



**A Report to the  
Audit Committee**

**Mayor**

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# Audit of Fund Commitments, Restrictions, and Assignments

June 9, 2021

Metropolitan  
Nashville  
Office of  
Internal Audit

# Audit of Fund Commitments, Restrictions, and Assignments

## EXECUTIVE SUMMARY

June 9, 2021



### Why We Did This Audit

This audit was performed because of a suggestion from the Tennessee Comptroller's Office. The recommendation was received during annual audit planning.

### What We Recommend

- Establish a comprehensive fund balance policy consistent with best practices.
- Enhance the interfund balance note to the Comprehensive Annual Financial Reports.

## BACKGROUND

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The fund balance of a government represents the difference between assets and deferred outflows of resources, and liabilities and deferred inflows of resources, in a governmental fund as presented in the Comprehensive Annual Financial Report. Governmental fund information helps to determine whether there are adequate financial resources that can be spent in the near future to finance Metropolitan Nashville Government programs. The Metropolitan Nashville Finance Department is responsible for the accounting, presentation, and disclosure of fund balance information for each fiscal year in the Comprehensive Annual Financial Report.

## OBJECTIVES AND SCOPE

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The purpose of the audit is to determine if committed, restricted, and assigned fund balances presented and disclosed in the Comprehensive Annual Financial Report provide all the information necessary for understanding and enhancing the usefulness and decision making by all stakeholders.

The objectives of this audit are to:

- Evaluate the design and operating effectiveness of internal controls for processes designated as risk areas.
- Assess the determination of restricted, committed, and assigned fund balances for compliance with statutory standards and state and local government codes and ordinances.
- Assess the presentation and disclosure of committed, restricted, and assigned balances in the Comprehensive Annual Financial Report.

The scope of this audit included committed, restricted, and assigned balances between July 1, 2017, and June 30, 2020.

## WHAT WE FOUND

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The processes for accounting and reporting of fund balances are adequately supervised and reviewed. Controls in place are operating effectively to ensure accurate and timely reporting of fund balance information in compliance with statutory and government requirements. The presentation and disclosure of fund balances in the Comprehensive Annual Financial Report comply with statutory standards.

Current fund balance policies can be enhanced to provide comprehensive information about fund balance accounting and reporting consistent with best practices. Enhanced disclosure of interfund balances will improve stakeholder understanding and expectations.

## GOVERNANCE

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Tennessee Code Annotated Chapter 5.13 and Metro Nashville Government Charter Section 8.103 stipulate the powers and duties of the Finance Director. Powers and duties include the administration of the financial affairs of the Metropolitan Nashville Government and preparation of a complete annual financial report of the financial activities of all funds and all departments, boards, commissions, and agencies of the Metropolitan Nashville Government.

Governmental Accounting Standard Board Statement 54 - *Fund Balance Reporting and Governmental Fund Type Definitions* establishes the generally accepted accounting principles and financial reporting standards for all governments that report governmental funds. The statement also creates a fund balance hierarchy of five possible classifications, including non-spendable, restricted, committed, assigned, and unassigned.

The Metropolitan Nashville Council authorizes the Director of Finance in the annual budget ordinance to perform various fiscal related functions. Authorized functions include the transfer, allocation, carry forward, and assignment of funds, as deemed necessary and within the constraints of the total approved budget appropriation. The Metropolitan Nashville Finance Department is responsible for the accounting, presentation, and disclosure of fund balance information for each fiscal year in the Annual Report.

## BACKGROUND

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A government's fund balance represents the difference between assets and deferred outflows of resources, and liabilities and deferred inflows of resources, in a governmental fund. Fund balances are calculated in accordance with generally accepted accounting principles and are presented in the Comprehensive Annual Financial Report. Governmental fund information helps to determine whether there are adequate financial resources available in the near future to finance government programs.

The Metropolitan Nashville Government reports governmental fund balances under the five established classifications. The initial distinction in reporting fund balance information is identifying amounts that are considered non-spendable, such as fund balance associated with inventories, prepaid amounts, and notes receivables. The restricted fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation.

The committed fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest-level of decision-making authority. The Metropolitan Council is the highest-level decision-making authority within the government.

Assigned fund balances are intended to be used by the government for specific purposes that do not meet the criteria to be classified as restricted or committed. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed. The Metropolitan Nashville Council authorizes the Finance Director to assign funds through the annual budget ordinance. The Metropolitan Council may also assign fund balance as it does when using fund balance to cover a gap between estimated revenue and appropriations in a subsequent year's appropriated budget.

Governments are required to disclose information about the processes through which constraints are imposed on amounts in the committed and assigned classifications.

Unassigned fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification should be used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned.

Exhibit A shows the summary of fund balances for all governmental funds for the three fiscal years reviewed.

**Exhibit A – Summary of Fund Balances by Classification**

Classification	Fiscal Year Ended June 30,		
	2018	2019	2020
Non-spendable	\$ 3,882,351	\$ 3,916,492	\$ 5,588,974
Restricted	57,785,371	60,687,925	56,053,323
Committed	134,273,729	132,150,162	139,745,835
Assigned	17,489,600	16,177,102	11,994,500
Unassigned	(594,416,318)	(177,267,894)	(499,414,355)
<b>Totals</b>	<b>\$ (380,985,267)</b>	<b>\$ 35,663,787</b>	<b>\$ (286,031,723)</b>

Source: Oracle E-Business Suite R12

## OBJECTIVES AND CONCLUSIONS

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1. *Are controls in place and operating effectively for fund balance accounting and reporting processes designated as risk areas?*

**Yes.** The processes surrounding the accounting and reporting of fund balances is under the supervision of the Chief Accountant/Assistant Finance Director and a Deputy Finance Director who ensure that fiscal information is disseminated and captured timely and accurately. Various levels of review of fiscal information ensure that information available to stakeholders reflects the fiscal status of the Metropolitan Nashville Government. An extensive review of a Government Finance Officer Association checklist occurs. However, policies can be enhanced to provide comprehensive guidance on the generally accepted accounting principles providing the basis for fund balance accounting and reporting, relevant state, and local government requirements, and internal Metropolitan Nashville Finance Department policies. (See Observation A.)

2. *Is the determination of restricted, committed, and assigned balances consistent and in compliance with statutory standards and state, and local government code and ordinances?*

**Yes.** The Metropolitan Nashville Finance Department ensures compliance with the Governmental Accounting Standard Board's Standard 54, the authorizations provided in the annual Metropolitan Nashville budget ordinances, and recommendations by the State of Tennessee. The Finance Director exercises the authority granted by the Metropolitan Nashville Council to ensure that committed, assigned, and unassigned fund balances, reflect the specific requirements in the respective authorizations. The budget ordinance identifies the funds and sub-funds and leaves the assignments to the following year at the Finance Director's discretion. The Office of Internal Audit verified that the total fund balance designated for subsequent year's expenditures and other governing board designations did not exceed the fund balance legally available for appropriation in any fund. The budget ordinance authorizes the Finance Director to carry forward unspent balances at the end of the fiscal year from certain funds and sub-funds and assign them for next fiscal year's expenditures. We reviewed the requirements in the budget ordinances and the budget versus actual information in Oracle E-Business Suite R12 and agreed them to the assignments without any exceptions.

3. *Did the presentation and disclosure of restricted, committed, and assigned balances in the Comprehensive Annual Financial Report comply with statutory standards?*

**Yes.** The presentation and disclosure of restricted, committed, and assigned balances in the Comprehensive Annual Financial Report comply with statutory standards. The Office of Internal Audit verified that the Comprehensive Annual Financial Report disclosure includes appropriate fund balance classifications, only the General Fund has a positive unassigned fund balance, and components of non-spendable fund balances include the statutory required items. Moreover, the disclosure of Special Fund Balances in the notes to the financial statements included the purpose for each major special revenue fund and which revenues and other resources are reported in each fund. However, the disclosure of interfund transfers and interfund balances could be enhanced to better clarify requirements of Governmental Accounting Standard Board's Statement 38 - *Certain Financial Statement Note Disclosures*. (See Observation B.)

## AUDIT OBSERVATIONS

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Internal control helps entities achieve important objectives to sustain and improve performance. The Committee of Sponsoring Organizations of the Treadway Commission (COSO), Internal Control – Integrated Framework, enables organizations to effectively and efficiently develop systems of internal control that adapt to changing business and operating environment, mitigate risks to acceptable levels, and support sound decision-making and governance of the organization. See **Appendix B** for a description of the observation *Assessed Risk Rating*.

### ***Observation A – Lack of Comprehensive Policy***

There is no comprehensive fund balance policy to guide all involved in the financial reporting and disclosure process. Preparation of the Comprehensive Annual Financial Report is a complex process requiring data analysis, data aggregation, and review to meet the requirements in Governmental Accounting Standard Board Statement Statements 54 and 38. The establishment of a formal fund balance policy is not required by the Governmental Accounting Standard Board Statement, but disclosure of adopted policies in the notes to the financial statements is required. Also, the Government Finance Officer Association and other best practices recommend the establishment of a comprehensive policy. Formally adopted fund balance policies help to define and communicate the balance that should be maintained in specific funds, use and replenishment of funds, authority to make changes, reporting requirements, and priority of use. The absence of a policy may lead to the omission and nondisclosure of relevant information and the associated misinformation of financial report users.

#### *Criteria:*

- COSO, Control Activities—Principle 10—The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
- COSO, Control Activities—Principle 11—The organization selects and develops control activities through policies that establish what is expected and procedures that put policies into action.

#### *Assessed Risk Rating:*

**Low**

#### *Recommendation for management of the Finance Department to:*

Establish a comprehensive fund balance policy consistent with best practices that will be available to all stakeholders, including employees and internal and external auditors.

### ***Observation B – Disclosure of Interfund Balances***

The interfund balance footnote disclosure could be enhanced to increase clarity in meeting the requirements in Governmental Accounting Standard Board Statement 38. Paragraphs 14(B) and 14(C) of the statement require the disclosure of the purpose of interfund balances and interfund balances that are not expected to be repaid within one year from the date of the financial statements. For the three years reviewed, the footnote disclosures for interfund balances in the Comprehensive Annual Financial Reports did not explicitly state if there were interfund balances not expected to be repaid within one

year from the date of the financial statements. Stakeholders need to understand when these balances are expected to be repaid so they can make informed decisions.

*Criteria:*

- *COSO, Control Activities—Principle 10*—The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.
- *COSO, Control Activities—Principle 11*—The organization selects and develops control activities through policies that establish what is expected and procedures that put policies into action.

*Assessed Risk Rating:*

**Low**

*Recommendations for management of the Finance Department to:*

Enhance the interfund balance note to the Comprehensive Annual Financial Reports so stakeholders understand if balances are or are not expected to be repaid within one year from the date of the financial statements.

## **GOVERNMENT AUDITING STANDARDS COMPLIANCE**

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We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our observations and conclusions based on our audit objectives.

## **METHODOLOGY**

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To accomplish our audit objectives, we performed the following steps:

- Interviewed key personnel within the Metropolitan Nashville Finance Department.
- Reviewed relevant Tennessee Code Annotated, Metropolitan Nashville Code of Laws, and other applicable laws, regulations, policies, and statutory requirements.
- Evaluated internal controls currently in place and their effectiveness.
- Reviewed the Comprehensive Annual Financial Reports and supporting documentation for the three years for compliance with Tennessee Code Annotated, Metropolitan Nashville Code of Laws and other applicable laws, regulations, policies, and statutory requirements.
- Considered risk of fraud, waste, and abuse.

## **AUDIT TEAM**

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Innocent Dargbey, CPA, CMFO, CICA, In-Charge Auditor

Lauren Riley, CPA, CIA, CMFO, ACDA, Metropolitan Auditor



## APPENDIX A – MANAGEMENT RESPONSE AND CORRECTIVE ACTION PLAN

We believe that operational management is in a unique position to best understand their operations and may be able to identify more innovative and effective approaches, and we encourage them to do so when providing their response to our recommendations.

	Recommendation	Concurrence and Corrective Action Plan	Proposed/Expected Completion Date
<i>Risk</i>	<i>Recommendations for the management of Metropolitan Nashville Finance Department to:</i>		
L	A.1 – 1. Establish a comprehensive fund balance policy consistent with best practices that will be available to all stakeholders, including employees, internal and external auditors.	Accept	December 31, 2021
L	B.1 – 1. Enhance the interfund balance note to the Comprehensive Annual Financial Reports so stakeholders understand if balances <b>are</b> or <b>are not</b> expected to be repaid within one year from the date of the financial statements.	Accept	December 31, 2021 (will be incorporated into the June 30, 2021 Comprehensive Annual Financial Report)

## APPENDIX B – ASSESSED RISK RANKING

Observations identified during the course of the audit are assigned a risk rating, as outlined in the table below. The risk rating is based on the financial, operational, compliance or reputational impact the issue identified has on the Metropolitan Nashville Government. Items deemed “Low Risk” will be considered “Emerging Issues” in the final report and do not require a management response and corrective action plan.

Rating	Financial	Internal Controls	Compliance	Public
<b>HIGH</b>	Large financial impact >\$25,000  Remiss in responsibilities of being a custodian of the public trust	Missing, or inadequate key internal controls	Noncompliance with applicable Federal, state, and local laws, or Metro Nashville Government policies	High probability for negative public trust perception
<b>MEDIUM</b>	Moderate financial impact \$25,000 to \$10,000	Partial controls  Not adequate to identify noncompliance or misappropriation timely	Inconsistent compliance with Federal, state, and local laws, or Metro Nashville Government policies	The potential for negative public trust perception
<b>LOW/ Emerging Issues</b>	Low financial impact <\$10,000	Internal controls in place but not consistently efficient or effective  Implementing / enhancing controls could prevent future problems	Generally, complies with Federal, state, and local laws, or Metro Nashville Government policies, but some minor discrepancies exist	Low probability for negative public trust perception
<b>Efficiency Opportunity</b>	An efficiency opportunity is where controls are functioning as intended; however, a modification would make the process more efficient			