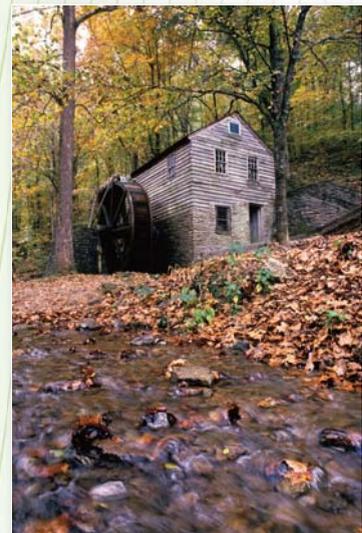
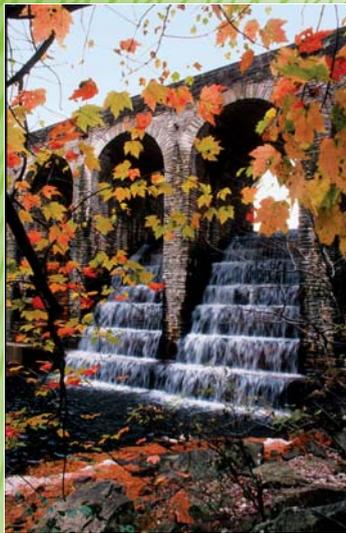




State of Tennessee  
**DEPARTMENT OF AUDIT**  
**2013 ANNUAL REPORT**



JUSTIN P. WILSON, COMPTROLLER





**Comptroller of the Treasury**  
**Justin P. Wilson**

**Department of Audit**

**Richard V. Norment, CIA, CGFM**

*Assistant to the Comptroller for the Department of Audit*

**State Audit**

**Deborah V. Loveless, CPA, CGFM**

*Director*

**Local Government Audit**

**Jim Arnette, CISA, CGFM**

*Director*

**Investigations**

**Kevin B. Huffman, CPA, CGFM, CFE**

*Investigative Audit Manager, Financial and Compliance Investigations*

**L. Rene Brison, CPA, CFE**

*Assistant Director, Special Investigations*



STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY  
STATE CAPITOL  
NASHVILLE, TENNESSEE 37243-0260  
PHONE (615) 741-2501

**Justin P. Wilson**  
Comptroller

December 31, 2013

The Honorable Bill Haslam, Governor  
The Honorable Ron Ramsey, Speaker of the Senate  
The Honorable Beth Harwell, Speaker of the House of Representatives, and  
Members of the General Assembly  
State Capitol  
Nashville, Tennessee 37243

Ladies and Gentlemen:

The 2013 annual report of the Department of Audit is submitted herewith in accordance with Section 4-3-304, *Tennessee Code Annotated*.

The Department of Audit conducts audits or ensures that audits are conducted of state, county, and municipal governments; utility districts; internal school funds; and other local government authorities and agencies. Audits are also performed of state grants to nongovernmental organizations and of numerous federal programs for state and local governments.

In submitting this report, I would like to express my appreciation to all those who made possible the results reported, particularly the members of the General Assembly and the staff of this office.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Justin P. Wilson".

Justin P. Wilson  
Comptroller of the Treasury

JPW/ab



# Contents

<b>Department of Audit</b> .....	<b>1</b>
Department of Audit Organizational Chart .....	2
Auditing Standards .....	3
Peer Review .....	3
Comptroller of the Treasury Strategic Plan Framework.....	4
<b>Division of State Audit</b> .....	<b>5</b>
Financial and Compliance .....	5
Information Systems.....	5
Performance .....	6
TennCare.....	7
Results of Audits.....	7
Audits in Progress at Year-End .....	8
<b>Division of Local Government Audit</b> .....	<b>9</b>
Financial and Compliance .....	9
The Audit Process .....	9
Results of Audits.....	10
Information System Reviews.....	10
Contract Audits .....	10
Other Services.....	11
<b>Division of Investigations</b> .....	<b>12</b>
Financial and Compliance Investigations.....	12
Special Investigations.....	12
Investigative Audits.....	12
<b>Comptroller’s Hotline</b> .....	<b>14</b>
Results of Hotline Notifications.....	14
Analysis of Substantive Hotline Notifications .....	16
<b>About the Department of Audit</b> .....	<b>17</b>
Department of Audit Staff .....	17
Department of Audit Staff Certifications .....	17
Department of Audit Expenditures .....	18
Contact Information .....	18



# Department of Audit

## 2013 Annual Report

The General Assembly created the Department of Audit in 1937. The authority to audit state, county, municipal and other local governmental entities as well as recipients of grant funds is established in *Tennessee Code Annotated*. The department is required to:

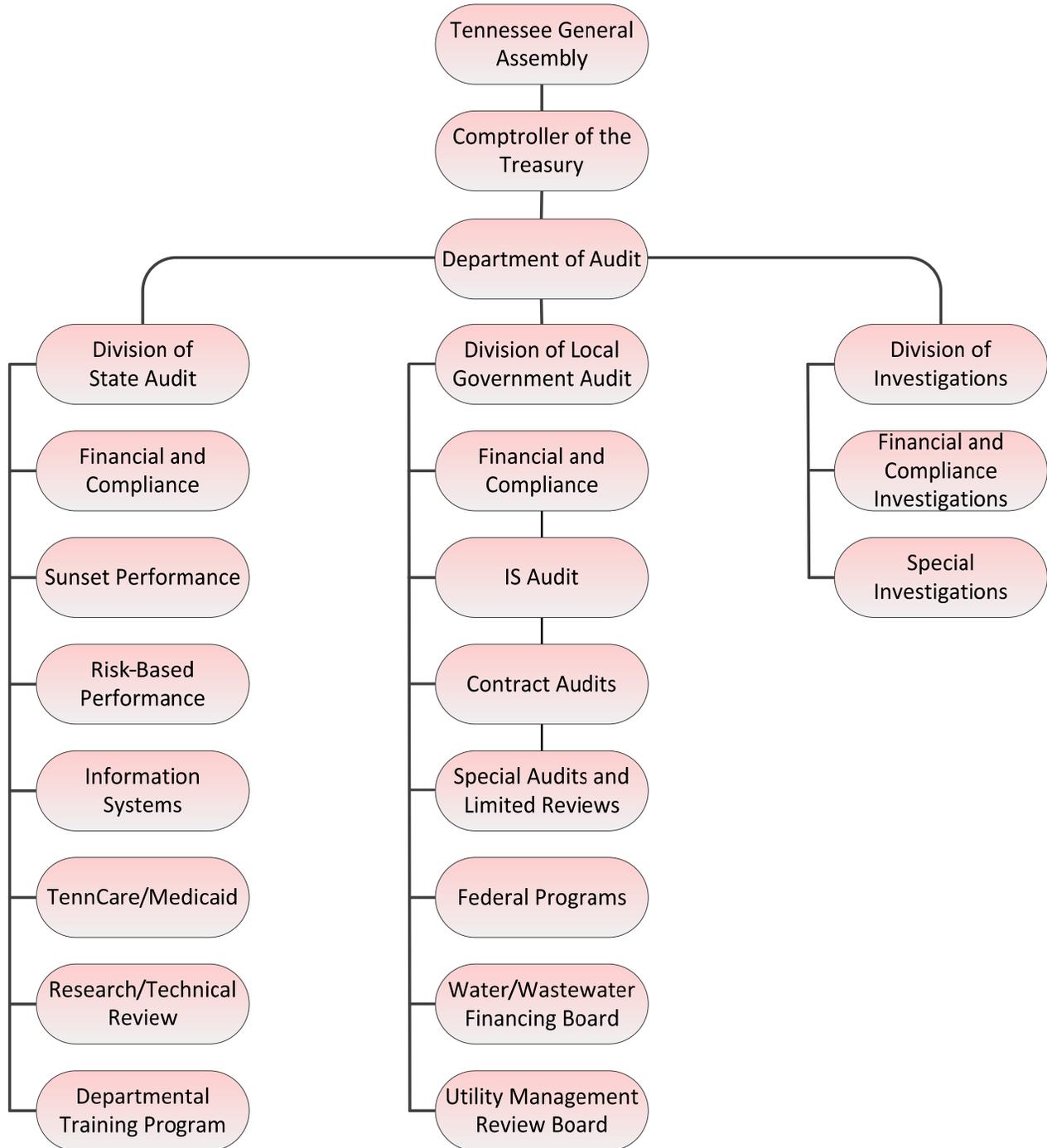
- perform currently a post-audit of all accounts and other financial records of the state government . . . in accordance with generally accepted auditing standards and . . . such procedures as may be established by the comptroller . . .
- make annually, and at such other times as the general assembly shall require, a complete report on the post-audit . . .
- certify to the fund balance sheets, operating and other statements, covering the condition of the state's finances, as prepared by the department of finance and administration, or by the state treasurer, before publication of such statements . . .
- serve as a staff agency to the general assembly, or to any of its committees, in making investigations of any phase of the state's finances . . .
- make annually an audit of all the records of the several counties of the state . . .
- perform economy and efficiency audits, program results audits and program evaluations . . .
- require that audits to be performed by the internal audit staffs of grantees or the internal audit staffs of state departments, boards, commissions, institutions, agencies, authorities or other entities of the state shall be coordinated with the office of the comptroller of the treasury . . . in accordance with standards established by the comptroller . . .
- require that all persons, corporations or other entities receiving grants from or through this state shall cause a timely audit to be performed, in accordance with auditing standards prescribed by the comptroller . . .
- establish minimum standards for the performance of audits by the internal audit staffs of local governments, special taxing districts, utility districts, political subdivisions, state departments, boards, commissions, institutions, agencies, authorities or other entities of the state . . .
- ensure that the audits of municipalities, utility districts, emergency communications districts, internal school funds, charter schools, public housing authorities, human resource agencies, development districts, and other special purpose governments are prepared in accordance with generally accepted governmental auditing standards and the minimum standards as prescribed by the Comptroller of the Treasury.

The Department of Audit comprises three divisions—State Audit, Local Government Audit, and Investigations—and employs approximately 300 people. State Audit and Local Government Audit are each administered by a director who is responsible for the audit function and addresses audit concerns and issues in the division. The Division of Investigations is overseen by the Assistant to the Comptroller for the Department of Audit, who also has oversight responsibility for all Department of Audit activities and coordinates with the directors and management in carrying out the goals and objectives of each of the three divisions.

The Department of Audit is a post-audit agency. As such, it audits an entity's basic financial statements and related notes to the financial statements; an entity's compliance with applicable statutes, grant agreements, rules, and regulations; and/or its past record of efficiency and effectiveness at the end of a fiscal period.

Because independence is so important in a post-audit agency, the Department of Audit is in the legislative branch of state government. The department is accountable to the General Assembly and provides information to assist the legislature in overseeing the use of public funds and the efficient operation of government.

# Department of Audit Organizational Chart



For additional information on the Department of Audit and the Comptroller, go to [www.comptroller.tn.gov](http://www.comptroller.tn.gov).



*The Historic Tennessee Theatre (above) in Knoxville, which opened in 1928, is listed on the National Register of Historic Places and is honored as the Official State Theatre of Tennessee.*

The basic purpose of post-audits is to identify and report material misstatements or noncompliance, whether due to fraud or errors, and recommend improvements. Pre-audits, in contrast, are performed by an entity's staff to prevent fraud and errors, detect problems, and suggest improvements. The most important distinction between the two is that post-audits are independent of the audited entity. In this respect, a post-audit agency in government is comparable to an independent certified public accounting firm in the private sector.

## **Auditing Standards**

The Department of Audit performs audits in accordance with auditing standards generally accepted in the United States of America promulgated by the American Institute of Certified Public Accountants (AICPA) and generally accepted government auditing standards issued by the Comptroller General of the United States in *Government Auditing Standards* (Yellow Book). These standards apply to financial and performance audits and attestation engagements. The Yellow Book incorporates auditing standards generally accepted in the United States of America for field work and reporting and attestation standards promulgated by the AICPA.

The Department of Audit conducts its Single Audit in accordance with the Single Audit Act as amended by the

1996 Single Audit Act amendments and Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

## **Peer Review**

To comply with Section 8-4-102, *Tennessee Code Annotated*, the Speakers direct the Department of Audit to undergo a quality assessment review under the auspices of the National State Auditors Association. The most recent review was performed in August 2012 by certified public accountants and other federal and state government professionals. The purpose of the review was to ensure that the department is following auditing standards generally accepted in the United States of America and Yellow Book standards.

The peer review for the year ended June 30, 2012, rendered an unqualified opinion on the department's system of quality control. In the opinion of the quality assessment team, "the system of quality control of the State of Tennessee Comptroller of the Treasury, Department of Audit in effect for the period of July 1, 2011, through June 30, 2012, has been suitably designed and was complied with during the period to provide reasonable assurance of conforming with applicable auditing standards." The next review is scheduled for July 2014.



# Comptroller of the Treasury Strategic Plan Framework



## *Mission*

**To improve the quality of life for all Tennesseans  
by making government work better**

## *Purpose*

**To serve the people of Tennessee by:**

- Contributing to the protection of the public trust and promoting the public interest
- Enhancing effective public policy decisions at all levels of government
- Fulfilling operational and oversight responsibilities as may be assigned with the highest possible degree of excellence, efficiency, and effectiveness

## *Goals and Objectives*

**Assure public resources are used effectively, efficiently,  
and in compliance with applicable law**

- Exercise an oversight role of governmental entities and agencies
- Continue to evaluate the effectiveness and efficiency of resources used by each division through a performance-based operation
- Ensure the secure, efficient, and effective use of technology solutions

**Accomplish and provide continuous improvement for the statutory  
and other assigned responsibilities of the Comptroller’s Office**

- Use cross-divisional teams to address office-wide themes and appropriate strategic objectives
- Continue to advance the Comptroller’s Office to a performance-based operation

**Provide timely, adequate, and accurate information to decision makers at all government levels**

- Maintain a process to develop appropriate information for decision makers
- Maintain a process to provide decision makers with appropriate information concerning policy, resource use, and management
- Encourage cooperation and joint efforts among divisions

**Provide a diverse, competent, ethical and professional staff  
and maintain continual development of such staff**

- Adhere to a uniform Code of Ethics Program
- Maintain a succession plan for management
- Maintain a training program for the continual development of all staff
- Seek a healthy and safe work environment
- Review compensation issues within the Comptroller’s Office on an annual basis
- Maintain a recruiting and hiring process that promotes diversity

**Provide and maintain effective communication with internal and external audiences**

- Maintain and improve a program which coordinates timely communications using the best available technology for internal and external communications
- Maintain appropriate historical information
- Inform and educate the citizens of the state, the general assembly, and other government entities about the role of the Comptroller
- Maintain a pro-active presence in professional organizations and associations

## *Core Values*

<i>Honesty and Integrity</i>	<i>Accuracy and Reliability</i>	<i>Accountability</i>
------------------------------	---------------------------------	-----------------------



# Division of State Audit

The Division of State Audit conducts financial and compliance audits and performance audits. It also performs special studies to provide the General Assembly, the Governor, and the citizens of Tennessee with objective information about the state's financial condition and the performance of the state's agencies and programs. This division thus aids the legislature in ensuring that state government is accountable to the citizens of Tennessee. In fulfilling this audit function, the division issued 65 reports during the year ended June 30, 2013; an additional 78 audits were in progress at year-end.

This division includes five sections: Financial and Compliance, Information Systems, Sunset Performance, Risk-Based Performance, and TennCare. Highlights of the division's work from July 1, 2012, through June 30, 2013, are presented. Complete reports are available at [www.comptroller.tn.gov/sa/AuditReportCategories.asp](http://www.comptroller.tn.gov/sa/AuditReportCategories.asp).

In addition to auditing, the division reviews and comments on due process documents from professional organizations and conducts technical research and training. The division also assists the Comptroller in the formulation of state policy and regulations, either directly by consulting with representatives of state agencies or indirectly by submitting comments about proposed policies and procedures.

## Financial and Compliance

The Financial and Compliance section conducts financial and compliance audits of state departments, agencies, and institutions.

Financial and compliance audits are conducted in accordance with auditing standards generally accepted in the United States of America and generally accepted government auditing standards issued by the United States Comptroller General. The objectives of financial and compliance audits are

- to consider the entity's internal control over financial reporting as a basis for designing auditing procedures to express an opinion on the financial statements;
- to determine compliance with certain provisions of laws, regulations, contracts, and grant agreements;
- to determine the fairness of the presentation of the financial statements; and
- to recommend appropriate actions to correct deficiencies.

## Information Systems

The Information Systems (IS) section provides three basic services: data retrieval, IS systems review, and computer forensic analysis.

To provide information for audit fieldwork, the data retrieval staff write computer programs to provide information from the state's centralized accounting system, individual agency service delivery systems, and college and university transaction files.

The IS review staff are responsible for obtaining and documenting an understanding of internal control in the computerized accounting and management information systems of entities undergoing audits by other sections of the division.

In the area of computer forensic analysis, evidence of fraud and abuse may be found on subjects' computers, and the IS section works in support of the Investigations Division to acquire, identify, and analyze this evidence. The section utilizes specialized software and hardware to recover evidence of official misconduct by state employees and in support of civil or criminal action against persons or entities engaging in illegal activities resulting in damages to the state.

## Performance

A performance audit is an independent examination of the extent to which agencies and departments of state government are faithfully carrying out their programs. The audit reports assist the General Assembly and agency management by

- assessing the extent to which state agencies have fulfilled their statutory mandate and the efficiency and effectiveness of their organization and use of resources,
- developing recommendations for management or legislative action that might improve the efficiency and effectiveness of the agencies' operations, and
- providing program and financial data.

Sunset Performance Audit work is directed by the Tennessee Governmental Entity Review Law, known as the Sunset Law (Section 4-29-101 et seq., *Tennessee Code Annotated*), which requires the Joint Government Operations Committee to review each entity at least once every eight years to determine whether the entity should be continued, restructured, or terminated.

Risk-Based Performance Audit work is based on risk assessments of state department and agency programs. The selection of audits is based on identification of risks in statewide processes and programs and agency-specific operations and activities. Auditors target state agencies with the greatest risks of fraud, waste, abuse, and noncompliance with federal program requirements.

Performance audits are conducted in accordance with *Government Auditing Standards* issued by the United States Comptroller General and move through six phases: planning, fieldwork, report writing, agency comments, report publication, and often presentation at a legislative hearing. Performance audits generally include the following:



- Review of relevant laws, cases, Attorney General's opinions, executive orders, rules, and regulations.
- Review of the agency's procedures, plans, and records.
- Interviews with staff of the agency and related agencies.
- Observation of the agency's operations and activities.
- Analysis of the agency's revenue and expenditure data, program data, performance, and results.
- Review of comparative data from other states.
- Surveys of individuals, agencies, and organizations served or affected by the agency.
- Tests for compliance with legal requirements.
- Evaluation of the extent to which the agency achieved desired results at the lowest reasonable cost.
- Legislative or administrative recommendations for accomplishing the agency's legislative mandate.

The Government Operations Committees held 11 public hearings on 57 entities in the year ended June 30, 2013. At these hearings, Performance Audit staff presented audit reports covering 24 entities. Another 29 entities submitted written responses to staff-prepared questions based on the entities' statutory authority and responsibility. Additionally, the committees held procedural hearings on self-sufficiency issues on three entities and a follow-up hearing on four entities.

## TennCare

Under an agreement with the Department of Finance and Administration, staff in the TennCare section perform the following audit and rate-setting functions for the state's TennCare program:

- Reimbursable rate computation and examinations for nursing homes and Intellectual and Developmental Disabilities facilities participating in the Medicaid Program.
- Computations of reimbursement settlements and prospective rates for Federally Qualified Health Centers and Rural Health Clinics as required by the Benefits Improvement and Protection Act of 2000.
- Cost settlements for state-operated Developmental Centers serving individuals with intellectual disabilities.
- Technical, financial, and budgeting support to the Bureau from nursing home paid claims extracts.
- Examinations of TennCare Managed Care Contractors (MCCs), who contract with the state to provide medical services under the program, performed jointly with the Department of Commerce and Insurance.

## Results of Audits

During the year ended June 30, 2013, a major endeavor of the division was the Single Audit of the State of Tennessee for the year ended June 30, 2012, conducted in accordance with Office of Management and Budget (OMB) Circular A-133. The *Single Audit Report* reflected federal awards of over \$15.9 billion.

We noted instances of noncompliance that resulted in qualified opinions on compliance for 2 of the state's 31 major federal programs. In addition, we noted other instances of noncompliance that met the reporting criteria contained in OMB Circular A-133. We also noted material weaknesses and significant deficiencies in internal control over compliance with requirements related to federal programs.

As a result of testing the state's compliance with the requirements of laws, regulations, contracts, and grant agreements applicable to each major federal program, costs of \$8,033,911.72 were questioned. We noted two deficiencies that we considered to be material

weaknesses in internal control over financial reporting. We noted one instance of noncompliance we considered material to the state's basic financial statements.

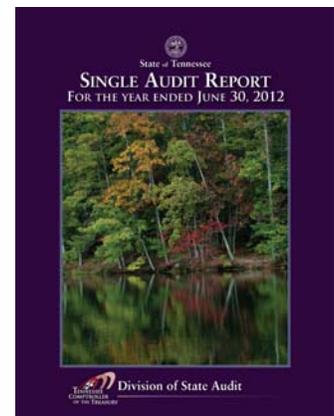
The Single Audit included an audit of the state's basic financial statements. This audit resulted in an unmodified opinion on the basic financial statements of the State of Tennessee for the year ended June 30, 2012.

The audit also determined that the Schedule of Expenditures of Federal Awards was fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

In addition to the *Single Audit Report*, separate audit reports were issued on many agencies and institutions of state government. The separate audits of the departments, agencies, and institutions are not meant to serve as organization-wide audits as described in the Single Audit Act as amended in 1996 and OMB Circular A-133. Some, however, serve as segments of the organization-wide audit of the State of Tennessee; therefore, they include the necessary tests for compliance with applicable laws, regulations, contracts, and grant agreements and the required consideration of the internal control.

Including the *Single Audit Report*, the division published 32 financial and compliance audit reports containing 56 audit findings and issued opinions on 58 sets of financial statements. These reports included the following:

- ◇ Austin Peay State University (2010)
- ◇ Austin Peay State University (2011)
- ◇ Comprehensive Annual Financial Report
- ◇ Clean Water State Revolving Fund
- ◇ Department of the Treasury
- ◇ Dyersburg State Community College
- ◇ East Tennessee State University
- ◇ Jackson State Community College
- ◇ Local Government Group Insurance Fund (2011)
- ◇ Local Government Group Insurance Fund (2012)
- ◇ Middle Tennessee State University



- ◇ Nashville State Community College
- ◇ Northeast State Community College
- ◇ Pellissippi State Community College
- ◇ Retiree Health Funds
- ◇ Roane State Community College
- ◇ Roane State Community College Foundation
- ◇ Teacher Group Insurance Fund (2011)
- ◇ Teacher Group Insurance Fund (2012)
- ◇ Tennessee Student Assistance Corporation
- ◇ Tennessee Consolidated Retirement System
- ◇ Tennessee Education Lottery Corporation
- ◇ Tennessee Housing Development Agency
- ◇ Tennessee Local Development Authority
- ◇ Tennessee Residence Foundation
- ◇ Tennessee Sports Hall of Fame
- ◇ Tennessee State School Bond Authority
- ◇ Tennessee State Veterans' Homes Board
- ◇ The University of Memphis
- ◇ The University of Tennessee
- ◇ Walters State Community College

The division released the following 21 performance audit reports:

#### Sunset

- ◇ Board of Probation and Parole
- ◇ Department of Correction
- ◇ Department of Economic and Community Development
- ◇ Department of Financial Institutions
- ◇ Department of Mental Health and Substance Abuse Services and the Statewide Planning and Policy Council
- ◇ Department of Tourist Development
- ◇ Emergency Communications Board
- ◇ Health Services and Development Agency
- ◇ Regulatory Boards and Commissions
- ◇ Selected Health Related Boards of the Department of Health
- ◇ Tennessee Film, Entertainment and Music Commission
- ◇ Tennessee Regulatory Authority
- ◇ Tennessee State Veterans' Homes Board

#### Risk-Based

- ◇ Department of Environment and Conservation
- ◇ Department of Intellectual and Developmental Disabilities
- ◇ Department of State
- ◇ Fiscal Review Committee
- ◇ Office of the Comptroller of the Treasury
- ◇ Revenue – Offsets

#### Special Reports

- ◇ Annual Report on the Status of Submission of Title IX Implementation Plans
- ◇ State Agency Energy Conservation and Alternative Energy Efforts and Review of Plans for Reducing the Use of Petroleum Products

The division completed examinations of the following 12 nursing facilities:

- ◇ Crestview Health and Rehabilitation
- ◇ Decatur County Manor, Inc.
- ◇ Good Samaritan Health and Rehabilitation Center
- ◇ Hillcrest Healthcare, LLC
- ◇ Imperial Gardens Health and Rehabilitation
- ◇ Laurel Manor Health Care
- ◇ MatureCare of Standifer Place, LLC, d/b/a The Health Center at Standifer Place
- ◇ Pigeon Forge Care & Rehabilitation Center
- ◇ Signature Healthcare of Columbia
- ◇ Signature Healthcare of Erin
- ◇ Signature Healthcare of Rogersville
- ◇ West Meade Place, LLP

The division's TennCare section also assisted the Department of Commerce and Insurance in two Managed Care Contractor (MCC) examinations. The summary of findings included financial, claims processing, and compliance deficiencies.

The state, legislature, or federal government often requests that the Division of State Audit work on special TennCare projects. In one such project, the state, under a consent decree with the federal court, has agreed to comply with requirements with respect to TennCare enrollee grievances and appeals. The TennCare MCCs and providers are also subject to the decree, so it has widespread implications. The agreement, commonly referred to as the "Grier Consent Decree," became effective November 1, 2000. The decree requires the state to enter into an agreement with the Comptroller's Office to monitor compliance and to report quarterly. Reports through June 2012 have been completed and released. Reports for the quarters ended in September and December 2012 are in progress.

### **Audits in Progress at Year-End**

On June 30, 2013, 44 financial and compliance audits, 3 information systems audits, 19 performance engagements, and 12 nursing facility examinations were in progress.

Through the Division of Local Government Audit, the Department of Audit is responsible for the audits of all local governmental entities with statutory audit requirements as well as certain nonprofit and for profit organizations that are publicly funded. The division may conduct the audit for governmental entities or accept an audit prepared by the certified public accountant provided the audit meets minimum standards established by the Comptroller of the Treasury. The division conducts the annual audits for 89 of the state's 95 counties. Through a contractual process with independent certified public accounting firms, the division ensures the performance of over 1600 audits for the state's remaining counties, municipalities, public internal school funds, charter schools, utility districts, housing authorities, local government created entities, quasi-governmental organizations, and other government-funded agencies.

## Financial and Compliance

The division presently conducts audits in 89 counties. These audits are assigned to teams that audit the various offices and/or departments and entities of county government. The audit staff is divided into four geographical areas: East, Mideast, Middle, and West. Each area is under the supervision of an audit manager who is responsible for audit planning and supervision.



## The Audit Process

The Division of Local Government Audit performs the following general procedures as part of the financial and compliance audit process:

- Evaluates the entity's existing internal controls in the appropriate areas of operation.
- Confirms the accountability for receipts by examining, for example, tax rolls, state and federal revenue data, and letters of inquiry.
- Determines the appropriateness of disbursements by examining budget authorization, paid invoice files, purchasing files, payroll records, and other financial records.
- Determines the authorization for transactions by reviewing the minutes of meetings of county commissions, school boards, highway commissions, and various committees such as budget and finance, and purchasing.

- Determines compliance with federal regulations and state and local laws.
- Obtains management's representations with respect to the financial statements, as well as the supporting accounting data, and other items of disclosure.
- Evaluates financial statement presentation to determine conformity with accounting principles generally accepted in the United States of America.
- Evaluates the validity of all evidence obtained throughout the audit process to formulate an opinion on the financial statements.

## Scope of Activity

### Post-Audit of County Governments

The Division of Local Government Audit conducted audits in 89 of the state's 95 counties for the 2011-2012 audit year. A minimum of ten offices or departments in each county was audited:

1. County Trustee
2. County Mayor
3. Department of Education
4. Department of Highways
5. County Clerk
6. Circuit Court Clerk
7. General Sessions Court Clerk
8. Chancery Court Clerk and Master
9. Register
10. Sheriff

The audits of all offices were for the fiscal year ended June 30, 2012. The audit field work in each county is conducted by an audit team. The size of the team is determined by the complexity of the assignment.

Approximately ten weeks of field work are required, including audit review and supervision by an auditor 4 and/ or audit manager. The draft audit reports are reviewed in the Nashville office and released. The division also prepares audits of two special school districts and performs special audits and reviews as requested or as deemed necessary.

## Results of Audits

### Financial and Compliance Audits

Audits of financial transactions for the year ended June 30, 2012, conducted by the Division of Local Government Audit revealed an increase in cash shortages of \$106,495 and total ending cash shortages of \$563,373. Details of the latest cash shortages report are available on the Comptroller's website at [www.comptroller.tn.gov/la](http://www.comptroller.tn.gov/la).

The audits conducted or reviewed by this division disclosed fund deficits totaling \$225,302,629 in 20 governmental fund accounts in 12 counties. Audits also reflected net asset deficits totaling \$67,635,111 in 17 enterprise funds and 5 internal service fund accounts in 14 counties.

### Information System Reviews

Most county government offices and departments in Tennessee have automated all or a portion of their daily operations. The information system (IS) review section is responsible for evaluating those computer-based accounting and information systems to determine whether an entity's existing procedures and controls provide adequate assurance of data accuracy and financial and operating statement reliability. An assistant director supervises this section's IS audit manager and seven IS auditors, who are assigned to different areas of the state.

General and application controls of a county's computer hardware and computerized accounting and information systems are evaluated. Findings resulting from this evaluation are discussed with the appropriate officials and included in the county's annual financial report.

### Scope of Activity

#### Information System Reviews

As required by the division's annual audit plan, information system related controls were evaluated in 89 counties and two special school districts during the year ending June 30, 2013.

#### Contract Audits

The Division fulfills its audit responsibility through a contractual process with independent certified public

accounting firms who perform the audits for the following Tennessee local governments:

#### Counties

- ◇ 6 of the state's 95 counties
- ◇ 257 county-related entities

#### Municipalities

- ◇ 342 municipalities
- ◇ 106 municipal-related entities

#### Quasi Governments

- ◇ 183 utility districts
- ◇ 85 housing authorities and 3 housing authority related entities
- ◇ 18 human resource agencies and development districts
- ◇ 103 other quasi governmental entities

#### Schools

- ◇ 143 public internal school funds
- ◇ 50 charter schools
- ◇ 13 of the 15 special school districts

The Division further ensures that 297 nonprofit and for-profit organizations are audited as required by state contracts and agreements.

The entities use standard contracts, prepared by the Comptroller of the Treasury, which must be approved by the Comptroller's designees in the Division of Local Government Audit before audit work begins. These audits must be performed in accordance with generally accepted government auditing standards and certain other minimum requirements prescribed by the Comptroller of the Treasury. In addition, the auditor must comply with other federal and state provisions.

For the six counties, the division monitors the contract audits in accordance with a four-year monitoring plan, which includes a review of working papers prepared by certified public accountants.

The Division of Local Government Audit approves the audit contracts of the certified public accountants and reviews each audit report to verify that it adheres to applicable reporting requirements. If a local governmental unit fails or refuses to have an audit, the Comptroller may direct the Division of Local Government Audit, or may appoint a certified public accountant, to perform the audit. If a nonprofit or for-profit organization refuses to have an audit, the Division works in connection with the respective state funding agency to obtain an audit. The division evaluates the audit working papers of certified public accounting firms that audit the entities. The objective of this review is to

ensure that in addition to standards prescribed by the American Institute of Certified Public Accountants and Government Auditing Standards issued by the United States Comptroller General, standards prescribed by the Comptroller of the Treasury have been followed. If the firm's audit working papers are deemed substandard, the Comptroller of the Treasury takes appropriate action, which might include referral to the State Board of Accountancy.

## Scope of Activity

### Monitoring and Review of Contract Audits

The division will monitor audits of six county governments during the next four years. The audits of Washington, Shelby, and McMinn counties were monitored for the year ended June 30, 2012, and the audits of Davidson and Knox counties will be monitored for the year ended June 30, 2013. For the year ended June 30, 2013, the division reviewed 1,770 audit reports submitted by certified public accountants for audits of local governments and other publicly funded entities.

## Other Services

### Technical Assistance

In addition to the basic audit function and the monitoring and review of audits by certified public accountants, the division provides other services. These services include providing information and assistance to facilitate implementation of new auditing and accounting standards; submission of federal program data to the federal clearing house on behalf of county governments; requesting technical data for pension and other postemployment benefits note disclosures from the State of Tennessee; maintenance of the uniform chart of accounts used by county governments; and participation in the review of notifications made to the Comptroller's Fraud Hotline. The division also provides, upon request, assistance to counties in resolving current problems with financial administration, as well as answering questions on various local governmental matters. The division provides fiscal reviews of new legislation related to county governments and works closely with the state legislature with regard to the passage of new statutes for county governments.

### Statutory Referral of Utility Systems

Sections 68-221-1010(a) and 7-82-703(a), *Tennessee Code Annotated*, require the Comptroller to refer financially distressed municipal water and/or wastewater systems and public utility districts to the state's Water and Wastewater Financing Board and/or the Utility Management Review Board. Sections 68-221-1010(d) and 78-82-401(h) of *Tennessee Code Annotated* require the Comptroller to refer water systems with excessive

unaccounted for water losses. After the Division of Local Government Audit refers applicable facilities to the appropriate board, the respective board obtains and reviews a proposed plan for correction by the facility. If the board finds the facility's plan unacceptable, the board will recommend an alternate course of action.

During the year ended June 30, 2013, the division referred 168 utility systems to the Water and Wastewater Financing Board and/or the Utility Management Review Board. As a result, several utility districts and municipal utility systems are now operating or are on their way to operating on a financially sound basis and/or are in the process of taking measures to decrease their water loss rates.

### Reviews of Funds Administered by District Attorneys General

During 2012, the division conducted reviews of District Attorney General Funds, Judicial District Drug Task Force Funds, and other funds the district attorneys general administer in the state's 31 judicial districts. Each review covered the period July 1, 2011, through June 30, 2012. The scope of each review was limited to the transactions of the individual funds and did not include the overall operation of the district attorneys' offices.

### Reviews of County Correctional Incentive Program (CCIP)

*Tennessee Code Annotated*, Title 41, Chapter 8, referred to as the County Correctional Incentive Act, provides counties financial incentives to house nondangerous felony offenders at local correctional facilities. The program's purpose is to mutually benefit state and county governments by helping to alleviate overcrowding in state correctional facilities and reduce high operating costs, and to assist counties in upgrading local facilities and programs. Counties participating may be reimbursed at a minimum statutory daily rate or a rate based on a county's "reasonable allowable cost" to house convicted felons.

The Division of Local Government Audit conducts reviews of various counties participating in the CCIP. The objectives of the reviews were 1) to determine if prisoners were properly listed on the State Prisoner Reports, 2) to determine if inmates were accurately reported on the Correction Facility Summary Reports, and 3) to recommend appropriate actions to correct any deficiencies.

Reviews were conducted in 8 detention facilities for the year ended June 30, 2012. As a result of the reviews, it was determined that the state had overpaid \$256,865 for three facilities. The Division of Local Government Audit will turn over the reviews of the CCIP to the Department of Correction for the year ended June 30, 2013.



# Division of Investigations

The Division of Investigations investigates allegations of fraud, waste, and abuse in state and local governments and other publicly funded entities within the State of Tennessee and reports the results of its investigations, including significant internal control and compliance deficiencies noted during the investigation. These investigations provide a basis, where applicable, for prosecutorial or administrative agencies to pursue criminal, civil, and/or administrative actions. Where criminal matters are involved, the division works with the local district attorneys general, the State Attorney General, the Tennessee Bureau of Investigation, the Federal Bureau of Investigation (FBI), and other federal, state, and local law enforcement.

The division includes two units: Financial and Compliance Investigations and Special Investigations.

## Financial and Compliance Investigations

The Financial and Compliance Investigations unit conducts investigations which support the financial and compliance audit report timelines of State Audit and Local Government Audit. More routine indicators of fraud are present. These cases may result in criminal prosecution. The unit also investigates certain allegations of waste and abuse of public funds.

## Special Investigations

The Special Investigations unit conducts investigations of allegations with strong indications of fraud present and a substantial potential for criminal prosecution. The unit also investigates certain allegations of waste and abuse of public funds.

## Investigative Audits

Investigative audits are performed as a result of allegations received through the Department of Audit's toll-free hotline; statutorily required fraud reporting forms, misappropriations or other significant issues indicative of fraud noted during routine audit work or audit report reviews; information received from certified public accountants, other state agencies, and concerned citizens and/or officials; and requests received from local district attorney generals, the State Attorney General's Office, the FBI, and other prosecutorial and law enforcement agencies. Results of investigations are

presented in reports or letters that document occurrences of improper activity. Reports are forwarded to the State Attorney General, the local district attorney general, and, when applicable, the local U.S. Attorney for any legal action deemed necessary.

The division's investigative audits also include an assessment of internal controls and compliance with applicable laws relative to the issues investigated. Investigators have often found that weak internal controls or ineffective management were contributing factors in most of the losses incurred as a result of fraud. In the resulting reports or letters, the division identifies these internal control and compliance weaknesses and recommends corrective action. The investigative audits point out to officials the importance of sound internal controls and compliance with applicable laws and regulations.

During the fiscal year ended June 30, 2013, the division received 604 notifications of fraud, waste, and abuse. The division released 20 investigative reports and letters revealing losses of at least \$322,021 due to fraud and cited an additional \$1,765,350 of apparent waste and/or abuse. Criminal proceedings arising as a result of the division's investigations resulted in felony indictments of 7 public officials on 46 criminal counts. Most investigative audits revealed weaknesses in (or the absence of) internal controls, lack of compliance with applicable laws and regulations, or other problem areas that created an environment conducive to fraud, waste, and abuse. At year-end, the division had 39 investigations in progress, with an additional 9 pending.

During fiscal year 2013, the Division of Investigations released the following 20 investigative audit reports and letters:

- ◇ Town of Pikeville
- ◇ Beech Elementary School – Sumner County School System
- ◇ Upper Cumberland Human Resource Agency
- ◇ Shelby County Election Commission
- ◇ Upper Cumberland Development District
- ◇ Tennessee Department of Veterans Affairs
- ◇ Northeast Henry County Utility District
- ◇ Tennessee Arts Commission
- ◇ Marshall County School System
- ◇ City of Rockwood
- ◇ Bearden Middle School-Knox County School System
- ◇ Sneedville Utility District
- ◇ Town of Henning
- ◇ City of Grand Junction
- ◇ Town of Newbern
- ◇ Chester County Soil Conservation District
- ◇ Morristown-Hamblen Humane Society
- ◇ Watauga River Regional Water Authority/North Elizabethton Water Division
- ◇ Polk County Office of Circuit and General Sessions Courts Clerk
- ◇ Town of Monterey



Pursuant to Section 8-4-403, *Tennessee Code Annotated*, the Office of the Comptroller is required to "establish, maintain, and publicize a toll-free telephonic and web-based hotline for the purpose of receiving allegations of fraud, waste, or abuse of public funds." Since its inception, the hotline has received over 18,000 notifications, including 1,944 calls between July 1, 2012, and June 30, 2013. In addition, on January 1, 2013, the Comptroller's Office introduced an online form that allows citizens to report allegations of fraud, waste, or abuse over the Internet. The website received 148 notifications. Of the 2,092 total notifications, 562 concerned allegations of fraud, waste, or abuse. The substantive notifications—those relating to fraud, waste, or abuse—concerned a wide range of entities, including municipalities, counties, state agencies and departments, and federal agencies and departments. A more detailed analysis is below. Substantive notifications are investigated by the Department of Audit or referred to the appropriate agency or program.

Of the 562 notifications referred for action, responses have been received on 434, and these are considered closed. The remaining 128 continue to be considered open. The remaining 1,530 notifications were not assigned for review because they were either repeat notifications or were not relevant to the purpose of the hotline. Notifications in the latter group include wrong numbers, hang-ups, general inquiries about the hotline, and requests for services provided by other agencies, such as tax assistance. Where applicable, the person making the notification is referred to the appropriate agency or department that can provide assistance.

## Results of Hotline Notifications

The following summaries are the results of hotline notifications upon which corrective action was taken for the year ending June 30, 2013.

### ***Board of Regents — Unprofessional Classroom***

The notification alleged that an instructor had not maintained a professional classroom. The review determined that the instructor had not properly controlled the class. The instructor was replaced, and the students were given the opportunity to transfer to a different class.

### ***Comptroller Investigations — Misappropriation in City Recorder's Office***

The notification alleged that misappropriations and unauthorized health insurance benefits were occurring in the city recorder's office. The review determined that an employee misappropriated \$24,267 and received \$1,583 in unauthorized insurance benefits. The employee was indicted on charges of theft, forgery, and official misconduct.

### ***Comptroller Local Government Audit — County Highway Department***

The notification alleged that a county highway department was not charging for work done for other government

entities in the county. The review determined that the highway department was authorized to do such work, but was not doing so through formal written contracts, resulting in inconsistent charging for services provided. A finding was taken against the county.

### ***Comptroller Local Government Audit — County Highway Department***

The notification alleged that the county highway department was allowing personnel to fill up their personal vehicles. Although the allegation could not be verified, the review determined that the highway department did not maintain inventory records documenting the receipt, usage, and storage of fuel. A finding was taken against the county.

### ***Comptroller Local Government Audit — Theft of Phone Cards from Sheriff's Department***

The notification alleged that phone cards purchased for jail inmates to buy were missing. The review determined that 152 cards valued at \$2,520 were missing. The review also determined that the department did not properly reconcile purchased cards with those on hand, that the cards were not adequately secured when not in the dispensing kiosk, and that the department was not properly using the kiosk. A finding was taken against the county.



**Comptroller Local Government Audit — Missing Titles and Funds from Clerk’s Office**

The notification alleged that titles, sales tax proceeds, and other funds were missing from a county clerk’s office. An employee used changes and deletions to transactions to conceal the misappropriation of approximately \$10,100. The matter has been referred to the district attorney general.

**Health — Personal Work During State Hours**

The notification alleged that a health department employee was doing homework and preparing for a class the employee taught during work hours and on government equipment. The employee admitted to doing work during lunch and during down time at work, but not on government equipment. The employee received an oral warning for preparing for a secondary job and personal education.

**Health — Regulated Professional With Unprofessional Behavior**

The notification alleged that a regulated professional had acted unprofessionally. The review determined that the individual had acted unprofessionally and had failed to comply with a lawful order or promulgated rule of the regulator board. The professional’s license was revoked as a disciplinary measure.

**Human Services — Daycare Violation**

The notification alleged that a state-supported daycare provider was late paying its employees. The review determined that the daycare’s payroll payments were paid late. The daycare was cited for the violation.

**Human Services — Daycare Violation**

The notification alleged that a state-supported daycare was not following dietary restrictions and was combining infants and toddlers with older children. The review determined that the daycare was not following dietary restrictions and was commingling children of varying ages. The agency was cited for not following dietary restrictions, and was cited and put on notice for grouping and adult-child ratio violations.

**Human Services — Food Stamp Fraud**

The notification alleged that an individual was improperly receiving food stamp benefits. The review determined that the individual was improperly claiming children who were not living with the individual. The case was referred for a claim and the individual’s file was amended to remove the individual’s children.

**Human Services — Employee Violating Acceptable Use of Computer Resources**

The notification alleged that a department employee was using the employee’s state email for personal purposes. The review determined that the employee had violated

the department’s state email account acceptable use policy. The employee was required to go through acceptable use training.

**Labor — Employee Violating Acceptable Use of Computer Resources**

The notification alleged that a department employee was using a work computer for personal purposes and thus was in violation of the department’s acceptable use policy. The review determined that the employee had violated the acceptable use policy. The employee was terminated.

**Labor — Unprofessional Career Center Staff**

The notification alleged that staff at a career center acted unprofessionally toward a client. The review determined that the employee had acted unprofessionally. The employee was required to attend counseling and customer service training, and was issued a written disciplinary statement.

**Mental Health — Abusive Facility Staff**

The notification alleged that staff at a licensed facility was verbally abusive. The review determined that the allegation had merit, and the department took action against the facility, including issuing a notice of non-compliance for reporting violations.

**Transportation — Transportation Service Provider (2)**

The notifications alleged that drivers for a transportation service provider were using their mobile phone while driving a provider vehicle. The review determined that the drivers were using mobile phones while driving, which is in violation of the entity’s policy. The drivers were required to attend special training with the entity’s public transit safety officer.

**Transportation — Employee Sleeping on the Job**

The notification alleged that an employee was sleeping in the employee’s work vehicle during work hours. Although it could not be determined whether the employee was on the employee’s lunch hour at the time the behavior was observed, the employee received an oral warning with a written follow up. The superintendent for the area met with all employees to restate the department’s policy of no sleeping during work hours.

**Transportation — Improper Transportation Information**

The notification alleged that a transportation provider told the individual that transportation between counties could only occur when there is a medical purpose for the trip. The review determined that the transportation provider’s call center staff provided the individual with incorrect information. The director of the transportation provider clarified the proper policy with staff.

## Analysis of Substantive Hotline Notifications

### Fiscal Year Ended June 30, 2013

Reviewing Agency	Notifications	Closed	Open
<u>State Government</u>			
Agriculture	1	0	1
Attorney General	1	1	0
Board of Regents	12	2	10
Children's Services	10	8	2
Commerce and Insurance	3	1	2
Commission on Aging and Disability	2	0	2
Comptroller of the Treasury	302	253	49
Correction	14	7	7
Corrections Institute	5	5	0
Education	4	3	1
Environment and Conservation	3	3	0
Finance and Administration	1	1	0
General Services	5	2	3
Health	24	20	4
Human Resources	1	0	1
Human Services	47	42	5
Intellectual and Developmental Disabilities	13	2	11
Labor and Workforce Development	22	16	6
Mental Health and Substance Abuse Services	17	15	2
Revenue	1	1	0
Safety and Homeland Security	6	4	2
Secretary of State	1	1	0
Southeast Human Resource Agency	1	1	0
TennCare	16	9	7
Tennessee Bureau of Investigation	3	0	3
Tennessee Higher Education Commission	1	0	1
Tennessee Housing Development Agency	3	2	1
Tennessee Human Rights Commission	1	1	0
Tennessee Wildlife Resources Agency	1	1	0
Transportation	27	25	2
Treasury	6	6	0
University of Tennessee	4	1	3
Veterans' Affairs	2	0	2
<u>Local Government</u>			
Memphis Area Transit	2	1	1
<b>Total</b>	<b>562</b>	<b>434</b>	<b>128</b>

Comptroller's Fraud, Waste, and Abuse Hotline  
(800) 232-5454

[www.comptroller.tn.gov/hotline](http://www.comptroller.tn.gov/hotline)



# About the Department of Audit

## Department of Audit Staff

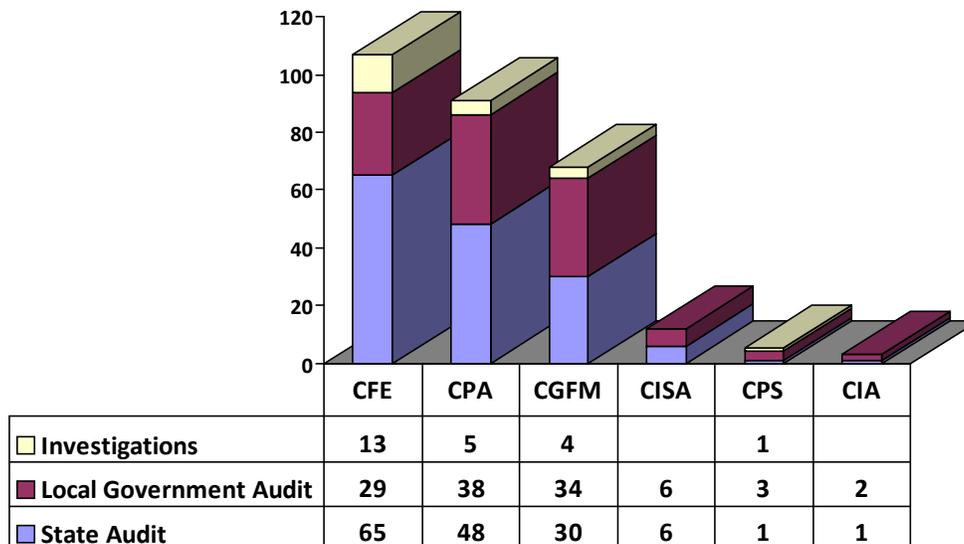
The department's professional staff perform a wide variety of audit work requiring different types of training and experience. Therefore, members of the staff have degrees in fields such as accounting, public administration, information systems, law, political science, criminal justice, education, and nursing. More than 60 of the professional staff have advanced degrees. The department encourages its employees to pursue professional certifications such as Certified Public Accountant, Certified Information Systems Auditor, Certified Fraud Examiner, and Certified Government Financial Manager.

As of June 30, 2013, more than 200 employees of the department had received one or more professional certifications. This range of experience gives a broad perspective to the department's audit work.

The Department of Audit ensures its auditors receive the required continuing professional education to meet certification standards and *Government Auditing Standards*. Auditors participate in the department's in-house training program as course developers, presenters, and participants. Over 13,000 hours of training were completed during the fiscal year ended June 30, 2013.

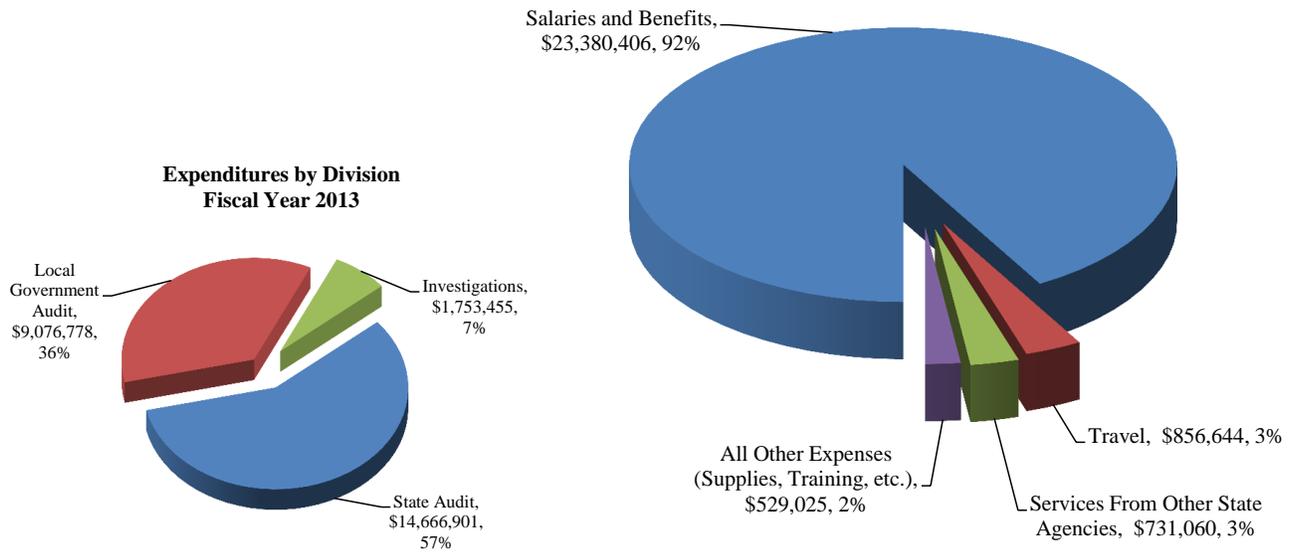
The Department of Audit fully supports its staff's active participation in local and national professional organizations, recognizing that these organizations contribute to the staff's continued growth.

## Department of Audit Staff Certifications as of June 30, 2013



Certified Fraud Examiner (CFE), Certified Public Accountant (CPA), Certified Government Financial Manager (CGFM), Certified Information Systems Auditor (CISA), Certified Professional Secretary (CPS), and Certified Internal Auditor (CIA)

## Department of Audit Expenditures Fiscal Year 2013



## Contact Information

### Office of the Comptroller of the Treasury

First Floor, State Capitol  
Nashville, Tennessee 37243-0260  
(615) 741-2501

### Division of Local Government Audit

James K. Polk Building, Suite 1500  
505 Deaderick Street  
Nashville, Tennessee 37243-1402  
(615) 401-7841

### Division of State Audit

James K. Polk Building, Suite 1500  
505 Deaderick Street  
Nashville, Tennessee 37243-1402  
(615) 401-7897

### Division of Investigations

James K. Polk Building, Suite 1600  
505 Deaderick Street  
Nashville, TN 37243-1402  
(615) 401-7907

*A special thank-you to Richard V. Norment for over 46 years of dedicated service to the Comptroller of the Treasury. Richard will be retiring from his position as Assistant to the Comptroller in January 2014.*