Knox County Community Services Agency

For the Year Ended
June 30, 2003

Arthur A. Hayes, Jr., CPA, JD, CFE
Director

Edward Burr, CPA
Assistant Director

Kandi Thomas, CPA, CFE
Audit Manager

Sam Alzoubi
In-Charge Auditor

Jonathan Ward
Susan Walker
Staff Auditors

Gerry C. Boaz, CPA
Technical Analyst

Amy Brack
Editor

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 401-7897

Financial/compliance audits of community services agencies are available on-line at www.comptroller.state.tn.us/sa/reports/index.html.
For more information about the Comptroller of the Treasury, please visit our Web site at www.comptroller.state.tn.us.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

November 30, 2004

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Board of Directors
Knox County Community Services Agency
413 Northshore Dr. SW, Suite E
Knoxville, Tennessee 37919

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Knox County Community Services Agency for the year ended June 30, 2003. You will note from the independent auditor's report that unqualified opinions were given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance disclosed certain deficiencies, which are detailed in the Results of the Audit section of this report. The agency's management has responded to the audit findings; the responses are included following each finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/th
04/085

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit
Knox County Community Services Agency
For the Year Ended June 30, 2003

AUDIT OBJECTIVES

The objectives of the audit were to consider the agency's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, and contracts; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

INTERNAL CONTROL FINDING

Internal Control Over Travel Claims Is Inadequate
The agency did not ensure travel claims were adequately completed, supported, and approved before payment (page 8).

COMPLIANCE FINDINGS

The Agency Did Not Comply With the Department of Children's Services' Contract Terms and Did Not Enter Into Contracts as Required by the State Rules and Regulations*
Management did not include required language in its contracts and did not enter into contracts when purchases of services exceeded certain limits (page 8).

The Agency Inappropriately Incurred Foster Care Expenditures After the Period of Eligibility and Did Not Comply With the Internal Policies and Procedures When Purchasing Goods and Services for Children and Families
The agency paid $1,791 to one youth beyond the period of eligibility. In addition, the agency paid for items that were not allowed according to its internal policy (page 10).

The Membership of the CSA Board of Directors Violates State Law
The Department of Children's Services' (DCS) Regional Administrator, a management-level DCS employee assigned to the community services agency (CSA) service area, serves on the Knox County CSA's board of directors in violation of state law (page 12).

* This finding is repeated from the prior audit.

OPINIONS ON THE FINANCIAL STATEMENTS

The opinions on the financial statements are unqualified.

Audit Report
Knox County Community Services Agency
For the Year Ended June 30, 2003

TABLE OF CONTENTS

TABLE OF CONTENTS (CONT.)

Knox County Community Services Agency
For the Year Ended June 30, 2003

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Knox County Community Services Agency. The audit was conducted pursuant to Section 37-5-313, *Tennessee Code Annotated*, which authorizes the Comptroller of the Treasury to "make an annual audit of the program established by this part as part of the comptroller's annual audit pursuant to Section 9-3-211."

BACKGROUND

The Community Services Agency Act of 1996 created the community services agencies. The purpose of these agencies is to coordinate funds and programs designated for care of children and other citizens in the state.

The Knox County Community Services Agency's administrative offices are in Knoxville, Tennessee. The governing body of the Knox County Community Services Agency is the board of directors. As of June 30, 2003, the board was composed of 12 members. (See Appendix.) An executive committee, consisting of five board members, has the authority to act on behalf of the board of directors in the management of the agency's property, affairs, and funds in extraordinary circumstances when the governing board cannot convene.

The agency's programs are carried out by staff under the supervision of the Executive Director, who is appointed by the Commissioner of the Department of Children's Services, subject to the approval of the board.

AUDIT SCOPE

The audit was limited to the period July 1, 2002, through June 30, 2003, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the year ended June 30, 2003, and for comparative purposes, the year ended June 30, 2002. The Knox County Community Services Agency has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report.*

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the agency's internal control over financial reporting to determine auditing procedures for the purpose of expressing opinions on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, and contracts;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDING

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Knox County Community Services Agency filed its report with the Department of Audit on January 14, 2004. A follow-up of the prior audit finding was conducted as part of the current audit. The prior audit report contained a finding concerning the agency's compliance with contract terms. This finding has not been resolved and is repeated in this report.

OBSERVATIONS AND COMMENTS

AUDIT COMMITTEE RECOMMENDED

As a result of the fraud-related business failures of companies such as Enron and WorldCom in recent years, Congress and the accounting profession have taken aggressive measures to try to detect and prevent future failures related to fraud. These measures have included the signing of the *Sarbanes-Oxley Act of 2002* by the President of the United States and the issuance of *Statement on Auditing Standards Number 99* (SAS 99) by the American Institute of Certified Public Accountants. This new fraud auditing standard has not only changed the way auditors perform audits but has also provided guidance to management and boards of directors on creating antifraud programs and controls. This guidance has included the need for an independent audit committee.

As a result of these developments, we are recommending that agencies with boards establish audit committees. The specific activities of any audit committee will depend on, among other things, the mission, nature, structure, and size of each agency. In establishing the audit committee and creating its charter, each board should examine its agency's particular circumstances. Anti-fraud literature notes that there are two categories of fraud: fraudulent financial reporting and misappropriation of assets. The audit committee should consider the risks of fraud in its agency in general as well as the history of its particular agency with regard to prior audit findings, previously disclosed weaknesses in internal control, and compliance issues. The audit committee should consider both the risk of fraudulent financial reporting and the risk of fraud due to misappropriation or abuse of agency assets. Also, the board and the audit committee should keep in mind that agencies receiving public funding should have a lower threshold of materiality than private sector entities with regard to fraud risks.

Boards should exercise professional judgment in establishing the duties, responsibilities, and authority of their audit committee. The factors noted below are not intended to be an exhaustive listing of those matters to be considered. The committee should not limit its scope to reacting to a preconceived set of issues and actions but rather should be proactive in its oversight of the agency as it concentrates on the internal control and audit-related activities of the entity. In fact, this individualized approach is one of the main benefits derived from an audit committee.

At a minimum, audit committees should:

1. Develop a written charter that addresses the audit committee's purpose and mission, which should be, at a minimum, to assist the board in its oversight of the agency.

2. Formally reiterate, on a regular basis, to the board, agency management, and staff their responsibilities for preventing, detecting, and reporting fraud, waste, and abuse.

3. Serve as a facilitator of any audits or investigations of the agency, including advising auditors and investigators of any information they may receive or otherwise note regarding risks of fraud or weaknesses in the agency's internal controls; reviewing with the auditors any findings or other matters noted by the auditors during audit engagements; working with the agency management and staff to ensure implementation of audit recommendations; and assisting in the resolution of any problems the auditors may have with cooperation from agency management or staff.

4. Develop a formal process for assessing the risk of fraud at the agency, including documentation of the results of the assessments and assuring that internal controls are in place to adequately mitigate those risks.

5. Develop and communicate to staff of the agency their responsibilities to report allegations of fraud, waste, or abuse at the agency to the committee and the Comptroller's Office as well as a process for immediately reporting such information.

6. Immediately inform the Comptroller of the Treasury's Office when fraud is detected.

7. Develop and communicate to the board, agency management, and staff a written code of conduct reminding those individuals of the public nature of the agency and the need for all to maintain the highest level of integrity with regard to the financial operations and any related financial reporting responsibilities of the agency; to avoid preparing or issuing fraudulent or misleading financial reports or other information; to protect agency assets from fraud, waste, and abuse; to comply with all relevant laws, rules, policies and procedures; and to avoid engaging in activities which would otherwise bring dishonor to the agency.

The charter of the audit committee should include, at a minimum, the following provisions:

1. The audit committee should be a standing committee of the board.

2. The audit committee should be composed of at least three members. The chair of the audit committee should preferably have some accounting or financial management background. Each member of the audit committee should have an adequate background and education to allow a reasonable understanding of the information presented in the financial reports of the agency and the comments of auditors with regard to internal control and compliance findings and other issues.

3. The members of the audit committee must be independent from any appearances of other interests that are in conflict with their duties as members of the audit committee.

4. An express recognition that the board, the audit committee, and the management and staff of the agency are responsible for taking all reasonable steps to prevent, detect, and report fraud, waste, and abuse.

5. The audit committee should meet regularly throughout the year. The audit committee can meet by telephone, if that is permissible for other committees. However, the audit committee is strongly urged to meet at least once a year in person. Members of the audit committee may be members of other standing committees of the board, but the audit committee meetings should be separate from the meetings of other committees of the board.

6. The audit committee should record minutes of its meetings.

The Division of State Audit will be available to discuss with the board any questions it might have about the creation of its particular audit committee. There are also other audit committees which have already been established at other state agencies that the board may wish to contact for advice and further information.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Knox County Community Services Agency's financial statements for the year ended June 30, 2003, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing opinions on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. A reportable condition, along with the recommendation and management's response, is detailed in the findings and recommendations. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

The results of our audit tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Immaterial instances of noncompliance, along with recommendations and management's responses, are included in the findings and recommendations.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered unqualified opinions on the Knox County Community Services Agency's financial statements.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

May 25, 2004

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the financial statements of the Knox County Community Services Agency, a component unit of the State of Tennessee, as of and for the year ended June 30, 2003, and have issued our report thereon dated May 25, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Knox County Community Services Agency's financial statements are free of material misstatement, we performed tests of the agency's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We did, however, note certain immaterial instances of noncompliance that we have included in the Findings and Recommendations section of this report. We also noted certain other less significant instances of noncompliance that we have reported to the agency's management in a separate letter.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Knox County Community Services Agency's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements.

The following reportable condition was noted:

- Internal control over travel claims is inadequate.

This condition is described in the Findings and Recommendations section of this report.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements 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 over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that the reportable condition described above is not a material weakness.

We also noted other matters involving the internal control over financial reporting that we have reported to the Knox County Community Services Agency's management in a separate letter.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee, the board of directors, and management, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA,
Director

AAH/th

FINDINGS AND RECOMMENDATIONS

1. <u>Internal control over travel claims is inadequate</u>

Finding

Management of the Knox County Community Services Agency has not properly designed a system of internal control related to the approval and documentation of employees' travel claims. We reviewed 86 of the agency's travel claims. Our review revealed that for 16 of these travel claims (18%), the claims were not adequately completed, not adequately supported, and/or were not approved prior to payment. Six of the travel claims did not contain adequate supporting documentation such as a hotel invoice, agenda, brochure, and/or the business purpose for the employees' travel. Some of the case mangers submitted claims for reimbursement of "vicinity" mileage; however, they did not state the purpose of the trip. Also, 13 of the travel claims were paid prior to approval.

Recommendation

Claims without documentation or approval should not be paid. The Executive Director should ensure that supervisors review travel claims for proper documentation and approve all claims for travel reimbursement before they are paid.

Management's Comment

We concur regarding the internal control over travel claims. In response to this finding a significant reassignment of tasks and responsibilities has taken place. This is to insure that adequate time is available to properly process travel claims with complete and adequate support documentation. In addition, the proper approval will be required prior to the issuance of checks.

2. <u>The agency did not comply with the Department of Children's Services' contract terms and did not enter into contracts as required by the rules and regulations</u>

Finding

The Knox County Community Services Agency (KCCSA) did not follow the Department of Children's Services' (DCS) contract terms concerning subcontracts and did not enter into contracts where appropriate.

Based on a review of 11 of the agency's contracts with providers, testwork revealed that the contracts did not include all required sections. The following discrepancies were noted:

- Nine of the 11 contracts reviewed (82%) did not include a section concerning public accountability.

- One of the 11 contracts reviewed (9%) did not include the telephone number for the Comptroller of the Treasury's hotline as required.

- Another one of the 11 contracts reviewed (9%) did not include the language "the contractor shall, upon request, show proof of such nondiscrimination and shall post in conspicuous places, available to all employees and applicants, notices of nondiscrimination," as required by the DCS contract.

- The Department of Children's Services' contract, section D.5, Subcontracting, states,

> The Grantee shall not assign this Grant or enter into a subcontract for any of the services performed under this Grant without obtaining the prior written approval of the State. If such subcontracts are approved by the State, they shall contain, at a minimum, sections of this Grant pertaining to Conflicts of Interest, Lobbying, Nondiscrimination, Public Accountability, and Public Notice (Sections D.6, D.7, D.8, D.9, and D.10). Notwithstanding any use of approved subcontractors, the Grantee shall be the prime contractor and shall be responsible for all work performed.

Additional contract testwork revealed the following discrepancies:

- Testwork also revealed that the agency's contract expenditures to the Northshore Group exceeded the maximum contract amount of $10,000, by $955. The agency did not amend the contract. This issue was also noted in a prior audit finding. Management concurred with the prior audit finding and stated that they were taking efforts to correct the finding including continued monitoring of the contract process.

- One contract was not signed by the CSA Executive Director or the board of directors. The contract maximum liability was $15,000. Total expenditures of $5,500 were paid to the vendor without a signed contract in place. According to the agency's internal operations policy entitled "Contract Approval Processes," both the board chair and the Executive Director must sign contracts in order for them to be valid. In addition, each contract states that the CSA is not bound by the contract until the appropriate officials sign it.

Recommendation

The Executive Director and the Fiscal Director should ensure that all of the agency's contracts comply with the Department of Children's Services' contract terms and conditions. Contracts should include all appropriate language as prescribed by the grantor. The Executive Director should ensure that all contracts are included in the agency's plan of operations and the contract expenditures do not exceed the contract maximum liability. The Executive Director and the Fiscal Director should ensure that contracts for services and any related amendments are signed prior to incurring expenditures.

Management's Comment

We concur with the finding concerning compliance with DCS contract terms and regulations. The agency was using the standard prototype contract that was crafted for all CSA's, but apparently this document did not contain all the required language regarding public accountability, nondiscrimination, and the Comptroller's hotline. Upon notification the omitted contractual requirements have been added to all new contracts written by this agency.

The area involving the Plan of Operation and contracts received intensified scrutiny during the year and corrective actions were taken. The two items listed were unusual and have served to increase our monitoring in the expectation of better results.

3. The agency inappropriately incurred foster care expenditures after the period of eligibility and did not comply with internal policies and procedures when purchasing goods for children and families

Finding

The agency incurred unnecessary expenditures in the Chafee Foster Care Independent Living program when it continued to pay living expenses beyond the period of eligibility. In addition, the agency purchased items for children and families which were not allowable according to its internal policy. Both programs are funded through a contract from the Department of Children's Services.

The Chafee Foster Care Independent Living program provides states and localities funds to establish and carry out programs to assist foster youth who are likely to remain in the state's foster care until 18 years of age and youth who have left foster care because they have attained 18 years of age (but have not yet reached 21 years of age) to make the transition from foster care to independent living.

Testwork revealed that the agency allowed one individual to continue receiving independent living services beyond the period of eligibility. This child was referred to the CSA by a Department of Children's Services' case manager. When the child turned 21 years of age, the DCS regional administrator for Knox County requested an extension of eligibility from the DCS Director of the Foster Care program, and received a nine-month waiver to extend eligibility. This waiver allowed the individual to continue to receive services from the CSA until November 16, 2003. However, after this date the CSA's case manager and Prevention Coordinator continued to approve and pay for services. The value of the services provided after November 16 was $1,791. The expenditures included a holiday gift of $200, transportation costs of $300, car repair costs of $750, and computer tools costing $541. Testwork also revealed that the agency made checks payable to the individual without requiring the individual to provide supporting documentation for the costs incurred. Thus, the agency cannot prove that the individual actually incurred the costs for transportation, computer tools, and car repairs. Furthermore, the policy does not specifically allow the agency to provide holiday gifts.

In addition, a review of expenditures for Child and Family Support Services (formerly the Family Support Services and Flex Funding) revealed that the agency purchased items that were not allowed according to its own list of allowable and unallowable purchases. According to the agency's list of "Groceries …What Is Allowed on FSS and FFF referral - What Not Allowed," the following items are not allowed:

> Soda . . . any kind; cleaning supplies; paper products; candy . . . any kind; coffee or tea; Alcoholic beverages; Bottled water; and Cigarettes or tobacco products.

However, the case managers and prevention coordinator continued to approve and pay for the following items purchased for children or their families: lemon-lime soda, lemonade, and punch; bottled water; and cleaning and paper products such as soap, dishwashing liquid, dryer sheets, trash bags, and duct tape.

We also found that items were purchased for children, but the items were not specifically allowed. These purchases included thongs, toothbrushes, toothpaste, shampoo, conditioner, cologne, hair spray, deodorant, Uno game cards, puzzles, playing cards, eye shadow, "MKA Eye STCK," eyeliner, and lipstick. The agency also purchased feminine products which were identified as being items for a male client. Because the items were not approved for purchase and were not allowed specifically by the agency's internal policy, the costs appear to be inappropriate charges to the program. Furthermore, our inquiries indicated that the agency has no controls to ensure that items purchased for their families are actually received by those individuals. Without such controls, the risk is increased that case managers could make purchases for their own use.

Our review also revealed that the agency used its Wal-Mart credit card to purchase items for agency programs. However, we did not find that the agency was authorized by the Department of Children's Services to obtain and use credit cards for any purpose.

When management and staff are not committed to following established program and purchasing policies and procedures, there is an increased risk that unnecessary and unallowable purchases will be made. In addition, the use of unauthorized methods to procure goods and services may result in unauthorized purchases.

Recommendation

The Executive Director should require staff to comply with Department of Children's Services' grant rules and regulations when the agency purchases goods and services for eligible individuals and their families. The Executive Director should ensure that the appropriate staff review the purchases for necessity and compliance with the grants. The Executive Director should require staff to advise him of any questionable purchases. Costs incurred for any unnecessary or unallowable expenditures should be returned to the Department of Children's Services. The Executive Director should seek authorization from the Department of Children's

Services before acquiring and using credit cards for purchases of any kind. The agency should also seek authorization to keep its existing credit cards or the agency should cancel the cards.

Management's Comment

We concur; however, Knox County CSA was informed by this client's home county case manager that a waiver signed by the DCS Regional Administrator existed allowing for purchases to be made beyond the age of 21. After asking for a copy of this waiver, it was determined that it could not be located but the purchases had already been made. This policy has since changed allowing for purchases to be made for clients until they reach age 23. This should not be an issue in the future.

4. The membership of the CSA board of directors violates state law

Finding

The Department of Children's Services' (DCS) Regional Administrator, a management-level DCS employee assigned to the community services agency (CSA) service area, serves on the board of directors of the Knox County CSA in violation of state law. Section 37-5-305(c), *Tennessee Code Annotated*, states, "The membership of each board serving a metropolitan community services agency shall consist of at least twelve (12) members appointed by the governor." The DCS Regional Administrator has not been appointed to the board by the Governor.

As a board member, the Regional Administrator can vote on all CSA business including the adoption of written policies, procedures, or rules and regulations to govern the CSA's internal operations; the making and executing of contracts; and the receiving, administering, allocating, and disbursing of funds made available under any federal or state assistance program.

The statute defining the board composition of the metropolitan community services agencies, such as Knox County CSA, does not include the Commissioner or the Commissioner's designee.

Recommendation

The membership of the Knox County Community Services Agency's board of directors should comply with the provisions of *Tennessee Code Annotated*.

Management's Comment

Knox County Community Services Agency

We concur that the DCS Regional Administrator has been a member of the Board of Directors. It has been the practice for Regional Administrators to serve as the Commissioner's Designee for all regions, which included voting privileges.

On October 1, 2003, we received notification from former DCS Commissioner Michael Miller's office that the Regional Administrator's role on the board could be construed as a conflict of interest. We were instructed to have them serve as an ex officio member of the board, without voting rights and without convening power or eligibility to hold board office. Again, it was the practice to have them service in all regions. Their role was to be a "consultant to the board from DCS and an informant to DCS concerning CSA board activities." This change was implemented.

On May 6, 2004, we received notification from DCS Commissioner Viola Miller that she reversed this decision. We were instructed to have the Regional Administrator serve on the board as a voting member in each DCS region. This change was implemented. We feel compelled to conduct board business as instructed by the DCS Commissioner.

Department of Children's Services

We concur that composition of the metropolitan CSA boards shall be made by appointment of the Governor. Any appointments not made by the Governor are invalid and void. However, should the Governor appoint the Commissioner of the Department of Children's Services or her designee, the department contends that such appointment is legal, valid and ethical.

This will be corrected by asking the Governor to appoint the Commissioner or her designee to serve on each metropolitan CSA board at the next available vacancy. The Regional Administrator will be advised to attend the meetings and represent the Commissioner but to refrain from voting until the appointment is made by the Governor.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

Independent Auditor's Report

May 25, 2004

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying financial statements of the governmental activities and the general fund of the Knox County Community Services Agency, a component unit of the State of Tennessee, as of and for the years ended June 30, 2003, and 2002, which collectively comprise the agency's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the agency's management. Our responsibility is to express opinions on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the general fund of the Knox County Community Services Agency as of June 30, 2003, and 2002, and the respective changes in financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and the Schedule of Pension Funding Progress for Knox County Community Services Agency are not a required part of the basic financial statements but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the agency's basic financial statements. The accompanying financial information on page 37 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 25, 2004, on our consideration of Knox County Community Services Agency's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/th

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Knox County Community Services Agency's discussion and analysis is designed to provide an overview of the financial activity and assist in focusing on significant financial issues. This narrative analysis of the financial activities is for the fiscal years ended June 30, 2003, and June 30, 2002, and should be read in conjunction with the agency's financial statements. The Knox County Community Services Agency implemented GASB 34 last fiscal year, effecting significant changes in both the content and structure of the financial information, and making much of the information not easily comparable to prior years. In addition, certain amounts presented for the preceding year have been reclassified or grouped together for comparative purposes. Complete comparative information will be presented in future years.

FINANCIAL HIGHLIGHTS

Government-Wide Highlights:
Net Assets - The assets of the agency exceeded its liabilities by $172,021.75 at June 30, 2003 and $174,806.48 at June 30, 2002 (presented as "net assets"). Basically these amounts can be classified as unrestricted and are available to meet the agency's ongoing obligations. The amounts that represent investment in capital assets, net of related debt, are ($770.08) and ($631.03), respectively.

Changes in Net Assets - The agency's total net assets decreased $2,784.73 in fiscal year 2003 after increasing $30,432.15 in the previous fiscal year.

Liabilities – The total liabilities at June 30, 2003, were $370,987.84. Total liabilities at June 30, 2002, were $327,566.96. The agency's total liabilities increased by $43,420.88 during the fiscal year ended 2003. This compares with a decrease of $17,301.16 during 2002.

Fund Highlights:
Governmental General Fund - As of the close of fiscal years 2003 and 2002, the agency's governmental fund reported ending fund balances of $233,104.03 and $236,899.46, respectively. This is a decrease of $3,795.43 for the year ended June 30, 2003, and an increase of $28,945.41 over the balance for the year ended June 30, 2002. The "unreserved fund balance" was $228,403.52 and $234,731.38 for each year, respectively.

THE FINANCIAL STATEMENTS

This annual report consists of financial data that can be separated into three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report also contains additional required supplementary information (the Schedule of Pension Funding Progress) and supplementary information which is not required (the Budgetary Comparison Schedule), in addition to the basic financial statements. These components are described below:

Basic Financial Statements
The basic financial statements include two kinds of financial statements that present different views of the agency—the ***Government-Wide Financial Statements*** and the ***Fund Financial Statements.*** These financial statements also include the ***Notes to the Financial Statements*** that explain some of the information in the financial statements and provide more detail.

Government-Wide Financial Statements
The *government-wide financial statements* provide a broad view of the agency's operations using accounting methods similar to a private-sector business. The statements provide both short-term and long-term information about the agency's financial position, which assists in assessing the agency's economic condition at the end of the fiscal year. These are prepared using the economic resources measurement focus and the accrual basis of accounting. They take into account all revenues and expenses connected with the fiscal year even if cash involved has not been received or paid. The government-wide financial statements include two statements:

The *statement of net assets* presents all of the government's assets and liabilities, with the difference between the two reported as "net assets." Over time, increases or decreases in the agency's net assets may serve as a useful indicator of whether the financial position of the agency is improving or deteriorating.

The *statement of activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will not result in cash flows until future fiscal periods (such as uncollected amounts and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each of the agency's programs. All of the agency's services are included as governmental activities. The agency provides services for children and presently receives 100% of its funding under a contract with the Tennessee Department of Children's Services (DCS).

The government-wide financial statements can be found immediately following this discussion and analysis.

Fund Financial Statements
In general, a fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The agency, like other agencies and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The fund financial statements focus on individual parts of the agency government, reporting the agency's operations in more detail than the government-wide statements.

Governmental General Fund Financial Statements – The services provided by the agency are accounted for through one fund, the General Fund, which is used to account for the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, the governmental fund financial statements focus on near-term inflows and outflows of spendable resources. They also focus on the balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the government's near-term financing requirements. This approach is known as using the current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the agency's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the agency. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. This presents a better understanding of the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between the governmental fund and governmental activities. These reconciliations are presented on the same page as the governmental fund financial statements found immediately following the government-wide statements.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and the fund financial statements. The notes to the financial statements can be found immediately following the financial statements.

Required Supplementary Information

The basic financial statements are followed by the required supplementary information, which consists of a Schedule of Pension Funding Progress.

Supplementary Information

The Budgetary Comparison Schedule is presented as supplementary information. It follows the required supplementary information.

FINANCIAL ANALYSIS

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of an agency's financial position. The agency's net assets (governmental activities) totaled $172,021.75 at the end of 2003, compared to $174,806.48 at the end of 2002.

Knox County Community Services Agency
Net Assets
Governmental Activities

	June 30, 2003	June 30, 2002
Current and other assets	$ 530,006.28	$ 483,368.61
Capital assets, net	13,003.31	19,004.83
Total Assets	543,009.59	502,373.44
Current and other liabilities	296,902.25	296,902.25
Long-term liabilities	74,085.59	81,097.81
Total Liabilities	370,987.84	327,566.96
Net assets:		
Invested in capital assets, net of related debt	(770.08)	(631.03)
Unrestricted net assets	172,791.83	175,437.51
Total net assets	$ 172,021.75	$ 174,806.48

Changes in Net Assets

The agency's net assets decreased $2,784.73 for the fiscal year ended June 30, 2003, and increased $30,432.15 for the previous fiscal year. All of the revenue came from the State of Tennessee except the amounts received as interest.

Knox County Community Services Agency
Changes in Net Assets
Governmental Activities

	June 30, 2003	June 30, 2002
Revenues:		
Program revenues:		
State grants and contracts	$ 2,844,770.41	$ 2,531,903.89
General revenues:		
Payments from Tennessee	-	211,800.49
Interest	1,898.55	5,563.50
Total revenues	2,846,668.96	2,749,267.88
Expenses:		
Administration	222,925.19	179,399.87
Child and Family Case Management	1,578,398.79	1,691,668.91
Child and Family Services	1,048,129.71	847,766.95

Total expenses	2,849,453.69	2,718,835.73
Change in net assets	$ (2,784.73)	$ 30,432.15

FINANCIAL ANALYSIS OF THE GENERAL FUND
Governmental Fund
As of the end of the current fiscal year, the agency's governmental fund reported an ending fund balance of $233,104.03, which compares to $236,899.46 for the fiscal year ended June 30, 2002. The fund has decreased $3,795.43 and increased $28,942.41 over each prior year's ending balance. These changes are not considered significant.

CAPITAL ASSET
The agency's investment in capital assets for its governmental activities amounts to $54,911.62, which, net of accumulated depreciation, leaves a net book value of $13,003.31 at June 30, 2003, and $19,004.83 at June 30, 2002. This investment in capital assets does not constitute a material balance on the balance sheet. More detailed information about the agency's capital assets is presented in Note 3 to the financial statements.

DEBT ACTIVITY
The agency typically does not use debt financing except for the five-year purchase of the telephone system through the Tennessee Office of Information Resources. The current monthly payment is $560.06 with 26 remaining payments. The other element of long-term liabilities, compensated absences, which is earned but not yet paid annual leave, is summarized in Note 4 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS
Management has been notified by the Department of Children's Services that the role of Community Services Agencies is being limited to working with non-custodial children. Knox County has had a reduction of three positions and approximately $365,500 in funding for the 03/04 fiscal year. This provides the agency with a total budget for the coming year of $2,857,241. There are no other restrictions, commitments, or other limitations that significantly affect the availability of fund resources for future use.

CONTACTING THE AGENCY'S FINANCIAL MANAGEMENT
This financial report is designed to provide our grantors, customers, and the citizens of the State of Tennessee with a general overview of the agency's finances and its use of the funds it receives. If you have any questions about this report or need additional information, contact the agency's Director of Fiscal Services, 413 Northshore Drive SW, Suite E, Knoxville, TN 37919-7567.

Exhibit A

Knox County Community Services Agency
Statements of Net Assets
June 30, 2003, and June 30, 2002

	Governmental Activities	
Assets	June 30, 2003	June 30, 2002
Cash (Note 2)	$ 137,082.74	$ 54,250.13
Accounts receivable	131.54	335.07
Due from the State of Tennessee	388,091.49	426,615.33
Prepaid items	4,700.51	2,168.08
Capital assets (Note 3):		
Furniture and equipment	54,911.62	54,911.62
Less accumulated depreciation	(41,908.31)	(35,906.79)
Total assets	543,009.59	502,373.44
Liabilities		
Accrued payroll, payroll taxes, and benefits	45,466.07	67,805.51
Accounts payable	214,595.66	145,866.84
Checks payable	-	8,580.52
Due to the State of Tennessee	36,840.52	21,868.28
Due to the University of Tennessee	-	2,348.00
Long-term liabilities:		
Portion due or payable within one year:		
Capital leases (Notes 4 and 6)	6,172.23	5,857.93
Compensated absences (Note 4)	40,638.36	28,866.48
Portion due or payable after one year:		
Capital leases (Notes 4 and 6)	7,601.16	13,777.93
Compensated absences (Note 4)	19,673.84	32,595.47
Total liabilities	370,987.84	327,566.96
Net Assets		
Invested in capital assets, net of related debt	(770.08)	(631.03)
Unrestricted	172,791.83	175,437.51
Total net assets	$ 172,021.75	$ 174,806.48

The notes to the financial statements are an integral part of this statement.

Exhibit B

Knox County Community Services Agency
Statements of Activities
For the Years Ended June 30, 2003, and June 30, 2002

	For the Year Ended June 30, 2003				For the Year Ended June 30, 2002			
		Program Revenues				Program Revenues		
Programs	Expenses	Charges for Services	Operating Grants and Contributions	Net (Expense) Revenue and Change in Net Assets	Expenses	Charges for Services	Operating Grants and Contributions	Net (Expense) Revenue and Change in Net Assets
Governmental Activities:								
Administration	$ 222,925.19	$ -	$ 217,350.82	$ (5,574.37)	$ 179,399.87	$ -	$ -	$ (179,399.87)
Child and Family Case Management	1,578,398.79	-	1,579,289.88	891.09	1,691,668.91	-	1,691,579.81	(89.10)
Child and Family Services	1,048,129.71	-	1,048,129.71	-	847,766.95	-	840,324.08	(7,442.87)
Total	$ 2,849,453.69	$ -	$ 2,844,770.41	(4,683.28)	$ 2,718,835.73	$ -	$ 2,531,903.89	(186,931.84)

	2003		2002
General revenues:		General revenues:	
Payment from the State of Tennessee	-	Payment from the State of Tennessee	211,800.49
Unrestricted investment earnings	1,898.55	Unrestricted investment earnings	5,563.50
Total general revenues	1,898.55	Total general revenues	217,363.99
Change in net assets	(2,784.73)	Change in net assets	30,432.15
Net assets - July 1	174,806.48	Net assets - July 1	144,374.33
Net assets - June 30	$ 172,021.75	Net assets - June 30	$ 174,806.48

The notes to the financial statements are an integral part of this statement.

Exhibit C

Knox County Community Services Agency
Balance Sheets
General Fund
June 30, 2003, and June 30, 2002

	June 30, 2003	June 30, 2002
Assets		
Cash (Note 2)	$ 137,082.74	$ 54,250.13
Accounts receivable	131.54	335.07
Due from the State of Tennessee	388,091.49	426,615.33
Prepaid items	4,700.51	2,168.08
Total assets	$ 530,006.28	$ 483,368.61
Liabilities and Fund Balance		
Liabilities:		
Accrued payroll, payroll taxes, and benefits	$ 45,466.07	$ 67,805.51
Accounts payable	214,595.66	145,866.84
Checks payable	-	8,580.52
Due to the State of Tennessee	36,840.52	21,868.28
Due to the University of Tennessee	-	2,348.00
Total liabilities	296,902.25	246,469.15
Fund balance:		
Reserved for prepaid items	4,700.51	2,168.08
Unreserved	228,403.52	234,731.38
Total fund balance	233,104.03	236,899.46
Total liabilities and fund balance	$ 530,006.28	$ 483,368.61

Reconciliation of the General Fund Balance Sheets to the Statements of Net Assets:

	June 30, 2003	June 30, 2002
Total fund balance	$ 233,104.03	$ 236,899.46
Amounts reported in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported as assets in the general fund.	13,003.31	19,004.83
Long-term liabilities are not due and payable in the current period and therefore are not reported as liabilities in the general fund. Long-term liabilities at year-end consist of:		
Capital leases payable	(13,773.39)	(19,635.86)
Compensated absences	(60,312.20)	(61,461.95)
Total net assets	$ 172,021.75	$ 174,806.48

The notes to the financial statements are an integral part of this statement.

Exhibit D

Knox County Community Services Agency
Statements of Revenues, Expenditures, and Changes in Fund Balance
General Fund
For the Years Ended June 30, 2003, and June 30, 2002

		For the Year Ended June 30, 2003		For the Year Ended June 30, 2002
Revenues				
State grants and contracts	$	2,844,770.41	$	2,743,704.38
Interest		1,898.55		5,563.50
Total revenues		2,846,668.96		2,749,267.88
Expenditures				
Administration		223,044.80		179,316.48
Child and Family Case Management		1,579,289.88		1,693,242.04
Child and Family Services		1,048,129.71		847,766.95
Total expenditures		2,850,464.39		2,720,325.47
Excess (deficit) of revenues over (under) expenditures and net change in fund balance		(3,795.43)		28,942.41
Fund balance - July 1		236,899.46		207,957.05
Fund balance - June 30	$	233,104.03	$	236,899.46

Reconciliation of the General Fund Statements of Revenues, Expenditures, and Changes in Fund Balance to the Statements of Activities:

Net change in fund balance	$	(3,795.43)	$	28,942.41
Amounts reported in the statement of activities are different because:				
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which depreciation expense exceeds capital outlays in the period.		(6,001.52)		(6,001.52)
Payments on capital leases consume the current financial resources of governmental funds. These transactions, however, have no effect on net assets.		5,862.47		5,563.43
The expense for compensated absences reported in the statement of activities does not require the use of current financial resources and, therefore, is not reported as an expenditure in governmental funds. This is the amount by which compensated absences used exceeds the amounts earned in the period.		1,149.75		1,927.83
Changes in net assets of governmental activities	$	(2,784.73)	$	30,432.15

The notes to the financial statements are an integral part of this statement.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Title 37, Chapter 5, of *Tennessee Code Annotated*, established the CSA as "a political subdivision and instrumentality of the state." The Knox County Community Services Agency is a component unit of the State of Tennessee and is discretely presented in the *Tennessee Comprehensive Annual Financial Report*. Although the CSA is a separate legal entity, the state is financially accountable for the CSA because the state appoints a majority of the CSA's governing body and approves the CSA's Plan of Operation (budget). The CSA's reporting entity does not include any component units.

Basis of Presentation

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).
Certain amounts presented for the preceding year have been reclassified for comparative purposes.

The CSA's basic financial statements consist of government-wide financial statements (the statement of net assets and the statement of activities), and fund financial statements (the balance sheet and the statement of revenues, expenditures, and changes in fund balance). The Knox County Community Services Agency does not have any proprietary or fiduciary funds, and its only governmental fund is the general fund.

The statement of net assets presents all of the CSA's financial and capital resources including both short-term and long-term information. The statement of activities presents a comparison between the direct expenses and program revenues for each of the CSA's programs. Direct expenses are those that are specifically associated with a program. Program revenues include (a) charges paid by the recipients for services provided by the program and (b) grants and contributions that are restricted to meeting the operational requirements of the program. Revenues that are not classified as program revenues are presented as general revenues.

Measurement Focus and Basis of Accounting

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they become susceptible to accrual, generally when they are measurable and become available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. Revenues that the CSA earns by incurring obligations are recognized in the same period the obligations are recognized. All other revenue items are considered to be available if collected within 60 days after the end of the current period.

Expenditures are recorded when the related fund liability is incurred, except for compensated absences, which are recognized as expenditures only when payment is due. Capital asset acquisitions are reported as expenditures in governmental funds.
Under the terms of grant agreements, the CSA funds certain programs by a combination of specific cost-reimbursement grants and general revenues. It is the CSA's policy to first apply restricted resources to such programs and then unrestricted resources.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, are followed in the government-wide statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board.

Assets and Liabilities

Cash

Cash reported in both the government-wide and the fund financial statements consists of petty cash, demand deposits, and deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. The liquidity of the LGIP is sufficient to cover any withdrawal request by a participant.

Prepaid Items

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both the government-wide and the fund financial statements.

Capital Assets

Capital assets are defined by the CSA as assets with an initial, individual cost of more than $5,000 and an estimated useful life in excess of one year. Capitalized assets are reported in the government-wide financial statements. Capitalized assets are recorded at historical cost. The CSA does not own any infrastructure. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Capitalized assets are depreciated on a straight-line basis over the following estimated useful lives of the assets.

Description	Estimated Life
Copiers	5 years
Telephone Equipment	5 years

Checks Payable

Checks payable represent the sum of checks written in excess of the Community Services Agency's checking account balance in both the government-wide and the fund financial statements.

Compensated Absences

It is the CSA's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the CSA's policy is to pay this benefit only if the employee is sick or upon death. In the government-wide financial statements, the liability for all vacation pay is accrued when earned. In the fund financial statements, a liability for these amounts is reported only if they have matured, for example, because of employee resignations and retirements.

Capital Leases

A capital lease arrangement for the acquisition of a capital asset is recognized as a long-term obligation in the government-wide financial statements at the inception of the arrangement. In the fund financial statements, a liability relating to a capital lease is only reported when payment is due.

Budgetary Process

Legislation requires the CSA board to submit an annual plan of operation for review and approval to the Commissioner of Children's Services, Commissioner of Finance and Administration, and the Comptroller of the Treasury. As part of this plan, the CSA is to submit a financial plan for operating and capital expenditures. This financial plan is prepared on the modified accrual basis of accounting. The Plan of

Operation may be amended during the year with the written approval of the Commissioners and the Comptroller.

The agency does not have an annual appropriated budget. The Plan of Operation serves as an annual financial plan for budgetary purposes.

NOTE 2. DEPOSITS

The Knox County Community Services Agency's bank accounts are in financial institutions that participate in the bank collateral pool administered by the Treasurer of the State of Tennessee. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure.

The Knox County Community Services Agency also has deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. The LGIP is part of the Pooled Investment Fund. The fund's investment policy and custodial credit risk are presented in the *Tennessee Comprehensive Annual Financial Report* for the year ended June 30, 2003. The report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 3. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2003, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Equipment	$ 54,911.62	$ -	$ -	$ 54,911.62
Less accumulated depreciation	(35,906.79)	(6,001.52)	-	(41,908.31)
Total capital assets, net of depreciation	$ 19,004.83	$ (6,001.52)	$ -	$ 13,003.31

Depreciation expense was charged to the CSA programs as follows:

Program		Amount
Administration	$	480.12
Child and Family Case Management		5,521.40
Total depreciation expense	$	6,001.52

Capital asset activity for the year ended June 30, 2002, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Equipment	$ 54,911.62	$ -	$ -	$ 54,911.62
Less accumulated depreciation	(29,905.27)	(6,001.52)	-	(35,906.79)
Total capital assets, net of depreciation	$ 25,006.35	$ (6,001.52)	$ -	$ 19,004.83

Depreciation expense was charged to the CSA programs as follows:

Program		Amount
Administration	$	360.09
Child and Family Case Management		5,641.43
Total depreciation expense	$	6,001.52

NOTE 4. LONG-TERM LIABILITIES

Long-term liability activity for the year ended June 30, 2003, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Compensated absences	$ 61,461.95	$ 71,515.00	$ 72,664.75	$ 60,312.20
Capital leases	19,635.86	-	5,862.47	13,773.39
Total long-term liabilities	$ 81,097.81	$ 71,515.00	$ 78,527.22	$ 74,085.59

Long-term liability activity for the year ended June 30, 2002, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Compensated absences	$ 63,389.78	$ 74,050.92	$ 75,978.75	$ 61,461.95
Capital leases	25,199.29	-	5,563.43	19,635.86
Total long-term liabilities	$ 88,589.07	$ 74,050.92	$ 81,542.18	$ 81,097.81

NOTE 5. OPERATING LEASES

The agency leases office space and equipment to carry out its activities and to administer the various grant programs. Total expenditures under operating leases for space were $81,597.96 for the years ended June 30, 2003, and June 30, 2002. Total expenditures under operating leases for equipment were $17,841.89 and $480.00 for the years ended June 30, 2003, and June 30, 2002. The leases were cancelable at the lessee's option.

NOTE 6. CAPITAL LEASE

The agency has a lease agreement in effect that is considered a capital lease. This agreement has beginning and ending dates of September 1, 2000, and August 31, 2005, and an imputed interest rate of 5%. The following is a schedule by years of future minimum lease payments under capital leases together with the present value of the net minimum lease payments at June 30, 2003.

Year Ending June 30	
2004	$ 6,720.72
2005	6,720.72
2006	1,120.12
Total minimum payments required	14,561.56
Less minimum representing interest	788.17
Present value of net minimum lease payments	$ 13,773.39

The total value of equipment capitalized under the lease agreement was $30,007.62 at June 30, 2003, and June 30, 2002.

NOTE 7. DEFINED BENEFIT PENSION PLAN

Plan Description

All employees are members of the Political Subdivision Pension Plan (PSPP), an agent, multiple-employer, defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS). The TCRS administers a defined benefit pension plan that provides retirement, disability, and death benefits, as well as annual cost-of-living adjustments, to plan members and beneficiaries. Benefit provisions are established in state statute found in Title 8, Chapters 34-37, *Tennessee Code Annotated*. State statutes are amended by the Tennessee General Assembly. Amendments to the TCRS are not applicable to a political subdivision unless approved by the political subdivision's governing body.
The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for the PSPP. The report may be obtained by writing to the Tennessee Department of the Treasury, Consolidated Retirement System, 10th Floor Andrew Jackson Building, 500 Deaderick Street, Nashville, Tennessee 37243-0230, or can be accessed at www.treasury.state.tn.us.

Funding Policy

As authorized by the agency's board of directors, the agency pays the total pension contribution for its employees. The agency is required to contribute an actuarially determined rate; for the year ended June 30, 2003, the rate was 8.75% of annual covered payroll, and for the year ended June 30, 2002, the rate was 7.74% of annual covered payroll. The contribution requirements of plan members are set by state statutes and approved by the political subdivision's governing body. Contribution requirements for the agency are established and may be amended by the TCRS' Board of Trustees.

Annual Pension Cost

The agency's annual pension costs of $101,128 for the year ended June 30, 2003, and $95,373 for the year ended June 30, 2002, were equal to the agency's required and actual contributions.

The required contributions for the years ended June 30, 2003, and June 30, 2002, were determined as part of the July 1, 2001, and July 1, 1999, actuarial valuations using the frozen initial liability actuarial cost method, a projected-benefit cost method. Significant actuarial assumptions used in both valuations included a rate of return on investment of present and future assets of 7.5% a year compounded annually and a projected annual increase in post-retirement benefits of 3% of the retiree's most recent benefit. Projected salary increases used in the 2001 valuation were 4.75% a year compounded annually, down from 5.5% a year in the 1999 valuation (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries). The 2001 valuation projected a 3.5% annual increase in the social security wage base, down from 4.5% in the 1999 valuation. The actuarial value of the agency's assets was determined using techniques that smooth the effect of short-term volatility in the market value of both fixed income and equity securities over a five-year period. The agency's unfunded actuarial accrued liability is being amortized as a level-dollar amount of projected payroll on a closed basis. The remaining amortization period at July 1, 2001, was 20 years.

Three-Year Trend Information

Fiscal Year Ended		Annual Pension Cost (APC)	Percentage of APC Contributed		Net Pension Obligation
June 30, 2003	$	101,128	100%	$	-
June 30, 2002	$	95,373	100%	$	-
June 30, 2001	$	94,131	100%	$	-

NOTE 8. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee administers a group health insurance program that provides post-employment health insurance benefits to eligible agency retirees. This benefit is provided and administered by the State of Tennessee. The agency assumes no liability for retiree health care programs. Information related to this plan is available at the statewide level in the *Tennessee Comprehensive Annual Financial Report*. Note 2 includes information to obtain the report.

NOTE 9. CONTINGENCIES

Sick Leave—The agency records the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent because of illness, injury, or related family death, there is no liability for sick leave at June 30. The amount of unused sick leave was $62,586.72 at June 30, 2003, and $56,131.17 at June 30, 2002.

NOTE 10. RISK MANAGEMENT

The agency is exposed to various risks of loss related to general liability; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters.

Commercial Coverage

The agency carries commercial insurance for risks of loss of its personal property and surety bond coverage for risks of employee dishonesty. In the past three fiscal years, the agency has had no claims filed with the commercial insurer.

State of Tennessee's Claims Award Fund

The agency participates in the State of Tennessee's Claims Award Fund, an internal service fund in which the state has set aside assets for claims settlement. This fund services all claims for risk of loss to which the state is exposed, including general liability, automobile liability, professional malpractice, and workers' compensation. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the participating agencies based on a percentage of each agency's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of each fiscal year-end to determine the fund liability and premium allocation. As a participant in the Claims Award Fund, the agency is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, Section 9-8-101 et seq., *Tennessee Code Annotated*. Liability for negligence of the agency for bodily injury and property damage is limited to $300,000 per person and $1,000,000 per occurrence. The limits under workers' compensation are set forth in Section 50-6-101 et seq., *Tennessee Code Annotated*.

Health Coverage

The agency has elected to provide health 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 risk 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. Premiums of participating units are deposited to this fund and used to pay claims for health care costs of participants, as well as the state's administrative costs of the plan. The agency's obligation under the plan is limited to 80% of the total premiums. The employees are responsible for the remaining 20% of the total premiums. Employees have the option of obtaining insurance through either Blue Cross Blue Shield of Tennessee or John Deere Health. Claims are administered by these companies, which are currently under contract to provide these and other services to the state. Insurance premiums are adjusted at the end of the year based on the claims 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 under Blue Cross Blue Shield of Tennessee and John Deere Health.

NOTE 11. RECLASSIFICATION FOR COMPARATIVE PURPOSES

Certain amounts presented for the preceding year have been reclassified for comparative purposes. Expenditures reported as Children and Family Services, Family Support Services, Flexible Funding, and Emergency Residential for the year ended June 30, 2002, were reclassified and reported as Child and Family Case Management and Child and Family Support Services for the year ended June 30, 2003.

NOTE 12. NEW ACCOUNTING PRONOUNCEMENTS

The Knox County Community Services Agency has implemented the provisions of Governmental Accounting Standards Board (GASB) Statements 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments;* and 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus—an amendment of GASB Statements No. 21 and No. 34.* These statements establish new financial reporting requirements and restructure much of the information that governments have presented in the past. Comparability with reports issued in all prior years will be affected. The State of Tennessee implemented these statements, as required, for the year ending June 30, 2002. As a component unit of the state, the Knox County Community Services Agency also implemented the statements for the year ending June 30, 2002.

NOTE 13. RELATED PARTY TRANSACTIONS

The designee of the Commissioner of the Department of Children's Services (DCS) serves as a member of the Community Services Agency's (CSA) Board of Directors. The commissioner has designated the DCS Regional Administrator, a management-level DCS employee assigned to the CSA service area. As a board member, the Regional Administrator can vote on all CSA business including: the adoption of written policies, procedures, or rules and regulations to govern the CSA's internal operations; the making and executing of contracts; or the receiving, administering, allocating, and disbursing of funds made available under any federal or state assistance program. As a DCS employee, the Regional Administrator can authorize transactions that will be paid by the CSA. DCS is the primary funding source of the Knox County Community Services Agency, providing over $2.8 million in revenue.
In addition, the DCS Commissioner appoints the agency's Executive Director with the approval of the CSA's board of directors. The DCS Commissioner also approves any CSA policies, procedures, or rules and regulations proposed by the board of directors, as well as all contracts for the purchase of services or the acquisition or improvement of real property. Furthermore, the Commissioner is responsible for the review and approval of the CSA's plan of operation submitted in accordance with Section 37-5-310, *Tennessee Code Annotated*.

Knox County Community Services Agency
Required Supplementary Information
Schedule of Pension Funding Progress

(Amounts presented in thousands)

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (Funding Excess) AAL (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	Unfunded (Funding Excess) AAL as a Percentage of Covered Payroll [(b-a)/c]
July 1, 2001	$ 835	$ 972	$ 137	85.91%	$ 1,185	11.56%
July 1, 1999	$ 568	$ 707	$ 139	80.34%	$ 945	14.71%
June 30, 1997	$ 357	$ 357	$ -	100.00%	$ 668	-

Changes in Actuarial Assumptions

An actuarial valuation was performed as of July 1, 2001, to establish contribution rates as of July 1, 2002. The July 1, 1999, actuarial valuation established contribution rates for the year ended June 30, 2002. Significant actuarial assumptions used in both valuations included a rate of return on investment of present and future assets of 7.5% a year compounded annually and a projected annual increase in post-retirement benefits of 3% of the retiree's most recent benefit. Projected salary increases used in the 2001 valuation were 4.75% a year compounded annually, down from 5.5% a year in the 1999 valuation (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries). The 2001 valuation projected a 3.5% annual increase in the social security wage base, down from 4.5% in the 1999 valuation.

Supplementary Information
Knox County Community Services Agency
Budgetary Comparison Schedules
General Fund
For the Years Ended June 30, 2003, and June 30, 2002

	For the Year Ended June 30, 2003				For the Year Ended June 30, 2002			
	Budgeted Amounts			Variance with Final Budget - Over	Budgeted Amounts			Variance with Final Budget - Over
	Original	Final	Actual	(Under)	Original	Final	Actual	(Under)
Sources of Financial Resources:								
Fund Balance - July 1								
Amount approved for expenditure	$ -	$ 5,700.00	$ 5,700.00		$ -	$ -	$ -	
Amount not approved for expenditure	236,899.46	231,199.46	231,199.46		207,957.05	207,957.05	207,957.05	
Revenues								
Department of Children's Services	3,382,957.00	3,217,074.00	2,844,770.41	$ (372,303.59)	3,304,745.00	3,304,745.00	2,743,704.38	$ (561,040.62)
Interest revenue	-	-	1,898.55	1,898.55	-	-	5,563.50	5,563.50
Total revenues	3,382,957.00	3,217,074.00	2,846,668.96	(370,405.04)	3,304,745.00	3,304,745.00	2,749,267.88	(555,477.12)
Total sources of financial resources	3,619,856.46	3,453,973.46	3,083,568.42	(370,405.04)	3,512,702.05	3,512,702.05	2,957,224.93	(555,477.12)
Expenditures								
Administration	237,629.00	298,100.00	223,044.80	(75,055.20)	233,257.00	233,257.00	179,316.48	(53,940.52)
Child and Family Case Management	1,976,283.00	1,626,274.00	1,579,289.88	(46,984.12)	2,097,043.00	2,097,043.00	1,693,242.04	(403,800.96)
Child and Family Services	1,169,045.00	1,298,400.00	1,048,129.71	(250,270.29)	974,445.00	974,445.00	847,766.95	(126,678.05)
Total expenditures	3,382,957.00	3,222,774.00	2,850,464.39	(372,309.61)	3,304,745.00	3,304,745.00	2,720,325.47	(584,419.53)
Fund Balance - June 30	$ 236,899.46	$ 231,199.46	$ 233,104.03	$ 1,904.57	$ 207,957.05	$ 207,957.05	$ 236,899.46	$ 28,942.41

NOTE: The budgeted and actual expenditures reported as Children and Family Services, Family Support Services, Flexible Funding, and Emergency Residential for the year ended June 30, 2002, were reclassified and reported as Child and Family Case Management and Child and Family Services.

APPENDIX

KNOX COUNTY COMMUNITY SERVICES AGENCY

Marcus Hill, Executive Director

BOARD OF DIRECTORS

<u>Board Officers</u>

Terry Brown, Chair
Ann Ince, Vice-Chair
Bert Bertelkamp, Treasurer
Cecelia J. Waters, Secretary
Steve Garrett, Sergeant-at-Arms

<u>Other Members of the Board of Directors</u>

Richard L. Bean
Addie Hudson
Annie M. Jones
Bobby Leverett
Carole Martin
Patsy Miller
Dannie Varlan