Tennessee Financial Reporting ☆☆☆

State Law directs the Comptroller to make quarterly reports to the Fiscal Review Committee concerning the state's fiscal affairs. In this second quarterly report, our concentration is on financial reporting, providing an update on:

- Results of the state's Single Audit Report and CAFR,
- County financial results and recommendations,
- Local frauds and commonly seen causes, and
- Continuing concerns for state government financial reporting and controls.

Tennessee Single Audit and CAFR

The state's Single Audit Report was issued on March 26, 2012. The Single Audit examines how the state spends taxpayer money received from the federal government. For example, the state receives federal money for programs such as TennCare and WIC, but the funds are only to be distributed to people that meet eligibility requirements of the federal government. These funds must be managed according to the grant agreements between the state and federal government agencies. The annual single audit assures the federal government that the state spent the money in accordance with federal rules. The federal government could ask the state to return the money if the state does not follow federal rules.

The Single Audit covers more than $16.9 billion in federal funds given to the State of Tennessee in fiscal year 2011.

Auditing Language

Unqualified Opinion	Good - Errors noted were not significant enough to question the program compliance
Qualified Opinion	Mostly good, except for a few problems that were significant
Adverse or Disclaimer	Bad overall - no assurance

The auditors performed detailed work on 32 different major federal programs with most receiving "unqualified" opinions on compliance. There were seven programs that received a "qualified" opinion because the state did not fully comply with federal rules. Ongoing patterns, such as findings related to monitoring, need to be watched. The Single Audit Report and all the findings leading to these opinions can be found at:
http://www.comptroller.tn.gov/repository/SA/2011_TN_Single_Audit.pdf

The Single Audit was performed concurrently with the audit of the state's finances. The financial position of Tennessee is presented in the Comprehensive Annual Financial Report (CAFR), prepared by the Department of Finance and Administration. The Comptroller audits and provides opinions on these basic financial statements, and gave "unqualified" opinions on the state's financial statements. This is in contrast to the federal government financial statements that were determined not to be auditable by the Government Accountability Office.

The Tennessee Comptroller of the Treasury found that the financial statements of the state, "present fairly, in all material respects, the respective financial position" of the government.

The Government Accountability Office could not give an opinion on the Financial Report of the U.S. Government, due to "widespread, material internal control weaknesses, significant uncertainties, and other limitations."

Local Government Audits and Reviews

County Financial Results and Recommendations

Last year was the first time in memory, certainly in the 21st Century, that the financial statements of all of Tennessee's 95 counties were timely filed. The Comptroller audits 89 counties. Six counties are audited by certified public accounting firms under contract with the Comptroller's Office. This year, again, all 95 were completed on a timely basis.

"Adverse" opinions were issued on seven counties and 35 counties required significant changes to their financial statements. Many of the issues identified in the annual financial reports are a result of county financial personnel not having a good understanding of accounting standards.

In the counties audited by the Comptroller, over 700 audit findings were reported, almost 300 of which were repeat findings. The most common audit findings were deficiencies in accounting and recordkeeping, lack of segregation of duties, information systems problems, internal controls, and improper budgeting and purchasing practices. Twenty-six counties had material, recurring audit findings that have been reported in their annual financial reports for three or more consecutive years. The repetitive nature of the findings indicates that the counties are either unwilling or unable to address problems or deficiencies.

The Comptroller is recommending as a best practice that all counties establish an audit committee. Audit committees can assist each county commission by providing independent and objective reviews of audit-related issues and would be responsible for monitoring county management's plans to address various risks. As of June 30, 2011, only 21 counties had functioning audit committees.

The Comptroller is also recommending as a best practice that all counties adopt a central system of accounting, budgeting and purchasing to improve internal controls and reduce duplication of effort.

Local Government Frauds and Commonly Seen Causes

For the year ended June 30, 2011, the Comptroller released 42 investigative reports revealing misappropriation of funds totaling $1,133,726.

The most commonly seen fraudulent acts include:

- **personal use of government or entity credit cards, checks, or fuel;**
- **check-swap schemes (exchanging checks payable to the government to replace stolen cash);**
- **skimming (stealing cash);**
- **payments to vendors that were actually redirected to personal accounts;**
- **unauthorized payroll and benefit changes; or**
- **stolen drug evidence, weapons, or cash.**

Frauds often occur when an employee has total control over a financial transaction that allows him or her to not only commit a crime, but also to hide it. This is frequently accompanied by a lack of management oversight. Most commonly we see fraud schemes and thefts of cash that involve failures to:

- **reconcile receipts with what was recorded and deposited;**
- **reconcile accounts receivable;**
- **prepare and retain collection records;**
- **individually list checks in deposits;**
- **review documentation, particularly with credit card use; or**
- **implement controls over computer data.**

In other situations, management disregarded controls that were in place. Of particular note, over the last two years our office has issued several investigative reports related to gas utility districts. We have seen personal use of credit cards, vehicles, and equipment. We have also seen lavish tropical vacations for employees and extravagant gifts for management. Improved internal control and oversight must be established by these entities.

Continuing Concerns for State Government Financial Reporting and Controls

The State Should Work Toward More Timely Reporting

State government has recently made significant strides to return to more timely financial reporting. Under current best practices the CAFR for a fiscal year ending June 30 should be issued before December 31 of that same calendar year. For 2009, the CAFR was issued on August 6, 2010, over thirteen months after the end of the fiscal year, and for 2010, the CAFR was issued on March 29 of the following year. The CAFR for 2011 was issued on schedule on December 29, 2011. Timely financial information, however, is a continuing challenge.

There is an on-going national discussion about the need for earlier government financial reporting. External pressures from credit rating agencies, the investing public, and the Securities and Exchange Commission are demanding it. Much effort will be required at both state and county levels to meet any condensed time frames.

> ***"To make good decisions, you need good information. Information is not good if it is not current."***
>
> ***Justin P. Wilson***
> ***Tennessee Comptroller of the Treasury***

Monitoring Efforts Must Be Improved

Several monitoring findings were noted in the state's Single Audit Report. The state grants funds to and contracts for services with many other governments and private companies and must monitor to ensure the funds were used appropriately. Individual state departments are responsible for ensuring recipients are monitored and required audits are conducted during the award period. In the Single Audit, we identified weak controls over monitoring efforts for 9 of the federal programs. In addition, we made several recommendations regarding statewide oversight of monitoring in our Review of Tennessee's Contract Monitoring and Management report, issued in September 2011. We recommended the Procurement Office develop and report specific actions to address oversight issues by October 1, 2012.
For full report details, see http://www.comptroller.tn.gov/repository/SA/pa09097.pdf.

Centralized Financial Information Is Needed to Facilitate Monitoring and Auditing Requirements

In December 2011, we communicated with the Department of Finance and Administration and the Procurement Office, the need to provide financial information to state departments and agencies to facilitate their identification of monitoring and auditing requirements. The individual departments have access to their own financial data, but not to statewide data, which could result in inadequate or insufficient audit and monitoring determinations at the state level.

In 2010, the General Assembly created the centralized Procurement Office. One of the duties of the Chief Procurement Officer is to establish a central database of information regarding grants. The current manual process is cumbersome. We are reviewing progress on this important endeavor.

Major Improvements Are Needed for Systems Development Oversight

The Title and Registration User's System for Tennessee (TRUST) project began in May 2000. The purpose of the project was to replace the mainframe software application that was currently being used by the Department of Safety and County Clerks to process motor vehicle titles and registrations with a more efficient and user-friendly application. To fund the development of the application, an additional $1 fee was assessed on all motor vehicle registrations and renewals of registrations.

As of December 2010, the project was transferred to the Department of Revenue and $62,679,152 had been collected from the $1 registration fee. Of that amount, $20 million had been transferred to the state's general fund. After several mishaps, over $40 million has been spent on the project and the system still does not work as intended.

There are other troubled systems development projects in the state. Findings in the Single Audit Report criticized the Department of Children's Services' new TFACTS system. TFACTS was turned on too early, even after an independent reviewer advised against implementation. As a result, a system was put in place that did not have adequate functionality to ensure timely payments and prevent duplicate payments. Reporting and adjustment capabilities were inadequate.
For full report details, see http://www.comptroller.tn.gov/repository/SA/tfacts_3_5_12.pdf.

The Vision Integration Platform (VIP) system at the Department of Human Services has also had difficulties. The original timeline for the VIP project was just over three years (January 30, 2006 - May 27, 2009). The contract term had to be extended and full implementation is not anticipated until at least April 1, 2013. According to the top-to-bottom review performed at the Department of Human Services, the department is seeking to procure consulting services with another contractor to reevaluate the status of the system.

A contract for the Multi Agency Regulatory System (MARS) was signed in late 2005. The state ultimately abandoned this system in 2009. At least $1.74 million was invested in this failed project.

The administration has acknowledged major systems problems and has formed a centralized Business Solutions Delivery unit with the goal of delivering large IT projects on time and within budget. We will continue to monitor this high-risk area.

Capital Projects Enhancements Are Needed

State agencies, Tennessee Board of Regents, and the University of Tennessee currently use various systems for the purpose of tracking, monitoring, and, where possible, reporting information related to capital projects and bond financing activities. A study of the process found that a number of the systems are limited in their ability to share information. Among the various systems and data there is no single information source or report that contains the information to allow for effective decision-making and oversight.

Another key observation of the study was that none of the existing systems include a project or total cash flow estimate, a projected construction schedule at the start of the project, or any other information that would provide more assistance in the timing of debt issuance or investment of related funds.

The study also criticized the general practice of using "contingency" amounts in the contract as a cushion for any higher-than-budgeted contract bid. Contingency amounts should be used to address the unknown conditions that may be encountered during construction.

The administration appears to be addressing capital projects weaknesses, but the project is in its early planning stage, and we do not yet know the scope of the work. An enhanced system with the capabilities to allow access and management reporting to all entities involved in the capital outlay process would provide much-needed transparency and accountability to support better timing of the state's cash flow projections and debt issuances and to provide for more effective decision-making and oversight.

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