structure would not necessarily disclose all matters in the internal control structure 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, we noted the following matter involving the internal control structure and its operation that we considered to be a material weakness as defined above. This condition was considered in determining the nature, timing, and extent of procedures to be performed in our audit of the agency's financial statements for the ten-month period ended April 26, 1996.

The following material weakness was noted: The agency did not maintain adequate records for land inventory. This weakness is described in the Results of the Audit section of this report.

We also noted other matters involving the internal control structure and its operation that we have reported to the agency's management in a separate letter.

This report is intended for the information of the General Assembly of the State of Tennessee, the board of directors, management, and the appropriate federal and state agencies. However, this report is a matter of public record, and its distribution is not limited.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/cr

Single Audit Report on the Internal Control Structure Used in Administering Federal Financial Assistance Programs

July 19, 1996

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the financial statements of the Tennessee Elk River Development Agency as of and for the ten-month period ended April 26, 1996, and have issued our report thereon dated July 19, 1996. The report is qualified because we were unable to verify the land inventory balance since the agency did not maintain a list of acreage included in the land account and since the land sold was removed at an amount other than historical cost. As described in Note 1 to the financial statements, the Tennessee General Assembly, in Public Chapter No. 816, dissolved the Tennessee Elk River Development Agency. As a result, the agency ceased all activities effective the close of business on April 26, 1996. We have also audited the agency's compliance with requirements applicable to major federal financial assistance programs and have issued our report thereon dated July 19, 1996.

We conducted our audit in accordance with generally accepted government auditing standards and Office of Management and Budget (OMB) Circular A-128, "Audits of State and Local Governments." Those standards and OMB Circular A-128 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and about whether the agency complied with laws and regulations, noncompliance with which would be material to a major federal financial assistance program.

In planning and performing our audit for the ten-month period ended April 26, 1996, we considered the agency's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinions on the agency's financial statements and on its compliance with requirements applicable to its major program, and to report on the internal control structure in accordance with OMB Circular A-128. This report addresses our consideration of internal control structure policies and procedures relevant to compliance with requirements applicable to its federal financial assistance program. We have addressed internal control structure policies and procedures relevant to our audit of the financial statements in a separate report dated July 19, 1996.

The agency's management is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles, and that federal financial assistance programs are managed in compliance with applicable laws and regulations. Because of inherent limitations in any internal control structure, errors, irregularities, or instances of noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures used in administering the federal financial assistance program in the following categories:

<u>Accounting Applications</u>

- Cash receipts
- Purchasing
- Cash disbursements
- Payroll
- Property and equipment
- General ledger

We have classified the significant controls used in administering the federal financial assistance program in the following categories:

General Requirements

- Political activity
- Civil rights
- Cash management
- Federal financial reports
- Allowable costs/cost principles
- Drug-free workplace
- Administrative requirements

Specific Requirements

- Types of services
- Reporting

Claims for Advances and Reimbursements

For all the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and determined whether they have been placed in operation, and we assessed control risk.

During the ten-month period ended April 26, 1996, the agency expended 100 percent of its total federal financial assistance under one major federal financial assistance program.

We performed tests of controls, as required by OMB Circular A-128, to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that we considered relevant to preventing or detecting material noncompliance with specific requirements, general requirements, and requirements governing claims for advances and reimbursements that are applicable to the agency's major federal financial assistance program, which is identified in the accompanying schedule of federal financial assistance. Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion.

Our consideration of the internal control structure policies and procedures used in administering federal financial assistance would not necessarily disclose all matters in the internal control structure that might constitute material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that noncompliance with laws and regulations that would be material to a federal financial assistance program may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above.

However, we noted certain matters involving the internal control structure and its operation that we have reported to the agency's management in a separate letter.

This report is intended for the information of the General Assembly of the State of Tennessee, the board of directors, management, and the appropriate federal and state agencies. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/cr

Compliance Report Based on an Audit of the Financial Statements Performed in Accordance With *Government Auditing Standards*

July 19, 1996

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the financial statements of the Tennessee Elk River Development Agency as of and for the ten-month period ended April 26, 1996, and have issued our report thereon dated July 19, 1996. The report is qualified because we were unable to verify the land inventory balance since the agency did not maintain a list of acreage included in the land account and since the land sold was removed at an amount other than historical cost. As described in Note 1 to the financial statements, the Tennessee General Assembly, in Public Chapter No. 816, dissolved the Tennessee Elk River Development Agency. As a result, the agency ceased all activities effective the close of business on April 26, 1996.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to the agency is the responsibility of the agency's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the agency's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under generally accepted government auditing standards.

We did, however, note certain immaterial instances of noncompliance that we have reported to the agency's management in a separate letter.

This report is intended for the information of the General Assembly of the State of Tennessee, the board of directors, management, and the appropriate federal and state agencies. However, this report is a matter of public record, and its distribution is not limited.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/cr

Single Audit Opinion on Compliance With Specific Requirements Applicable to Major Federal Financial Assistance Programs

July 19, 1996

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the financial statements of the Tennessee Elk River Development Agency as of and for the ten-month period ended April 26, 1996, and have issued our report thereon dated July 19, 1996. The report is qualified because we were unable to verify the land inventory balance since the agency did not maintain a list of acreage included in the land account and since the land sold was removed at an amount other than historical cost. As described in Note 1 to the financial statements, the Tennessee General Assembly, in Public Chapter No. 816, dissolved the Tennessee Elk River Development Agency. As a result, the agency ceased all activities effective the close of business on April 26, 1996.

We have also audited the agency's compliance with the requirements governing types of services allowed or unallowed; reporting; and claims for advances and reimbursements that are applicable to its major federal financial assistance program, which is identified in the accompanying schedule of federal financial assistance, for the ten-month period ended April 26, 1996. The agency's management is responsible for the agency's compliance with those requirements. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit of compliance with those requirements in accordance with generally accepted government auditing standards and Office of Management and Budget (OMB) Circular A-128, "Audits of State and Local Governments." Those standards and OMB

Circular A-128 require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the agency's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

The results of our audit procedures disclosed immaterial instances of noncompliance with the requirements referred to above, which are discussed in the accompanying Schedule of Noncompliance and Questioned Costs. We considered these instances of noncompliance in forming our opinion on compliance, which is expressed in the following paragraph.

In our opinion, the agency complied, in all material respects, with the requirements governing types of services allowed or unallowed; reporting; and claims for advances and reimbursements that are applicable to its major federal financial assistance program for the ten-month period ended April 26, 1996.

This report is intended for the information of the General Assembly of the State of Tennessee, the board of directors, management, and the appropriate federal and state agencies. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/cr

Single Audit Report on Compliance With the General Requirements Applicable to Federal Financial Assistance Programs

July 19, 1996

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the financial statements of the Tennessee Elk River Development Agency as of and for the ten-month period ended April 26, 1996, and have issued our report thereon dated July 19, 1996. The report is qualified because we were unable to verify the land inventory balance since the agency did not maintain a list of acreage included in the land account and since the land sold was removed at an amount other than historical cost. As described in Note 1 to the financial statements, the Tennessee General Assembly, in Public Chapter No. 816, dissolved the Tennessee Elk River Development Agency. As a result, the agency ceased all activities effective the close of business on April 26, 1996.

We have applied procedures to test the agency's compliance with the following requirements applicable to its federal financial assistance program, which is identified in the schedule of federal financial assistance, for the ten-month period ended April 26, 1996: political activity, civil rights, cash management, federal financial reports, allowable costs/cost principles, drug-free workplace, and administrative requirements.

Our procedures were limited to the applicable procedures described in the Office of Management and Budget's *Compliance Supplement for Single Audits of State and Local Governments*. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on the agency's compliance with the requirements listed in the preceding paragraph. Accordingly, we do not express such an opinion.

The Honorable W. R. Snodgrass
July 19, 1996
Page Two

With respect to the items tested, the results of those procedures disclosed no material instances of noncompliance with the requirements listed in the second paragraph of this report. With respect to items not tested, nothing came to our attention that caused us to believe that the agency had not complied, in all material respects, with those requirements. However, the results of our procedures disclosed immaterial instances of noncompliance with those requirements which are described in the accompanying Schedule of Noncompliance and Questioned Costs.

This report is intended for the information of the General Assembly of the State of Tennessee, the board of directors, management, and the appropriate federal and state agencies. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/cr

FINDINGS

INADEQUATE AGENCY LAND INVENTORY RECORDS

1. FINDING:

When the agency acquired land from the Tennessee Valley Authority (TVA), neither established a per-acre cost. As land was developed, the agency sold lots through public auction. The land sold was removed from the agency's land inventory account at amounts determined by TVA; however, these amounts were not based on cost or market value. In addition, the agency did not maintain a list of the actual acreage included in the current land inventory account.

Generally accepted accounting principles require that inventory items be accounted for at the lower of cost or market. Cost appears to be the most appropriate method for the valuation of the land inventory account. Also, prudent accounting practices require adequate documentation to support the amounts shown on the agency's financial statements.

Because the agency did not maintain a list of acreage included in the land inventory account and since the land sold was removed at an amount other than the historical cost per acre, we were not able to verify the total land balance shown on the agency's balance sheet. Therefore, we have qualified the opinion on the agency's financial statements.

When the Tennessee Elk River Development Agency was dissolved April 26, 1996, through action of the General Assembly, the agency's real property and water rights were transferred to the Tennessee Department of Environment and Conservation. Because the agency departed from generally accepted accounting principles and did not maintain a verifiable land inventory balance, the department must now determine how many acres the agency owned, the location of the land, and the historical cost per acre. Only then can the department carry out the intent of the law and dispose of all land suitable for development.

MANAGEMENT'S COMMENT:

Management did not respond.

POOR CONTROLS OVER PAYROLL

2. FINDING:

The agency did not maintain adequate control over certain aspects of the payroll process for the agency's central office in Fayetteville and the Tims Ford office. Problems noted concerned (a) overpayment of payroll and unused annual leave to the central office employees, (b) noncompliance with tax laws, and (c) inconsistent payroll procedures between the Tims Ford office and the central office.

a. Although only one week had elapsed since the last payday, the two central office employees were paid their normal two-week salary when the agency terminated. As a result, the central office employees were overpaid one week's wages totaling $762.31.

   The central office employees were also paid for unused annual leave exceeding the maximum leave accumulation permitted. According to the agency's *Employment Procedures Manual*, employees can accumulate a maximum of 36 days for six to ten years of service and 42 days for 20 or more years of service. The central office employees were overpaid an amount of $1,096.01, representing an excess of 50 hours for one employee and 31.25 for another.

b. The agency did not deduct federal income tax from the central office annual leave checks and did not remit amounts for income tax to the Internal Revenue Service.

   In addition, federal income tax deductions were consistently miscalculated throughout the fiscal year. The agency did not update the tax tables in its payroll computer system and continued to use the prior year's tax data; the deductions for all paychecks tested were based on prior-year tables. As a result, the actual deductions from payroll checks were greater than the amounts that would have been deducted had the correct Internal Revenue Service tax tables been used.

c. The Board of Directors did not ensure that consistent payroll policies and procedures were applied to all staff. First, employees of the Tims Ford office were not paid for their unused annual leave on the day of the agency's termination; although central office employees were. Second, the financial manager required Tims Ford office employees to maintain time sheets but exempted central office employees from this requirement. Third, pay periods for both offices were not concurrent. Tims Ford office employees were paid one week in arrears, but central office employees' pay was not delayed. Finally, the financial manager gave paychecks to central office employees before the pay period ended, in essence paying them wages they had not yet earned.

The Department of Environment and Conservation should consider attempting to recover the overpayments to central office employees.

MANAGEMENT'S COMMENT:

Management did not respond.

Independent Auditor's Report

July 19, 1996

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the accompanying balance sheet of the Tennessee Elk River Development Agency as of April 26, 1996, and the related statements of revenues, expenses, and changes in retained earnings and cash flows for the ten-month period then ended. These financial statements are the responsibility of the agency's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

We were unable to verify the land inventory balance since the agency did not maintain a list of acreage included in the land account and since the land sold was removed at an amount other than historical cost. The agency's records do not permit the application of other auditing procedures to verify the land inventory balance.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding the land inventory, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee Elk River Development Agency as of April 26, 1996, and the results of its operations and cash flows for the ten-month period then ended in conformity with generally accepted accounting principles.

As described in Note 1 to the financial statements, the Tennessee General Assembly, in Public Chapter No. 816, dissolved the Tennessee Elk River Development Agency. As a result, the agency ceased all activities effective the close of business on April 26, 1996.

Our audit was made for the purpose of forming an opinion on the financial statements, taken as a whole. The accompanying supplementary information on pages 40 through 43 is presented for purposes of additional analysis and is not a required part of the agency's financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements, taken as a whole.

In accordance with generally accepted government auditing standards, we have also issued reports dated July 19, 1996, regarding our consideration of the agency's internal control structure and its compliance with laws and regulations.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/cr

NOTE 1. GENERAL

The Tennessee Elk River Development Agency was created in 1963 in accordance with Title 64, Chapter 1, as amended, of *Tennessee Code Annotated* to develop and implement a program of comprehensive resource and economic development for those portions of the Elk River watershed lying in Coffee, Franklin, Giles, Grundy, Lawrence, Lincoln, Marshall, and Moore counties in Tennessee. The agency and the Tennessee Valley Authority (TVA) cooperated to carry out this mandate to ensure full utilization of the resources of the Tims Ford Project. An agreement between the agency and TVA (TVA Agreement) transferred certain land surrounding the Tims Ford Reservoir to the agency in return for two obligations. The agency must repay one of the obligations in cash; the other may be met by TVA-approved credits received for contributions to area development projects (see Note 5).

The Tennessee General Assembly, in Public Chapter No. 816, dissolved the agency as of April 26, 1996. All powers, duties, contractual obligations, and functions of the agency were transferred to the Tennessee Department of Environment and Conservation. The law specified distribution of all funds allotted to and held by the agency. Moreover, all interests in real property and in water rights held by the agency were transferred to the Tennessee Department of Environment and Conservation. The law also provided for distribution of funds in the event real property is sold. Any projects initiated by the agency that have received final approval from the Tennessee Valley Authority will be implemented.

The financial statements reflect the agency's financial position at April 26, 1996, immediately prior to the agency's dissolution, and its results of operations and cash flows for the period July 1, 1995, through April 26, 1996.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Reporting Entity

The agency was governed by an 18-member board. The board consisted of directors from each county in the Elk River watershed. For financial reporting purposes, the agency included all activities over which the Board of Directors was financially accountable.

Basis of Presentation

The accompanying financial statements of the Tennessee Elk River Development Agency have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The agency follows all applicable GASB pronouncements, as well as applicable private-sector pronouncements issued on or before November 30, 1989.

Measurement Focus and Basis of Accounting

The financial records of the agency were accounted for on the flow of economic resources measurement focus and maintained on the accrual basis of accounting. Revenues were recorded when earned, and expenses were recorded at the time liabilities were incurred. Grant revenue was recognized in the period in which qualifying expenses were incurred.

Cash and Certificates of Deposit

Cash includes demand deposits and savings deposits in banks (both restricted and unrestricted). Certificates of deposit (both restricted and unrestricted) with original maturities of three months or longer are stated at cost, which approximates market, and are not considered cash equivalents.

Property and Equipment and Depreciation

Property and equipment in service are reported at cost and include improvements that significantly add to utility or extend useful lives. Costs of maintenance and repairs are charged to expense.

Depreciation is calculated by the straight-line method to allocate the cost of the assets over their estimated useful lives. The general range of useful lives is 20 to 40 years for buildings and recreational facilities and 3 to 10 years for all other depreciable assets.

Land and Development Costs

The inventory account for undeveloped land is reported at an amount determined by TVA. Development costs, consisting principally of direct costs and certain allocable indirect costs, were capitalized as projects in progress and transferred to developed land upon completion.

Restricted Assets

Certain cash, certificates of deposit, and accrued interest are classified as restricted assets because their use is restricted by the TVA Agreement. The TVA Agreement requires a specified allocation of capital projects receipts in excess of project expenses (net receipts). Net receipts were to be allocated as follows:

50% to a principal obligation sinking fund to be utilized for the sole purpose of repaying the TVA principal obligation (See Note 5.)

30% to an unrestricted operating fund

10% to a reservoir development fund to be utilized for construction of reservoir and shoreline improvements, which are not intended to produce capital projects income

10% to an area development fund to be utilized to provide area development assistance that produces credits against the area development obligation (See Note 5.)

The agency could have allocated net receipts in a different ratio if TVA approved.

The TVA Agreement required that these funds be deposited in federally insured institutions and that deposits in excess of FDIC coverage be collateralized by government securities or invested in Tennessee bonds or United States securities.

Contributed Capital

Reductions in the area development obligation to TVA resulting from participation in area development projects were accounted for as capital contributions. Credits were recorded upon approval by TVA (see Note 5). Grants received for purchase of capital assets were recognized as contributed capital. There were no changes in contributed capital during the period.

Reserved Retained Earnings

Reserved retained earnings is the total of restricted assets less the TVA principal obligation.

NOTE 3. DEPOSITS

The bank balances of deposits including cash, certificates of deposit, and accrued interest as of April 26, 1996, were entirely insured or collateralized with securities held by the agency or by its agent in the agency's name.

NOTE 4. NOTES RECEIVABLE

Notes receivable at April 26, 1996, consist of a 20-year, 12% installment note executed by an individual who purchased a house and lot. A schedule of annual principal maturities follows:

Year Ending April 26	Principal
1997	$ 1,857.89
1998	2,093.51
1999	2,359.03
2000	2,658.22
2001	2,995.37
2002-2006	18,476.75
	$30,440.77

NOTE 5. LONG-TERM OBLIGATIONS

Certain land surrounding the Tims Ford Reservoir was deeded to the agency by TVA for development in exchange for two $3,000,000 obligations—the principal obligation and the area development obligation. The principal obligation was to mature in 30 annual payments beginning January 1, 1981, with an interest rate of 3.125 percent. With prior approval by TVA, this obligation could also be reduced by an amount equal to 75 percent of the fair value up to $1,000,000 of all land or interests in land transferred to the state, counties, or municipalities as provided in the contract.

A schedule of annual maturities on the principal obligation as of April 26, 1996, follows:

Year Ending April 26	Principal	Interest
1997	$ 75,012.62	$ 40,393.76
1998	77,356.77	38,049.61
1999	79,774.17	35,632.21
2000	82,267.11	33,139.27
2001	84,837.96	30,568.42
2002-2010	893,351.57	145,305.85
	$1,292,600.20	$323,089.12

The area development obligation allowed the agency to earn credits toward the obligation by participating in area development projects. Public facilities, such as parks and other recreational facilities, and economic development projects qualified for these credits. Credits could be earned by direct investment and indirect investment obtained from other non-federal funds in qualifying projects. The agency could earn up to $500,000 in area development credits in any five-year period, beginning with the period ended December 1, 1980, until the entire $3,000,000 obligation had been retired. If the agency earned less than the full $500,000 credit in any five-year period, the shortfall was to be added to the principal obligation unless TVA provided a waiver of that requirement. Because TVA had to approve the credits, no accrual was made until TVA reviewed and approved the credits.

The area development obligation has a balance of $377,286.65 which is due by December 1, 2000.

The agency was involved in ten area development projects and three Tims Ford site projects at April 26, 1996, that had received the approval of the agency's board and TVA. These projects were either in progress at April 26, 1996, or the funding for the projects had been approved. It is anticipated that the area development projects will be completed in a twelve-month period except for the speculative buildings projects that run for a period of two years. The approved projects and remaining approved funding are listed below.

Area Development Projects

1.	Multi-Media Project	$ 15,838.55
2.	Abbo's Alley	10,000.00
3.	Hannah's House	3,148.92
4.	Dellrose Siderail	75,000.00
5.	Moore County Swimming Pool	2,083.00
6.	Plainview Community Center	12,000.00
7.	Southern Middle Tennessee Skywarn Station	18,235.00
8.	Speculative Building - Lincoln County	6,331.96
9.	Speculative Building - Lauderdale County	23,843.17
10.	Public River Access - Elkton	40,000.00
	Total Remaining Approved Funding	$206,480.60

Tims Ford Site Projects

1.	Fanning Bend Lot Development	$802,050.30
2.	Maintenance Building Addition	10,458.82
3.	Bathhouse Addition - Campground	6,093.81
	Total Remaining Approved Funding	$818,602.93

NOTE 6. DEFINED BENEFIT PENSION PLAN

A. Plan Description

Certain employees of the agency are members of the Tennessee Consolidated Retirement System (TCRS), an agent multiple-employer plan. TCRS acts as a common investment and administrative agent for political subdivisions in the state. The agency's payroll for employees covered by the plan for the ten-month period ended April 26, 1996, was $156,279.64 and total payroll was $179,682.62.

The TCRS administers a defined benefit retirement plan covering teachers and general employees of the state, higher education employees, and employees of participating political subdivisions. The TCRS provides retirement benefits as well as death and disability benefits. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members are eligible to retire at age 60 with five years' service or upon completion of 30 years' service. Early retirement with reduced benefits is available to vested members at age 55. Disability benefits are available to members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member performed duties. Members joining the system on or after July 1, 1979, become vested after ten years of service; members joining prior to July 1, 1979, were vested after four years of service. Benefit provisions are established and amended by state statute. Amendments to the TCRS plan are not applicable to a political subdivision unless approved by the political subdivision's governing body.

The agency's retirement plan is contributory whereby the employee contributes 5 percent of his/her gross salary and the employer is responsible for the remaining balance of the required contribution for the plan year.

B. Funding Status and Progress

The amount shown below as the "total pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure is intended to help users assess the funding status of the agency's pension program as administered by TCRS on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among public employee retirement systems and among employers. The measure is the actuarial present value of credited projected benefits and is independent of the funding method used to determine contributions to the system.

The pension benefit obligation was computed as part of an actuarial valuation performed as of June 30, 1995. Significant actuarial assumptions used in the valuation include (a) rate of return on investment of present and future assets of 8 percent a year compounded annually, (b) projected salary increases of 7 percent a year (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries) compounded annually, (c) projected 6 percent annual increase in Social Security wage base, and (d) projected post-retirement benefit increases of 3 percent of the retiree's initial benefit.

The pension benefit obligation and assets available for benefits are not available for the ten-month period ended April 26, 1996. Total unfunded pension benefit obligation applicable to the agency's employees was $27,071 at June 30, 1995, as follows:

Pension benefit obligation:	
Retirees and beneficiaries currently receiving benefits and terminated employees not yet receiving benefits	$216,586
Current employees:	
Accumulated employee contributions including allocated investment earnings	117,030
Employer-financed vested	325,851
Employer-financed nonvested	22,009
Total pension benefit obligation	681,476
Net assets available for benefits, at cost or amortized cost (market value–$710,146)	654,405
Unfunded pension benefit obligation	$ 27,071

C. Actuarially Determined Contribution Requirements and Contribution Made

It is the policy of the Board of Trustees of the TCRS to fund pension benefits by actuarially determined contributions intended to provide funding for both the normal cost and the unfunded actuarial accrued liability cost, so that sufficient assets will be available to pay benefits when due. The frozen initial liability method, a projected-benefit cost method, is used to value the plan. At June 30, 1995, the last actuarial valuation, the agency's unfunded actuarial accrued liability for its pension plan totaled $32,987. All unfunded actuarial accrued liabilities are amortized over a 20-year period. The amortization period began on the political subdivision's initial date of participation in the TCRS or on July 1, 1975, whichever is later. The accrued liability for basic benefits and cost-of-living benefits is amortized as a level-dollar amount. Political subdivisions such as the agency participate in the TCRS as individual entities and are liable for all costs associated with the operation and administration of their respective plans.

The significant actuarial assumptions used to compute the actuarially determined contribution requirement are the same as those used to compute the pension benefit obligation as described in B. above.

The contribution of $19,581.62 to the TCRS for the ten-month period ended April 26, 1996, was made in accordance with actuarially determined requirements computed through an actuarial valuation performed as of June 30, 1993. The contribution consisted of (a) $14,393.24 in normal costs (9.21% of current covered payroll) and (b) $5,188.38 in amortization of the unfunded actuarial accrued liability (3.32% of current covered payroll). An additional contribution was made by the agency in the amount of $44,228.00 in January 1996.

	April 26, 1996
Agency contribution	
(7.53% of current covered payroll)	$11,767.66
Employee contribution	
(5% of current covered payroll)	7,813.96
Additional pension contribution	44,228.00
	$63,809.62

The actuarial valuation as of June 30, 1993, computed contribution rates effective July 1, 1994, through June 30, 1996.

The agency ceased operations on April 26, 1996. TCRS information was not available for fiscal year 1996.

D. Trend Information

Three-year historical trend information designed to give an indication of the progress made by the agency in accumulating sufficient assets to pay benefits when due is presented below:

	(1)	(2)	(3)	(4)	(5)	(6)
Fiscal Year	Net Assets Available for Benefits	Pension Benefit Obligation	Percentage Funded (1)/(2)	Unfunded Pension Benefit Obligation (2)-(1)	Annual Covered Payroll	Unfunded Pension Benefit Obligation as a Percentage of Covered Payroll (4)/(5)
1993	$484,503	$524,014	92.5%	$39,511	$165,779	23.8%
1994	$548,920	$591,781	92.8%	$42,861	$179,121	23.9%
1995	$654,405	$681,476	96.0%	$27,071	$186,286	14.5%

In addition, for the three years ended 1993, 1994, and 1995, the agency's contributions to the TCRS, all made in accordance with actuarially determined requirements, were 6.9%, 6.9%, and 7.5%, respectively of annual covered payroll.

Ten-year historical trend information for the retirement system as a whole may be found in the *Tennessee Consolidated Retirement System Comprehensive Annual Financial Report* for the year ended June 30, 1995.

NOTE 7. TELECOMMUNICATIONS PROJECT

During 1993, the agency signed an agreement with TVA to implement in the Elk River watershed a demonstration telecommunications project which would last approximately two years and would set the stage for further implementation as the program matured. The program focused on the application of existing telecommunication technologies in four areas: education, health, business and industrial development, and government services. The program was implemented at the county level. The agreement with TVA set aside $1,500,000 in a trust fund for the agency's use in the project. The trust fund was under the control of TVA, and expenditures for the project were reimbursed to the agency after TVA's approval. Since the trust fund was not under the control of the agency, it has not been included as a part of the financial reporting entity.

During 1994, the agency began establishing demonstration telecommunication centers in the Elk River watershed, assisting in establishing a leadership group in each county, identifying suitable sites for the centers, and acquiring telecommunications equipment. The leadership group will be responsible for management of the center after its establishment.

Most telecommunications equipment acquisitions were expensed by the agency since the agency received no direct benefit. The agency, in conjunction with TVA, had a reversionary interest in the equipment in case the leadership group discontinued its use in telecommunication centers.

On October 12, 1995, TVA terminated the project.

NOTE 8. RISK MANAGEMENT

The agency participated in the Tennessee Municipal League (TML) Risk Management Pool, for the following risks of loss: commercial general liability; theft of, damage to, or destruction of real and personal property; employee dishonesty; bodily injury, property damage, physical damage, and personal injury liability for vehicle operation; and worker's compensation and employer's liability. The agency's participation in the TML Risk Management Pool was similar to purchasing commercial insurance, in that the agreement provided for payment of premiums and did not provide for additional member assessments. Settled claims resulting from these risks did not exceed coverage in any of the past three fiscal years.

The agency carried commercial insurance for the following risks of loss: bodily injury, property damage, physical damage, and personal injury liability for automobile, truck, and maintenance equipment operation.

The agency elected to provide health insurance coverage for its employees through a health plan for eligible local governments and quasi-governmental agencies in Tennessee. The Local Government Group Insurance Fund provides access to affordable health insurance by pooling risks among the groups. The plan provides for greater stability in controlling premium increases and, through a structured managed-care program, helps contain health care costs of participating members. The plan is administered by the State of Tennessee, using a separately established fund. To this fund, premiums of participating units are deposited and used to pay claims for participants' health care costs as well as to the state's administrative costs of the plan. Monthly insurance premiums ranged from $1.64 to $447.50, depending on the employees' coverage and salaries. Claims are administered by Blue Cross and Blue Shield of Tennessee, which is currently under contract to provide these and other services to the state. Insurance premiums are adjusted at the end of each year based on the claim experience of the pool. Individual pool participants are not assessed additional premiums based on individual claims experience. Employees and providers have 13 months to file medical claims.