County Government Finances in Tennessee ☆☆☆

Many Tennessee counties have done well managing resources through the recent difficult economic times, yet a number of county governments continue to struggle financially.

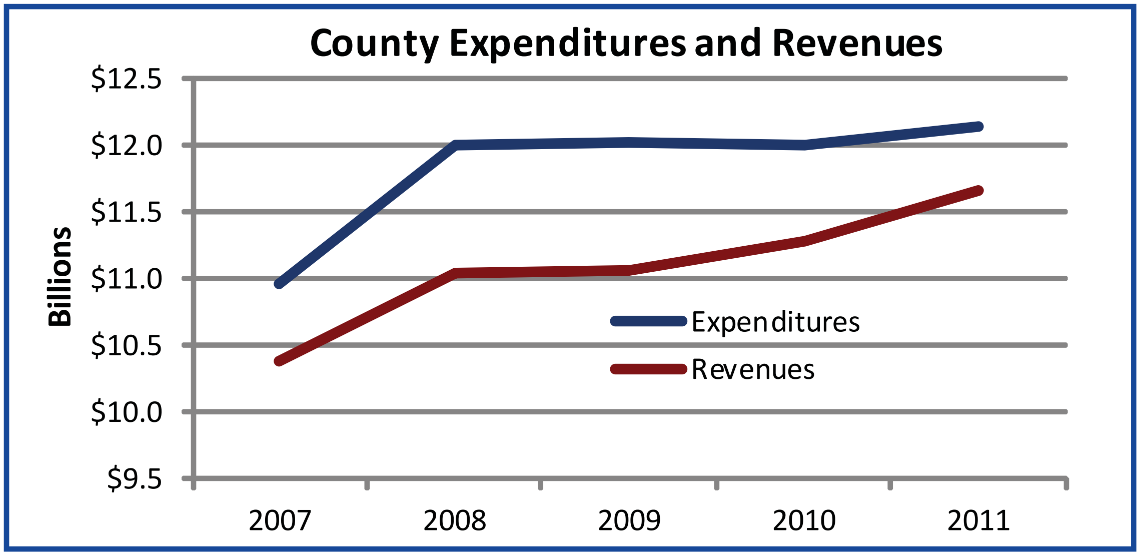
County governments in Tennessee operate accounting, budgeting, and purchasing activities under the provision of general statute, private act, or two financial management acts, the most recent of which was enacted over 30 years ago. The financial health of counties is increasingly becoming linked to the financial health of the state. This report focuses on the financial condition of county governments, the financial management in Tennessee counties, the audit process, recent audit results, audit committees, and challenges facing county governments in Tennessee.

> ***A county government is not the same as a private business. Public trust is involved. Counties have the power to tax. Taxpayers can limit this power by exercising the privilege of voting. These differences do not mean counties should not utilize sound business practices and financial management.***

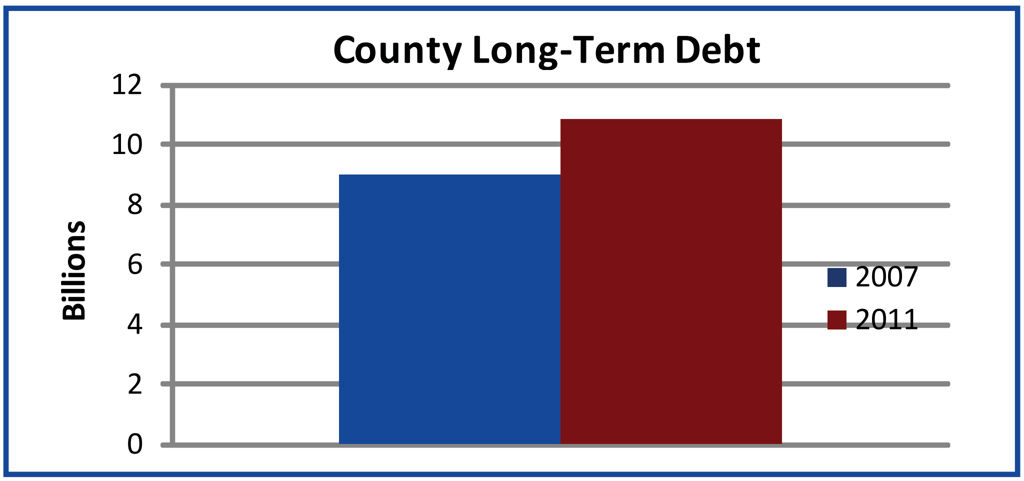
Financial Condition of County Governments

If county government was a business, it would be a big one. Even the smallest county in Tennessee had total revenues of approximately $12.5 million for the fiscal year ended June 30, 2011. Total revenues for all Tennessee county governments totaled approximately $11.65 billion for the fiscal year ending June 30, 2011. In contrast, total expenditures for the same period were approximately $12.14 billion. Therefore, counties spent approximately $490 million more than they received in general and operating revenues.

County governments have seen sluggish growth in revenues over the last five years, as expenditures have exceeded revenues in each year over this time period. The slow growth includes years in which counties received federal money from the 2009 American Recovery and Reinvestment Act. This trend indicates that either debt was increasing during the same time period, or fund balances were decreasing, or both.



Total county-related debt in Tennessee increased almost $1.41 billion from 2007 to 2011. This indicates that many county governments are deferring debt prinicipal payments and other obligations to future years. Audits conducted or reveiwed for the fiscal year ended June 30, 2011, disclosed fund deficits totaling $110.29 million in governmental funds in 14 counties. Audits also reflected net asset deficits totaling $83.24 million in enterprise and internal service funds in 14 counties.



Tennessee counties have avoided the bankruptcy crisis seen elsewhere around the nation as a result of the economic downturn. Although bankruptcies have been avoided to date, concerns remain. Along with the substantial increase in long-term debt, liabilities continue to grow for other post-employment benefits, such as health insurance premiums, awarded to government employees after those employees leave public service. In addition, new accounting standards will require the recognition of significant long-term pension costs. These costs, which previously have not been recorded on the financial statements when they were incurred, will dramatically impact large and small governments alike.

Financial Management in Tennessee Counties

Simply put, the complex issues that county governments face today were not issues in 1981 or 1957.

In 1957, the Tennessee State Legislature recognized the benefit and importance of having a centralized system of accounting, budgeting, and purchasing in county governments by enacting the local option Fiscal Control Acts. As time passed, the Legislature again recognized the need for a more modern approach to centralized accounting, budgeting, and purchasing. In 1981, the General Assembly enacted the local option Financial Management System of 1981. Now, 55 years after the first Act, and 31 years after the most recent focus on the importance of centralized accounting, budgeting, and purchasing, many county governments still are not centralized and do not have a financial management staff prepared to handle the complicated financial issues facing county governments.

The Governmental Accounting Standards Board (GASB), which establishes accounting standards for governments, did not exist until 1984. The Single Audit Act, which provides a framework for accounting and auditing federal programs, did not exist until that same year. Many county governments lack the ability to implement GASB standards and to prepare complex financial statements and notes to financial statements. Lack of a qualified financial management staff to implement these required changes is a significant reason that many county governments are ill-equipped to deal with such complex issues.

The Audit Process

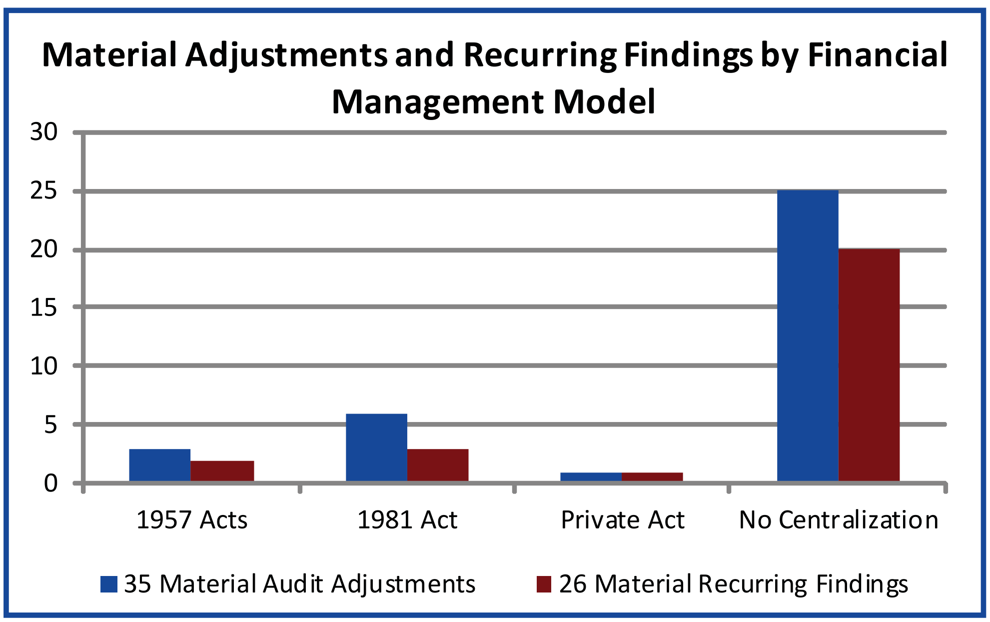
For the first time in memory, the audits of county governments have met federal deadlines by ensuring the completion of all 95 county audits.

Audits of county governments in Tennessee incorporate a complex maze of accounting principles and auditing standards combined with local, state, and federal laws and regulations. Financial and compliance audits are designed to provide reasonable assurance, in the form of an opinion, about whether an entity's financial statements are free of material misstatement, whether that misstatement was caused by error or fraud.

Recent Audit Results

The Comptroller's Office reported outstanding cash shortages of over $900,000 in 41 counties for the fiscal year ended June 30, 2011. These shortages include the theft of over $200,000 from a rural west Tennessee county. In this non-centralized county, the County Mayor's bookkeeper issued 191 vendor checks from the county's general fund for personal use.

Material audit adjustments are monetary adjustments proposed by auditors which were not detected by the county's internal controls and were so large that the county's financial statements would have been materially misstated if the auditors had not found and proposed the adjustments. Material recurring findings may involve substantial weaknesses in internal controls or noncompliance with laws, rules, and regulations.



The vast majority of findings and adverse opinions are reported in counties that do not have a centralized system of accounting, budgeting, and purchasing.

Audit Committees

The Comptroller's Office recommends as a best practice that all counties establish an audit committee. As of June 30, 2011, only 21 counties had functioning audit committees. The repetitive nature of the Comptroller's reported audit findings indicates that counties are either unwilling or unable to address these problems or deficiencies. The purpose of an audit committee would be to facilitate the discussion about and correction of audit findings and to deal with emerging issues such as a reported fraud.

Challenges Facing County Governments

As the economy continues to recover from the recession, county governments are faced with many fiscal challenges. Local officials must prepare budgets with fewer revenues to fund rising demands for resources in areas such as education, social services, health, and public safety. These core responsibilities often come with state or federal mandates. If a local government is not facing severe budget issues, the government may still find it difficult to maintain the level of services demanded by its citizens. Some local governments are overcoming these challenges, while others are finding it more difficult. Local governments in Tennessee have not reached the point of considering options such as shrinking their geographic footprints or consolidating with other local governments.

Local governments continue to face unpopular property and sales tax increases, shrinking fund balances, cutting expenditures, refunding debt, and deferring obligations to future years.

There are currently no provisions in Tennessee state law that deal with insolvency or bankruptcy of local governments. In addition, there are no provisions that would trigger state control, supervision, or receivership of defunct local governments. Tennessee state law does provide a means to aid local governments in financial distress, which may help avoid the need for more serious actions, such as bankruptcy.

CONCLUSION

Qualified financial and accounting personnel are essential to the health of county government finances. All Tennessee counties are doing the best they can during these difficult times, and many are doing well. The sophisticated demands placed on financial information in today's world, however, require us all to modernize our processes. As credit rating agencies are increasingly linking the health of county government finances to the financial condition of the state, it is essential for state government to protect its own health by assisting these local governments.

The time is now for county governments to upgrade their financial management systems.

Ensuring the overall financial health of local governments in Tennessee is a priority of this office. We will continue to encourage local governments to eliminate repeat audit findings, establish audit committees, and to adopt a centralized financial management system. Our office will also continue to monitor the financial condition of the entities for which we are responsible.

Justin P. Wilson

Comptroller of the Treasury

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