Tennessee Human Rights Commission

August 2004

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STATE OF TENNESSEE
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John G. Morgan
Comptroller

August 10, 2004

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Ms. Amber D. Gooding, Executive Director
Tennessee Human Rights Commission
530 Church Street, Suite 305
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Human Rights Commission for the period July 1, 2000, through May 31, 2003.

The review of management's controls and compliance with policies, procedures, laws, and regulations resulted in certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report.

Sincerely,

John G. Morgan

John G. Morgan
Comptroller of the Treasury

JGM/mb
03/092

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COMPTROLLER OF THE TREASURY
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March 12, 2004

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

Dear Mr. Morgan:

We have conducted a financial and compliance audit of selected programs and activities of the Tennessee Human Rights Commission for the period July 1, 2000, through May 31, 2003.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. These standards require that we obtain an understanding of management controls relevant to the audit and that we design the audit to provide reasonable assurance of the Tennessee Human Rights Commission's compliance with the provisions of policies, procedures, laws, and regulations significant to the audit. Management of the Tennessee Human Rights Commission is responsible for establishing and maintaining internal control and for complying with applicable laws and regulations.

Our audit disclosed certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. The commission's administration has responded to the audit findings; we have included the responses following each finding. We will follow up the audit to examine the application of the procedures instituted because of the audit findings.

We have reported other less significant matters involving the commission's internal controls and/or instances of noncompliance to the Tennessee Human Rights Commission's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/mb

State of Tennessee

Audit Highlights

Comptroller of the Treasury   Division of State Audit

Financial and Compliance Audit
Tennessee Human Rights Commission
August 2004

AUDIT SCOPE

We have audited the Tennessee Human Rights Commission for the period July 1, 2000, through May 31, 2003. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of revenue, expenditures, payroll and personnel, equipment, and the Financial Integrity Act. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

AUDIT FINDINGS

The Commission's Revenue Procedures and Controls Were Inadequate**
Cash receipting functions are not adequately segregated. Also, commission revenue records were not being reconciled to the State of Tennessee Accounting and Reporting System (page 4).

Internal Controls for Purchasing Are Inadequate
The commission does not have an adequate segregation of duties relating to purchasing. Access for ordering, receiving, invoicing, and paying are not separate (page 6).

Inadequate Controls Over Expenditures*
The commission did not pay vendor invoices in accordance with the Prompt Payment Act of 1985. Also, supporting documentation was not maintained for all expenditures (page 7).

The Commission Did Not Adhere to Personnel Policies and Procedures*
The commission did not comply with the Department of Personnel's rules governing employment practices for interim and emergency employees. Also, employees did not receive an annual evaluation in accordance with Department of Personnel policy (page 9).

Controls Over Equipment Need to Be Strengthened**

The commission could not locate a piece of its equipment, equipment reported as stolen had not been removed from the Property of the State of Tennessee (POST) system, and the serial number and tag number on equipment did not agree with POST. Also, a former employee's access to POST had not been terminated (page 13).

* This finding is repeated from the prior audit.

** This finding is repeated from prior audits.

Financial and Compliance Audit
Tennessee Human Rights Commission

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Financial and Compliance Audit
Tennessee Human Rights Commission

INTRODUCTION

FINANCIAL AND COMPLIANCE AUDIT

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Tennessee Human Rights Commission. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to "perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller."

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

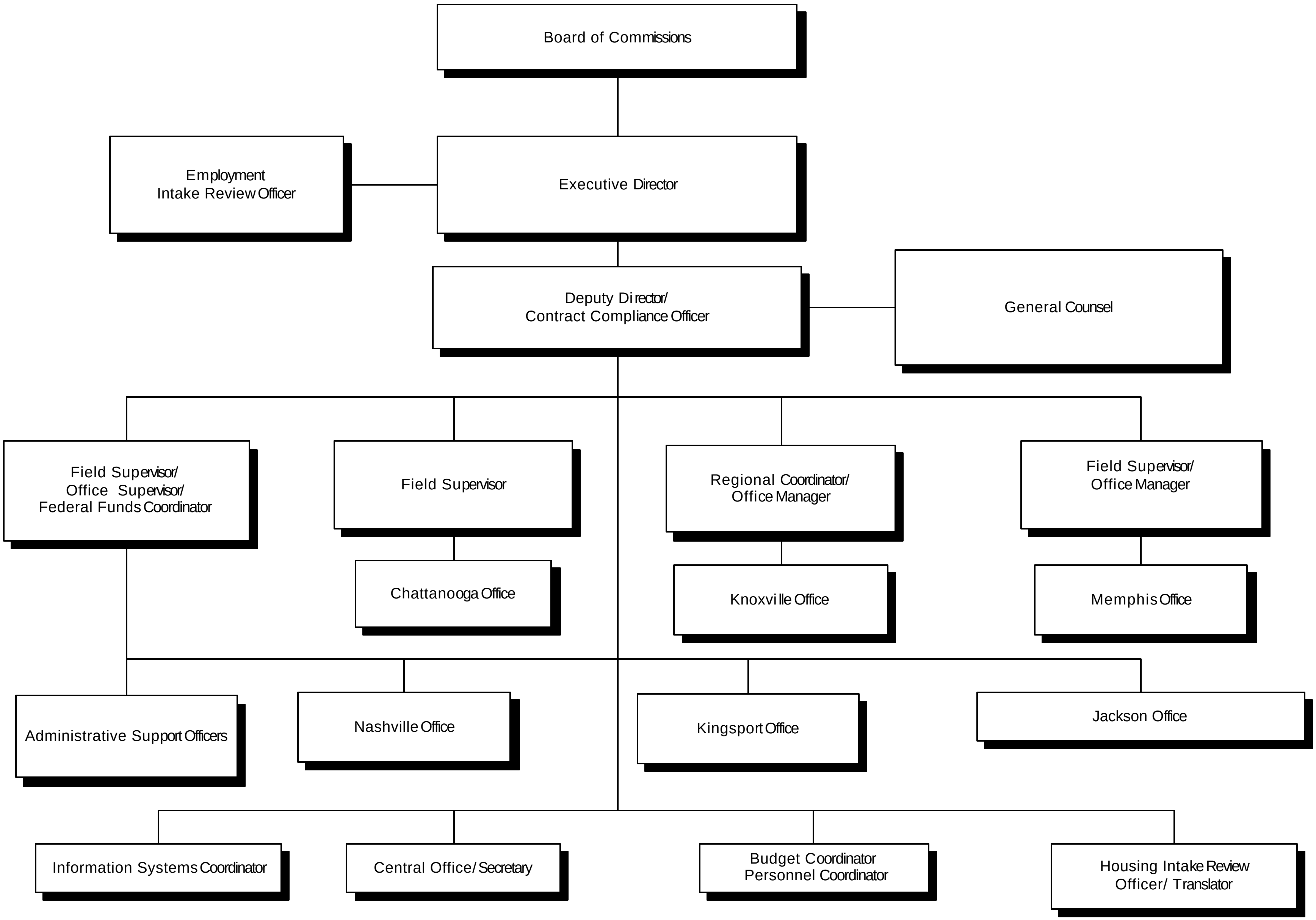
The mission of the Tennessee Human Rights Commission is to promote civil rights in Tennessee. The commission is charged to encourage, promote, and develop fair and equal treatment of, and opportunity for, all Tennesseans regardless of race, color, creed, sex, or national origin; to assist local governmental agencies with human relations; to report yearly to the Governor and the legislature the commission's activities; and to adopt rules and regulations to govern the proceedings of the commission.

An organization chart of the commission is on the following page.

AUDIT SCOPE

We have audited the Tennessee Human Rights Commission for the period July 1, 2000, through May 31, 2003. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of revenue, expenditures, payroll and personnel, equipment, payroll and personnel, and the Financial Integrity Act. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Tennessee Human Rights Commission
Organization Chart



PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Tennessee Human Rights Commission filed its report with the Department of Audit on May 2, 2002. A follow-up of all prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the Tennessee Human Rights Commission has corrected previous audit findings concerning the failure to comply with the Financial Integrity Act, not recording federal funding in accordance with state policy or requesting exemption from the policy, and not having a formal, written conflict of interest policy for the commissioners.

REPEATED AUDIT FINDINGS

The prior audit report also contained findings concerning inadequate revenue procedures, not following job performance evaluation policy, untimely payment to vendors, and inadequate controls over equipment. These findings have not been resolved and are repeated in the applicable sections of this report.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

REVENUE

The objectives of our review of revenue controls and procedures were to determine whether

- controls our revenue were adequate;
- transactions were properly supported, coded, and recorded;
- commission records were reconciled with the State of Tennessee Accounting and Reporting System (STARS); and
- journal vouchers were properly initiated, authorized, and approved.

We interviewed key commission personnel to gain an understanding of the commission's procedures and controls over revenue. We also reviewed supporting documentation for these procedures and controls. We selected a nonstatistical sample of revenue transactions to determine whether they were properly supported, coded, and recorded. Journal vouchers in the sample were tested to determine whether they were properly initiated, authorized, and approved. We also determined if commission records were being reconciled with STARS.

Based on our interviews, review of supporting documentation, and testwork, we determined that transactions were properly supported, coded, and recorded, and journal vouchers were properly initiated, authorized, and approved. However, testwork revealed that controls and procedures were inadequate with regard to the cash receipting function and commission records were not reconciled to STARS. See finding 1.

1. The commission's controls over revenue procedures still need to be improved

Finding

As noted in the two prior audits, controls over revenue procedures need to be improved. The former Executive Director concurred with the prior audit findings and stated in the most recent audit that cash receipt functions had been segregated, mail was being logged in, and revenue records were being reconciled. However, the following inadequacies still existed during the current audit.

a. Cash receipt functions were not properly segregated. The Budget/Personnel Coordinator was still performing the following incompatible duties: preparing the deposit, making the deposit, and posting to the accounting records. There was still no documented reconciliation between the check log and deposit prepared or deposit receipt. There was still no documented reconciliation of the deposit with the accounting records.

b. Reconciliations between commission revenue records and the State of Tennessee Accounting and Reporting System (STARS) were not performed.

There were no compensating controls noted for either of these conditions. Proper segregation of duties helps to ensure that funds and assets are not lost, stolen, misappropriated, or recorded improperly. The duties of authorizing transactions, recording transactions, and maintaining assets should be separated whenever possible. Prompt reconciliation of the commission's internal accounting records with transactions in STARS, along with maintaining documentation of the reconciliation, helps to ensure that the information in the centralized accounting system is accurate. Inadequate segregation of duties and the failure to reconcile revenue records with STARS significantly increase the potential for errors and fraud to occur and go undetected.

Recommendation

The Executive Director should ensure that revenue procedures and controls are implemented. Duties within the cash receipts functions should be adequately segregated. Cash receipts and deposits should be reconciled. Whenever possible, the duties of preparing the deposit, making the deposit, reconciling cash receipts to the deposit, and posting to the accounting records should be separated. When duties cannot be segregated because of limited staff, other compensating controls, such as a documented managerial review, should be in place. Also, revenue records should be promptly reconciled with STARS and adequately documented.

Management's Comment

We concur. Starting in November 2003, the administration of the fiscal responsibilities for Tennessee Human Rights Commission (THRC) was assigned to the Office of Business and Finance in the Department of Finance and Administration (F&A) through a shared services concept. This allowed the Commission to eliminate the single position that dealt with all fiscal concerns and to become a part of a bigger section that has adequate internal controls and procedures. The procedures currently in place for cash receipt functions are as follows:

> Mail containing checks, money orders, or cash is received and logged by the amount and issuer on a monthly log and filed by the mail person in THRC. The monies are then submitted to F&A for deposit to be processed by the Office of Business and Finance. The monthly log is forwarded by THRC to F&A at the first of each month for reconciliation.

EXPENDITURES

The objectives of our review of expenditure controls and procedures were to determine whether

- controls over expenditures were adequate;
- access to the State of Tennessee Accounting and Reporting System (STARS) and the Tennessee On-line Purchasing System (TOPS) was properly restricted;
- voucher registers were signed by those authorized to sign according to the signature authorization obtained from the Department of Finance and Administration;
- expenditures were for goods and services that were properly authorized and recorded, adequately supported, and made in accordance with applicable requirements;
- payments were made in a timely manner;
- Type J journal vouchers were processed in accordance with the Department of Finance and Administration's Policy 18; and

- agency records were reconciled with STARS.

We interviewed key commission personnel and examined supporting documentation to gain an understanding of controls over expenditures. We obtained a listing of persons with access to STARS and TOPS. We then determined if employees were still employed at the time of the listing and whether the employees' duties required the level of system access they were given. We scanned voucher registers and compared the approved signatures to the authorized Department of Finance and Administration (F&A) signatures listing to determine whether the registers were properly approved. We also determined if commission records were being reconciled with STARS. We selected a nonstatistical sample of expenditure transactions to determine if the expenditures were adequately supported, properly authorized and recorded, and made in accordance with applicable requirements. Also, we determined whether payments were made in a timely manner. We tested Type J journal vouchers to determine whether they were processed in accordance with F&A Policy 18.

Based on our interviews, reviews of supporting documentation, and testwork, we determined that controls over expenditures were not adequate. One employee had access to incompatible duties in both STARS and TOPS. Also, another employee could order, receive, and pay in TOPS. This matter will be noted in finding 2. The commission also did not always maintain supporting documentation at the commission for expenditure transactions, and the receipt of goods was not always documented. Vendors were not always paid in a timely manner, and expenditures were not always properly authorized and recorded and made in accordance with applicable requirements. These matters are noted in finding 3. Type J journal vouchers were not always processed in accordance with F&A's Policy 18 as reported in a separate letter to management. Voucher registers were properly approved, and commission records were being reconciled to STARS.

2. <u>Controls over purchasing need to be improved</u>

Finding

The Tennessee Human Rights Commission does not have adequate segregation of duties relating to purchasing. Job duties are not adequately segregated as follows:

a. The Budget/Fiscal Officer was performing the following incompatible duties: ordering, receiving, and paying in the Tennessee On-line Purchasing System (TOPS). He was also responsible for the payable and disbursement functions in the State of Tennessee Accounting and Reporting System (STARS).

b. The Personnel/Payroll Coordinator also has access to order, receive, and pay in TOPS.

If an individual is responsible for ordering, receiving, and paying for goods, the opportunity for errors or fraud to go undetected is increased. Individuals could order goods and divert them for personal use or could, through collusion with a vendor, order goods which are not delivered but for which payment is made.

Recommendation

The Executive Director should ensure that adequate controls over purchasing are implemented. Access for ordering, receiving, invoicing, and paying should be separated. The individual ordering the goods should not also receive and inspect the goods.

Management's Comment

We concur. The Tennessee Human Rights Commission (THRC) no longer has a Budget/Fiscal Officer. As stated previously, all of these functions are performed by the Office of Business and Finance at the Department of Finance and Administration (F&A). Goods are requested by THRC from Central Stores via the State of Tennessee Accounting and Reporting System (STARS) by the Personnel Officer. They are received, inspected, and signed for by an Administrative Assistant upon delivery. A file is maintained with delivery documentation. Access to the Tennessee On-line Purchasing System (TOPS) has been removed. The only person having access is the Executive Director. Under the new shared services concept, all other TOPS purchases are entered into the system by F&A staff and are approved by the Executive Director.

3. Controls over expenditures need to be improved

Finding

The Tennessee Human Rights Commission has inadequate controls over expenditures. Vendors are not paid in a timely manner, nor is there evidence that goods purchased were actually received. Also, documents supporting expenditures were not always maintained at the commission.

Testwork performed on a sample of 21 expenditures revealed the following discrepancies.

For 6 of the 21 transactions tested (29%), payment was made to the vendor 50 to 278 days after the invoice was received. The Prompt Pay Act of 1985 as codified in Section 12-4-703, *Tennessee Code Annotated*, states,

> An agency which acquires property or services pursuant to a contract with a business shall pay for each complete delivered item of property or service in accordance with the provisions of the contract between the business and agency or, if no date or other provision for payment is specified by contract, within forty-five (45) days after receipt of the invoice covering the delivered items or services.

By not paying invoices in a timely manner, the commission could lose purchase discounts, and relations with vendors could deteriorate. The commission could also be required to pay interest to these vendors.

For 4 of the 21 transactions (19%), there was no documentation that goods had been received. The commission does not have any procedure in place to ensure that receipt of the goods is documented. No indication of receipt of goods or services increases the risk of theft within the commission.

Also, supporting documentation for 25 sample expenditures was requested at the beginning of the audit. Supporting documentation for 9 of the 25 expenditures could not be located at the commission. Support for 5 of the 9 (56%) was subsequently obtained from the Department of Finance and Administration. If the commission does not maintain supporting documentation, it may not be able to support the fact that goods and services purchased were for state business.

Recommendation

The Executive Director should ensure that the commission complies with the Prompt Pay Act. Payments to vendors should be made in a timely manner. Also, documentation supporting the receipt of goods should be prepared and maintained along with supporting documentation for all expenditures made by the commission.

Management's Comment

We concur. As stated previously, the Tennessee Human Rights Commission (THRC) entered into a shared services arrangement with the Department of Finance and Administration (F&A). All invoices are received at the THRC office and date stamped. They are reviewed and approved by the Executive Director on a daily basis and then sent by courier to F&A for processing. F&A has adequate controls and procedures in place.

PAYROLL AND PERSONNEL

The objectives of our review of the payroll and personnel controls and procedures were to determine whether

- controls over payroll and personnel were adequate;
- gross pay agreed with personnel records, deductions were properly supported, salaries were charged to the proper cost center, time cards were signed by the employee and approved by the supervisor, and leave was accrued and taken in accordance with applicable guidelines;

- performance evaluations were completed as required;
- the supplemental pay register was reasonable; and
- new hires or employees who changed positions during the audit period met the qualifications for the jobs held, and if civil service, were hired or promoted from the appropriate lists, and initial wage and amount paid were properly computed.

We interviewed key commission employees to gain an understanding of procedures and controls over payroll and personnel. We reviewed supporting documentation for these controls and procedures. A nonstatistical sample of payroll transactions was tested to determine if payroll disbursements were authorized, adequately supported, and charged to the correct cost center. Testwork was also performed on the sample of payroll transactions to determine whether time cards were properly signed and approved, leave was properly accrued and taken, and performance evaluations were properly completed, and to determine if new hires or employees who changed positions during the audit period met the qualifications for the jobs held, and if civil service, were hired or promoted from the appropriate lists, and initial wage and amount paid were properly computed. Also, we examined reasonableness of the supplemental pay registers.

Based on our interviews, reviews of supporting documentation, and testwork, we determined that controls over payroll and personnel were inadequate, as noted in finding 4. Initial wage and amount paid were properly computed, and gross pay agreed with personnel records. Also, the supplemental pay register appeared reasonable. We determined that performance evaluations were not performed in accordance with policy, as noted in finding 5. In addition to the findings, other minor weaknesses were reported to management in a separate letter.

4. <u>The commission's employment and timekeeping practices need to be improved</u>

Finding

The Tennessee Human Rights Commission did not comply with the Department of Personnel's rules governing employment practices. Also, as noted in the prior audit report, employees did not receive an annual performance evaluation in accordance with commission and Department of Personnel policy. In addition, leave requests were not obtained from employees when leave was taken, and employees were allowed to handwrite time on time cards instead of using the time clock.

With regard to employment practices, the commission did not follow the state's hiring procedures for four of six new hires tested (67%). The commission hired four individuals as interim or emergency appointments. All four appointments exceeded the time limit established by the Department of Personnel. The Department of Personnel's "Employment Practices," Rule 1120-2-.10 (4), states, "An interim appointment is an appointment to a full-time career service position for a period of service not to exceed one (1) year." Rule 1120-2-.10 (3) states, "An emergency appointment is an appointment to a full-time career service position for a period of service not to exceed one hundred twenty (120) days and may be made when conditions exist that necessitate an immediate short term appointment." The positions of the interim employees included an Executive Assistant, hired January 28, 2002; a Housing Intake Coordinator/Spanish Interpreter, hired July 30, 2001; and a Title VI Coordinator, hired February 1, 2002. The Title VI Coordinator resigned February 25, 2003, and the Executive Assistant resigned July 1, 2003. The Budget/Personnel Coordinator was hired March 16, 2001, as an emergency appointment, and on June 1, 2001, he was given an interim appointment. Discussions with agency personnel revealed that the person hired as the Title VI Coordinator was the sister-in-law of the then Executive Director. The personnel file of this person also did not contain an employment application. As a result, the auditors could not determine whether this person met the minimum qualifications for the position held.

According to the above rules, the commission may grant regular appointments in these positions using the certificate of eligibles (register) from which the interim appointments were selected, provided:

(a) the employees were within the original top five (5) eligibles on an employment certificate or the original top three (3) eligibles on a promotional certificate,

(b) the rules for contacting eligibles were followed and eligible applicants on the register at the time of the interim appointments were notified that the interim appointments could change to regular appointments at a later time.

Based on testwork performed, the commission did not always hire interims based on the criteria noted because employees were not hired from the top five eligibles. By not following proper employment practices, the commission has not complied with rules established by the Department of Personnel and may hire ineligible applicants and give the appearance of favoritism in hiring.

In addition, as noted in a prior audit finding, the commission did not comply with its job performance evaluation policy requiring annual performance evaluations. Also, employees did not always receive an annual evaluation in accordance with Department of Personnel policy. The former Executive Director concurred with the prior audit finding and stated that "the agency is utilizing the Department of Personnel's annual evaluation system." The system referred to by the former Executive Director is the Department of Personnel's *Performance Evaluation Cycle Status Report,* which identifies those employees requiring an evaluation. The commission's Director of Personnel receives this report on a quarterly basis from the Department of Personnel; however, it does not appear that the Director of Personnel is effectively using this report to identify those employees needing evaluations, as many employees still are not receiving annual evaluations.

Eleven of 14 personnel files of employees required to have annual performance evaluations (79%) disclosed that employees had not always received annual evaluations. Department of Personnel Rule 1120-5-.01, "Job Performance Planning and Evaluation," states that the purpose of job performance evaluation is "to promote employee development, enhance employee productivity, serve as a basis for sound personnel decisions, and provide a permanent record of the performance of major duties and responsibilities for employees in the State service." To maintain and improve job performance and to properly consider individuals for merit increases and promotions, the department needs to evaluate employees regularly.

Other problems noted include the following:

a. Four of 22 leave authorization forms requested (18%) were not provided. Time cards showed employees had not clocked in for attendance, yet during fieldwork, no one could provide a leave authorization form documenting that the employees actually took leave for the missed day of work. Subsequent to fieldwork by the auditors, the Director of Personnel obtained leave authorizations for two employees, and that leave was deducted from their leave balance. However, the other two employees had terminated employment with the commission.

b. Seven of 17 employee time cards tested (41%) showed that employees were permitted to handwrite time on time cards and were not required to have the time cards approved and initialed by a supervisor. These same time cards showed that employees also repeatedly worked through lunch hours without clocking out.

If employees are allowed to handwrite on time cards and not use the time clock and are not required to turn in leave authorization forms, employees may be paid for time not worked.

Recommendation

The Executive Director should comply with the employment practices established by the Department of Personnel governing interim and emergency employees. Employees who have exceeded the time limit should be terminated, and regular appointments should be pursued.

Also, the Executive Director should ensure that all applicable employees are evaluated on an annual basis. These evaluations should be promptly forwarded to the Department of Personnel to ensure that the *Performance Evaluation Cycle Status Report* is updated promptly.

Management should establish and enforce policies regarding time cards, clocking out for lunch periods, and obtaining leave authorizations in a timely manner.

Management's Comment

We concur. The present Executive Director presented a "turnaround" plan to the Government Operations Committee in September 2003 in response to the 2003 Performance Audit. The above findings were noted in that audit. As of October 2003, all interim employee situations were rectified. The Commission has complied with all employment practices established by the Department of Personnel.

The Personnel Officer is required to notify each supervisor of upcoming due dates of evaluations and required to notify the Executive Director when a supervisor has not turned in an evaluation.

New policies and procedures have been established for time and attendance and leave authorization. There are two timekeepers for the agency. As of August 2003, the agency eliminated the use of time clocks and began utilizing a Department of Personnel approved Leave and Attendance form. Each employee is required to obtain approval of leave through the use of a Leave Authorization form that requires the supervisor's signature. If leave has been authorized during any pay period, the form must accompany the employee's timesheet at the end of the pay period.

EQUIPMENT

The objectives of our review of the equipment controls and procedures were to determine whether

- controls over equipment appeared adequate;
- access to the Property of the State of Tennessee (POST) system was properly restricted;
- equipment on the POST inventory listing could be physically located or confirmed, and the description, tag number, serial number, and location in POST were correct;
- office items traced to the POST inventory listing were in agreement with pertinent data;
- State of Tennessee Accounting and Reporting System (STARS) expenditures for the audit period reconciled to items added to POST;
- physical security over equipment items was adequate; and
- procedures for lost or stolen equipment were followed, including informing the Comptroller's Office and deleting the equipment from the POST system in a timely manner.

We interviewed key commission employees to gain an understanding of procedures and controls over equipment. We obtained a listing of employees with access to the POST system to determine if the person was an employee as of the date of the listing and if the employee's job duties required the level of access given. A nonstatistical sample of equipment items on the POST inventory listing was tested to determine if the equipment could be physically located or confirmed and whether the description, tag number, serial number, and location in POST were correct. Equipment located in the central office and field offices was traced back to POST for agreement of pertinent data. Documentation supporting lost or stolen property was reviewed to see if proper procedures were followed, including informing the Comptroller's Office and deleting the equipment from the POST system.

Based on our interviews, reviews of supporting documentation, and testwork, we determined that although physical security over equipment appeared adequate, controls over equipment were not adequate. One equipment item could not be physically located or confirmed, and a tag was not attached to another equipment item. In addition, the tag number, serial number, and location of some equipment in POST were incorrect. Equipment located in the central office and field offices did not always agree with pertinent data in POST. Also, equipment reported as stolen had been reported to the Comptroller's Office in January 2001, as noted in the prior audit; however, it still had not been removed from the POST system. In addition, a former employee's access to the POST system had not been terminated. See finding 5.

5. <u>Controls over equipment still need to be strengthened, and access to the property system needs to be terminated in a timely manner</u>

Finding

As noted in the two prior audit reports, the Tennessee Human Rights Commission needs to strengthen controls over equipment. Also, access to the Property of the State of Tennessee (POST) system by former employees needs to be terminated in a timely manner. The former Executive Director concurred with the prior audit finding and stated that the agency was taking affirmative steps to ensure that all equipment was tagged and listed on POST. In addition, the Executive Director subsequently submitted a report of action in response to the prior audit finding and stated, "Management has taken steps to ensure the proper recording of all equipment on the State of Tennessee System (POST). All equipment has also been inventoried and properly tagged."

However, testwork performed on a sample of 25 equipment items revealed the following discrepancies, some of which are the same items noted in the prior audit finding:

- one item tested (4%) could not be located,
- a tag was not affixed to one item (4%), and
- the actual location of four items (16%) did not agree with the location shown on POST.

Auditors noted the following discrepancies while observing equipment at the Nashville, Memphis, and Knoxville offices:

- 2 of 15 items observed (13%) were not listed on POST and did not have state tags affixed to them;
- 2 of 15 items observed (13%) had serial numbers that did not agree with the serial numbers listed on POST;

- 5 of 15 items observed (33%) were physically located in a place other than the location shown on POST;
- one of 15 items observed and recorded on POST (7%) had a state tag and serial number that did not agree with the numbers listed on POST; and
- 2 items were reported stolen during the period January 27-29, 2001, but these items have not been removed from POST.

Although the Department of General Services and the Tennessee Human Rights Commission have policies and procedures for personnel to follow in maintaining proper control and accountability over equipment, the commission has not followed these procedures. The commission's inventory records are inaccurate because location changes and other events are not properly documented. Failure to follow prescribed procedures and not adequately segregating access to the POST system also increases the risk of items being stolen without detection. In addition, inventory valuations may not be proper because of the inaccuracies in equipment recordkeeping.

Also, the Budget/Personnel Coordinator left the employment of the Tennessee Human Rights Commission in March 2001. However, as of May 2003, this employee still had access to POST.

Recommendation

The Executive Director should take steps to ensure that all equipment items are accurately recorded on the Property of the State of Tennessee (POST) system and that transfer documentation is completed and POST is updated each time equipment location changes or errors are detected. POST should also be updated in a timely manner when equipment is lost or stolen. All equipment should be tagged and properly identified in the property records. Also, requests for termination of access to POST should be prepared in a timely manner, and appropriate follow-up action should be taken by the agency to ensure that the requested system access termination has been performed.

Management's Comment

We concur. The designated Property Officer has reviewed the inventory list for the Tennessee Human Rights Commission and signed off that all equipment is in its proper location and tagged appropriately. Management has taken steps to ensure that termination of access to the Property of the State of Tennessee (POST) is completed in a timely manner.

FINANCIAL INTEGRITY ACT

Section 9-18-104, *Tennessee Code Annotated*, requires the head of each executive agency to submit a letter acknowledging responsibility for maintaining the internal control system of the agency to the Commissioner of Finance and Administration and the Comptroller of the Treasury by June 30 each year.

Our objective was to determine whether the commission's June 30, 2003, and June 30, 2002, responsibility letters were filed in compliance with Section 9-18-104, *Tennessee Code Annotated.*

We reviewed the June 30, 2003, and June 30, 2002, responsibility letters submitted to the Comptroller of the Treasury and to the Department of Finance and Administration to determine adherence to the submission deadline. We determined that the June 30, 2002, Financial Integrity Act responsibility letter was submitted 25 days late, and the June 30, 2003, Financial Integrity Act responsibility letter was submitted on time.

OBSERVATIONS AND COMMENTS

AUDIT COMMITTEE RECOMMENDED

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

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

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

At a minimum, audit committees should:

1. Develop a written charter that addresses the audit committee's purpose and mission, which should be, at a minimum, to assist the board in its oversight of the agency.
2. Formally reiterate, on a regular basis, to the board, agency management, and staff their responsibilities for preventing, detecting, and reporting fraud, waste, and abuse.
3. Serve as a facilitator of any audits or investigations of the agency, including advising auditors and investigators of any information they may receive or otherwise note regarding risks of fraud or weaknesses in the agency's internal controls; reviewing with the auditors any findings or other matters noted by the auditors during audit engagements; working with the agency management and staff to ensure implementation of audit recommendations; and assisting in the resolution of any problems the auditors may have with cooperation from agency management or staff.
4. Develop a formal process for assessing the risk of fraud at the agency, including documentation of the results of the assessments and assuring that internal controls are in place to adequately mitigate those risks.
5. Develop and communicate to staff of the agency their responsibilities to report allegations of fraud, waste, or abuse at the agency to the committee and the Comptroller's Office as well as a process for immediately reporting such information.
6. Immediately inform the Comptroller of the Treasury's Office when fraud is detected.
7. Develop and communicate to the board, agency management, and staff a written code of conduct reminding those individuals of the public nature of the agency and the need for all to maintain the highest level of integrity with regard to the financial operations and any related financial reporting responsibilities of the agency; to avoid preparing or issuing fraudulent or misleading financial reports or other information; to protect agency assets from fraud, waste, and abuse; to comply with all relevant laws, rules, policies and procedures; and to avoid engaging in activities which would otherwise bring dishonor to the agency.

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

1. The audit committee should be a standing committee of the board.
2. The audit committee should be composed of at least three members. The chair of the audit committee should preferably have some accounting or financial management background. Each member of the audit committee should have an adequate

background and education to allow a reasonable understanding of the information presented in the financial reports of the agency and the comments of auditors with regard to internal control and compliance findings and other issues.

3. The members of the audit committee must be independent from any appearances of other interests that are in conflict with their duties as members of the audit committee.
4. An express recognition that the board, the audit committee, and the management and staff of the agency are responsible for taking all reasonable steps to prevent, detect, and report fraud, waste, and abuse.
5. The audit committee should meet regularly throughout the year. The audit committee can meet by telephone, if that is permissible for other committees. However, the audit committee is strongly urged to meet at least once a year in person. Members of the audit committee may be members of other standing committees of the board, but the audit committee meetings should be separate from the meetings of other committees of the board.
6. The audit committee should record minutes of its meetings.

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

TITLE VI OF THE CIVIL RIGHTS ACT OF 1964

Section 4-21-901, *Tennessee Code Annotated*, requires each state governmental entity subject to the requirements of Title VI of the Civil Rights Act of 1964 to submit an annual Title VI compliance report and implementation plan to the Department of Audit by June 30 each year. The Tennessee Human Rights Commission filed its 2001, 2002, and 2003 compliance reports and implementation plans on June 28, 2001; June 29, 2002; and June 27, 2003, respectively.

Title VI of the Civil Rights Act of 1964 is a federal law. The act requires all state agencies receiving federal money to develop and implement plans to ensure that no person shall, on the grounds of race, color, or origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal funds. The Tennessee Title VI Compliance Commission is responsible for monitoring and enforcement of Title VI." A summary of the dates state agencies filed their annual Title VI compliance reports and implementation plans is presented in the special report *Submission of Title VI Implementation Plans*, issued annually by the Comptroller of the Treasury.

APPENDIX

ALLOTMENT CODES

The Tennessee Human Rights Commission allotment code is 316.04.