Department of Education

December 2004

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John G. Morgan
Comptroller

December 21, 2004

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable Lana C. Seivers, Commissioner
Department of Education
Suite 600, Andrew Johnson Tower
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Department of Education for the period July 1, 2002, through March 31, 2004.

The review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements 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/th
04/059

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COMPTROLLER OF THE TREASURY
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April 15, 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 Department of Education for the period July 1, 2002, through March 31, 2004.

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. These standards require that we obtain an understanding of internal control significant to the audit objectives and that we design the audit to provide reasonable assurance of the Department of Education's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Department of Education is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

Our audit disclosed certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. The department'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 department's internal control and/or instances of noncompliance to the Department of Education's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/th

State of Tennessee

A u d i t H i g h l i g h t s

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit
Department of Education
December 2004

AUDIT SCOPE

We have audited the Department of Education for the period July 1, 2002, through March 31, 2004. Our audit scope included a review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements in the areas of equipment, payroll and personnel, cash receipts, travel claims, petty cash bank accounts and trust funds, Executive Order No. 3, grant contracts, the Coordinated School Health Program, and the Financial Integrity Act. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

AUDIT FINDINGS

Inadequate Equipment Controls
The department has not maintained adequate controls over equipment, nor has it adequately updated the Property of the State of Tennessee system to reflect accurate equipment information (page 4).

Unauthorized Account at WTSD
The West Tennessee School for the Deaf was operating an unauthorized bank account (page 10).

Inadequate Contract Controls
The department failed to approve contracts before the beginning of the contract period (page 17).

Performance Evaluations Not Being Performed
The department has not complied with the Department of Personnel's policies requiring periodic employee performance evaluations (page 7).

Inadequate CSHP Expenditure Controls
The Coordinated School Health Program's expenditures were missing supporting documentation and included questionable expenditures (page 18).

Financial and Compliance Audit
Department of Education

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INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Department of Education. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which requires 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

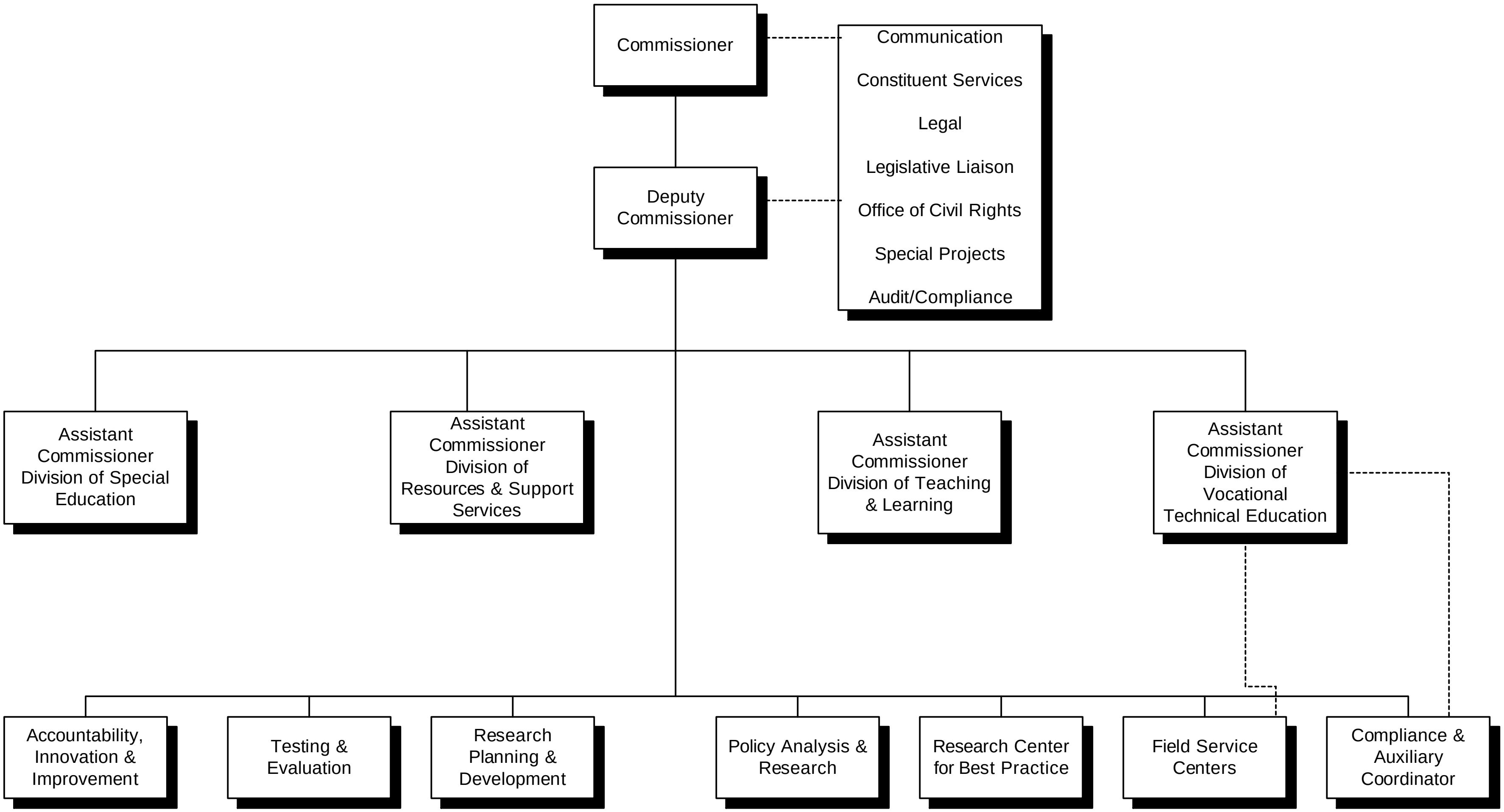
The mission of the Department of Education is to assist school districts in their efforts to ensure equal educational opportunities for all children in Tennessee and equip them with the skills necessary to succeed in higher education, the workplace, and society. The department fulfills this mission through four major divisions: the Division of Teaching and Learning, the Division of Special Education, the Division of Vocational Education, and the Division of Resources and Support Services.

The department provides technical assistance and monitoring on a statewide basis through its central office and nine field service centers. The department allocates state and federal funds to 136 public school districts in Tennessee, which annually serve approximately 973,000 students and employ more than 67,000 teachers and administrators.

The department also operates four state special schools. These are the Alvin C. York Agricultural Institute, a model rural high school in Jamestown; the Tennessee School for the Blind in Nashville; the Tennessee School for the Deaf in Knoxville; and the West Tennessee School for the Deaf in Jackson.

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

Tennessee Department of Education



AUDIT SCOPE

We have audited the Department of Education for the period July 1, 2002, through March 31, 2004. Our audit scope included a review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements in the areas of equipment, payroll and personnel, cash receipts, travel claims, petty cash bank accounts and trust funds, Executive Order No. 3, grant contracts, the Coordinated School Health Program, and the Financial Integrity Act. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

EQUIPMENT

Our objectives for reviewing equipment controls and procedures were to determine whether

- policies and procedures regarding equipment were adequate;
- property and equipment were adequately safeguarded;
- equipment information is properly recorded in the Property of the State of Tennessee listing (POST);
- POST access granted to department employees was appropriately documented, approved, and appeared reasonable, based on the types of duties the employees performed; and
- lost or stolen equipment, reported to the Comptroller of the Treasury, was removed from POST.

We interviewed key department personnel and reviewed supporting documentation to gain an understanding of the department's procedures and controls over equipment and whether the property and equipment were adequately safeguarded. We selected four nonstatistical samples of equipment from POST to determine whether the equipment information was properly recorded. Equipment information included state tag number, description, location, and serial number. Equipment items were physically observed at the Andrew Johnson Building, Tennessee School for the Blind, and the West Tennessee School for the Deaf; equipment confirmations were used for other locations. We accessed POST to determine which employees were recognized users and to determine these employees' level of access. We reviewed the documentation authorizing these employees to determine whether the access appeared reasonable, based on the types of duties the employees performed. We examined the listing of equipment from POST to determine whether the lost or stolen equipment reported to the Comptroller of the Treasury had been removed.

Based on our interviews and reviews of supporting documentation, we determined that policies and procedures regarding equipment were adequate and property and equipment were adequately safeguarded. Based on our testwork, we determined that POST access granted to department employees was appropriately documented, approved, and appeared reasonable based on the types of duties the employees performed. Also, lost or stolen equipment reported to the Comptroller of the Treasury had been removed from POST. However, equipment information was not properly recorded in POST (see finding 1).

1. <u>Equipment information was not accurately reflected in POST</u>

Finding

The Department of Education has not maintained adequate controls over equipment, nor has it adequately updated the Property of the State of Tennessee (POST) system to reflect accurate equipment information. The department uses POST to maintain its equipment information such as descriptions, serial numbers, state tag numbers, acquisition costs, locations, dates of acquisition, funding sources, etc. Testwork on 175 equipment items revealed the following problems:

- Four items (2%) could not be located. These items include two computers, a printer, and a videocassette recorder.

- Eight items (5%) could not be traced to POST. All of these items were tagged as state equipment; however, they were not recorded in POST. These items include a digital camera, television, printer, and sewing machine.

- Seventeen items (10%) were not tagged to identify them as state equipment. These items include computers, digital cameras, and printers.

- Twenty-seven items (15%) did not have inventory bar codes affixed to the equipment. The department scans these bar codes when conducting the annual inventory. If the equipment does not have a bar code, then the item is manually added to the inventory, which can lead to additional errors. These items include printers, televisions, digital cameras, and computers.

- Seven items (4%) had an incorrect serial number recorded in POST. These items include a scanner, digital camera, computer, and printer.

- Eleven items (6%) did not have the correct description recorded in POST. These items include a piano, cameras, and printer.

- Six items (3%) did not have the correct location code recorded in POST. These items include printers and a learning module.

- One external tape drive was tagged under a tag number that was assigned to another piece of equipment.

Using computer-assisted audit techniques (CAATs), 26 of 4,794 equipment items assigned to the Department of Education (0.5%) were identified as not having a serial number recorded in POST. These items include televisions, computers, and videocassette recorders. Additional CAAT procedures revealed some location coding errors. Due to a keying error, one location code was used even though the department had no equipment at that location. Also, two location codes for the Tennessee Infant Parent Services schools were not listed in POST.

The Department of General Services' rules for adding an asset to POST, Appendix B – Basic Requirements for Additions, Part B, states that "items purchased with an object code of 099 with a cost between $100.00 and $5,000.00 . . . are sensitive items." Sensitive equipment includes 35 millimeter and digital camera bodies; computers; external computer peripherals, such as printers, external tape drives, scanners, etc.; televisions; and video recorders and players.

Testwork relating to POST access revealed that 8 of 48 departmental employees with access to POST (17%) were no longer employed by the department. According to the Office of Information Resources' *Information Technology Standards,* under Security Procedures, "on the last day of employment or as soon as possible thereafter, managers should . . . revoke [the] State ID and submit a request to remove the User account."

When proper equipment records are not accurately maintained, the probability increases that equipment will be lost or stolen and not be detected. When access to POST is not properly controlled, the risk increases that an unauthorized user could make changes to the records.

Recommendation

The department's property officer should ensure that all equipment items are recorded in POST and that the information in POST is accurate and up-to-date. The correct location information, descriptions, serial numbers, and other information should be promptly recorded in POST. Individual sensitive equipment items should be assigned different tag numbers. All equipment should be properly identified with the state tag number and a bar code sticker. In addition, the POST access listing should be reviewed periodically to remove individuals who are no longer employed by the department.

Management's Comment

We concur. To improve compliance, property management duties have been reassigned within the department.

PAYROLL AND PERSONNEL

Our objectives for reviewing payroll and personnel controls and procedures were to determine whether

- policies and procedures regarding payroll and personnel were adequate;
- payroll disbursements were authorized, adequately supported, and properly calculated;
- annual, compensatory, and sick leave were earned and taken in accordance with Department of Personnel guidelines;
- State Employee Information System (SEIS) access granted to department employees was appropriately documented, approved, and appeared reasonable based on the types of duties the employees performed;
- annual performance evaluations were given in accordance with Department of Personnel guidelines; and
- overtime was approved.

We interviewed key department personnel and reviewed supporting documentation to gain an understanding of the department's procedures and controls over payroll and personnel. We also tested a nonstatistical sample of payroll transactions from the audit period to determine whether payroll disbursements were authorized, adequately supported, and properly calculated; and annual, compensatory, and sick leave were earned and taken in accordance with Department of Personnel guidelines. We accessed SEIS to determine which employees were recognized users and to determine these employees' level of access. We reviewed the documentation authorizing these employees to access SEIS and compared the employees' level of access to the employees' job description. We also reviewed annual performance evaluations to determine whether they were given in accordance with Department of Personnel guidelines. We selected a nonstatistical sample of individuals who received overtime pay to determine whether the overtime was approved.

Based on our interviews and reviews of supporting documentation, we determined that policies and procedures regarding payroll and personnel were adequate. Based on our testwork, we determined that payroll disbursements were authorized, adequately supported, and properly calculated; leave was earned and taken in accordance with Department of Personnel guidelines; SEIS access granted to department employees was appropriately documented, approved, and appeared reasonable based on the types of duties the employees performed; and overtime was fully approved. However, annual performance evaluations were not given in accordance with Department of Personnel guidelines (see finding 2).

2. **<u>Performance evaluations were not performed in compliance with written rules or regulations</u>**

Finding

The Department of Education has not complied with the Department of Personnel's policies requiring periodic employee performance evaluations. The Department of Personnel's policies require that each career service employee's performance be evaluated at least once every 12 months. A review of 25 personnel files for employees with evaluations due during the period July 1, 2002, through February 24, 2004, disclosed that 16 employees (64%) had not been evaluated in the last 12 months and/or had received an evaluation after the due date.

- Twelve of the 16 employees had not been evaluated in the last 12 months. The number of months since the last evaluation ranged from 20 to 110 months, with an average of 59 months. Eight of these 12 employees received their last evaluation anywhere from 3 to 184 days after the due date, with an average of 80 days after the due date.

- Four of the 16 employees were evaluated in the last 12 months but received their evaluations after the due date. The number of days late ranged from 22 to 58 days, with an average of 35 days late.

Section 8-30-201(b), *Tennessee Code Annotated*, gives the Department of Personnel the responsibility of administering and improving a system of personnel administration. Section 8-30-202(a), *Tennessee Code Annotated*, states, "The commissioner, as executive head of the department of personnel, shall direct and supervise all its administrative and technical activities with respect to state service." According to the *Rules of the Tennessee Department of Personnel*, Chapter 1120-5-02, "Job Performance Planning and Evaluation," the evaluation periods "will be provided to the Department on dates and forms prescribed by the Commissioner."

The Department of Personnel uses reports from the State Employee Information System (SEIS) to notify other departments that performance evaluations need to be completed, that evaluations are approaching their due dates, or that evaluations are overdue. The Department of Education's Personnel Office examines these reports and informs the appropriate manager about the evaluations. However, based on the results of our review, management appears to not take appropriate and timely action on these reports.

The *Rules of the Tennessee Department of Personnel*, Chapter 1120-5-01, "Job Performance Planning and Evaluation," states that the purpose of job performance evaluations 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 promotions and resolve performance issues, the department needs to evaluate employees regularly.

Recommendation

The Commissioner of the Department of Education should ensure that the evaluation process is monitored to ensure that department supervisors are in compliance with the Department of Personnel's policies for employee performance evaluations.

Management's Comment

We concur. The department will enhance its monitoring system to improve compliance with Department of Personnel policies.

CASH RECEIPTS

Our objectives for reviewing cash receipts controls and procedures were to determine whether

- policies and procedures regarding cash receipts were adequate;
- cash was deposited promptly and intact, in accordance with the Department of Finance and Administration's (F&A) Policy 25 concerning deposit practices; and
- cash receipts transactions were properly recorded.

We interviewed key department personnel and reviewed supporting documentation to gain an understanding of the department's procedures and controls over cash receipts. We also tested a nonstatistical sample of cash receipts transactions during the audit period to determine whether cash was deposited promptly and intact, and the transaction was properly recorded.

Based on our interviews and reviews of supporting documentation, we determined that policies and procedures regarding cash receipts were adequate. Based on our testwork, we determined that cash was deposited promptly and intact in accordance with F&A Policy 25 and cash receipts transactions were properly recorded.

TRAVEL CLAIMS

Our objectives for reviewing travel claim controls and procedures were to determine whether

- policies and procedures regarding travel claims were adequate,
- travel claims were in compliance with the Department of Finance and Administration's (F&A) Policy 8 concerning the State of Tennessee's Comprehensive Travel Regulations, and
- travel claims were properly approved and appropriate.

We interviewed key department personnel and reviewed supporting documentation to gain an understanding of the department's policies and procedures regarding travel claims. We tested two nonstatistical samples of paid travel claims to determine whether the travel claims were in compliance with the state's travel regulations. We also tested both samples to determine whether travel claims were properly approved and appropriate.

Based on our interviews and reviews of supporting documentation, we determined that travel claim policies and procedures were adequate. Based on our testwork, we determined that travel claims were in compliance with F&A's Policy 8 and that travel claims were properly approved and appropriate.

PETTY CASH BANK ACCOUNTS AND TRUST FUNDS

Our objectives for reviewing the petty cash bank accounts and trust funds controls and procedures at the West Tennessee School for the Deaf in Jackson and the Tennessee School for the Blind in Nashville were to determine whether

- policies and procedures regarding the petty cash bank accounts and trust funds were adequate;
- normal operations of the petty cash bank accounts and trust funds (receipts, disbursements, and bank statement reconciliations) were handled in accordance with Finance and Administration (F&A) Policy 7, "Petty Cash and Departmental Bank Accounts";
- reimbursements to the petty cash bank account were handled in accordance with F&A Policy 7, "Petty Cash and Departmental Bank Accounts"; and
- policies and procedures regarding allocating interest to the various trust fund accounts were adequate and in accordance with F&A Policy 7.

We interviewed key department personnel and reviewed supporting documentation to gain an understanding of the department's policies and procedures regarding petty cash bank accounts and trust fund accounts at the two specialty schools. We selected nonstatistical samples of receipts and disbursements to determine whether these operations were handled in accordance with F&A Policy 7. We selected and tested two bank statement reconciliations to determine whether they were performed in accordance with F&A Policy 7. The bank statement reconciliations were for one month for each account. We tested all reimbursements to the petty cash bank accounts at both specialty schools to determine whether they were handled in compliance with F&A Policy 7. We interviewed key department personnel and reviewed supporting documentation to gain an understanding of the procedures and processes of allocating interest to the various trust fund accounts. We selected and tested one interest allocation at each specialty school to determine whether the interest allocation was in accordance with F&A Policy 7.

Based on our interviews and reviews of supporting documentation, we determined that the policies and procedures regarding the petty cash bank accounts, trust funds, and interest allocation to the various trust fund accounts were adequate. Based on our testwork, we determined that normal operations of the petty cash bank accounts and trust funds (receipts, disbursements, and bank statement reconciliations), reimbursements to the petty cash bank accounts, and interest allocation to the various trust fund accounts were handled in accordance with F&A Policy 7. However, we determined that the West Tennessee School for the Deaf in Jackson was operating an unauthorized bank account (see finding 3).

3. The West Tennessee School for the Deaf operated an unauthorized bank account

Finding

During our initial fieldwork at the West Tennessee School for the Deaf (WTSD), we discovered a bank account that had not been authorized as a departmental bank account in accordance with Department of Finance and Administration (F&A) Policy 7, "Petty Cash and Departmental Bank Accounts."

The account was discovered when the auditors asked the school's business officer to complete a "Disclosure of Bank Accounts Form," which asks for both official and unofficial bank accounts. The disclosure form showed a petty cash bank account; a trust account; and a Parent, Teacher, Counselor (PTC) account. A listing of departmental bank accounts from F&A did not indicate the existence of the PTC account. School management admitted that this account was unofficial. According to the bank statement, the account's tax identification number matched the number assigned to the State of Tennessee. Initial inquiries concerning this account indicated that school personnel exercised all control over this account in the following ways:

- the account's custodian was a school employee,
- school personnel were the authorized signers for this account,
- money was received for this account at the school and was included in the school's mail log,
- school personnel completed the written receipts,
- the bank statements were mailed to the school, and
- school personnel retained all supporting documentation for disbursements and deposits at the school.

The account received funds from donations and from services the school offers. The account was used for purchases related to school and student functions, such as in-service activities, field trips, and assistance for needy students. Similar transactions at the Tennessee School for the Blind are processed through a subsidiary account of the trust account. According to the bank statements, the PTC account had deposits of $12,276.96 and withdrawals of $11,667.54 during the period July 1, 2002, through December 31, 2003.

The existence of such an account raises serious internal control and fraud risk issues. The policies governing departmental bank accounts are not just bureaucratic technicalities that can be disregarded as being too cumbersome. Too often, such accounts result in serious legal issues and result in very negative consequences for all who are involved in the administration of the accounts and/or those in management positions who have knowledge of the accounts. Such accounts can be created with good intentions, to provide additional "flexibility" for meeting the perceived needs of the agency's clients. However, due to the murky nature of the accounts and the lack of clear rules about their administration, it is too easy for the funds in the account to be abused and converted to personal use. Often this is a gradual process, with more liberties being taken over time. When payments are made from the account on a regular basis without appropriate support such as receipts or other independently generated documentation, it reinforces a lax attitude that can lead very quickly to abuse. Furthermore, practically any type of transaction that is truly appropriate for the needs of an agency's clientele can be processed through the legitimate bank accounts. There is no need to have separate bank accounts in order to effectively account for funds from different sources or to be used for different clients or purposes. Of course, adequate records must be maintained to reflect those funds and their use. But to create a separate bank account is inappropriate.

In light of the discovery of this unauthorized bank account and the risk of fraud that such an account presents, the auditors returned to conduct additional interviews and to obtain additional information about the bank account, including direct communications with the bank.

Agency staff cooperated fully with our enhanced review of the bank account, as did officials of the bank.

Our interviews included the primary custodian of the account and her immediate supervisor, as well as teachers and others who had received checks from the account. We also reviewed every check that had been issued from the account for the period July 1, 2002, through September 4, 2004. Since the school only had the copies of the fronts of the checks as returned to the school from the bank, we requested the original checks from the bank so that we could examine the endorsement side of the check to determine that the check was actually negotiated by the individual presented as the payee.

Our interviews determined that the account had been open for more than 15 years. It had begun as part of an effort by a former superintendent to encourage more dialogue between the school and the parents or guardians of the students. There was an informal association of parents established, although it was never converted into a formal not-for-profit entity. As part of the activities of the association, the bank account was opened to collect donations from parents and others to be used on behalf of students who did not have enough money to participate in activities such as field trips. It was felt, appropriately, by leadership of the school that it would be unfair for a child going to the school to be denied the opportunity to participate in such events just because the child did not have enough money.

Apparently there was always a support staff person who actually handled the day-to-day management of the bank account. The present custodian of the account assumed that role in 1999, and the administrator has been at the school since it was started in 1986.

Our extensive review of the activity in the account did not disclose any evidence of embezzlement of funds from the account. However, the laxity of the administration of the account, including the signing of blank checks and the lack of complete documentation for all transactions, prevents a definitive conclusion that there was no abuse of the funds. It is for this very reason that it is essential that officials in government offices take all steps to ensure that funds are not placed in unauthorized bank accounts. The cloud resulting from the lack of documentation and procedures is practically impossible to remove. In addition, the establishment and maintenance of such an account can contribute to an overall attitude in the entity that rules are made to be broken and that the ends justify the means.

Although this bank account was unauthorized by the Department of Education, it was not a secret account that no one at the school knew about. This factor supports the proposition that the account was not subjected to serious abuse. When an unauthorized bank account is also known to only a few people, then the risks of fraud are dramatically magnified. Not only is such an account not subject to the review of auditors and to the powerful compensating effect of openness, but such an account is actually hidden from view. Any transactions based on concealment are not only contrary to the concept of government transparency, but involve intentions that are less than pure.

During our interviews with the supervisor of the account, we recommended that he immediately close the account and transfer the funds into the authorized trust account. The school can retain the identity of expenditures made for individual children through subsidiary ledgers. The supervisor was totally in support of our recommendations and said that he would immediately close the account and transfer the funds into the trust bank account.

Other test work related to the authorized petty cash and trust account at the WTSD did not result in any reportable conditions. Our examination covered the operations (receipting, disbursements, and bank account reconciliation) related to these authorized accounts.

In 2002, the American Institute of Certified Public Accountants (AICPA) promulgated a new auditing standard relative to fraud detection and prevention. This is not the institute's first effort to improve the public's confidence in the financial operations of organizations in the United States. However, it contains some critical new measures. In addition, in the wake of the highly publicized frauds and abuses in major corporations, other measures, such as the Sarbanes-Oxley Act, have been enacted to attempt to increase the diligence of auditors and management with regard to fraud. Although the auditing standards do apply to government audits, the

Sarbanes-Oxley Act only applies to publicly traded companies. Still, both actions are consistent in their approach to fraud and provide excellent guidance to all who are engaged in financial operations.

As part of the efforts of this office in effectuating the letter and spirit of these reforms, we are obtaining from management of state departments and agencies more assurances that they are taking all appropriate steps to ensure that their organizations have effectively designed and operated internal controls and that they have performed an effective self-assessment of the risk of fraud in their organization. After all, auditors cannot prevent fraud. It is the duty of the people in positions of trust and responsibility, who are given the power by their positions, to protect their organization and the assets provided by the taxpayers from fraud, waste, and abuse.

Management, and boards, when part of the structure of an organization, have often tried to avoid these responsibilities by pointing out that they cannot stop what they don't know. If staff under them decides to act inappropriately, how are they to know? Well, having no knowledge about something is not the same thing as having no responsibility to know. To effectively fight fraud, it is essential that management take proactive steps to assure themselves that they have made it clear to staff that they are to be apprised of departures from controls or breakdowns of controls. Furthermore, management should monitor the activities of their respective organizations to assure themselves that they are being given accurate information by staff. It should no longer be acceptable for management to say that they just didn't know what was going on. They may not have actual knowledge, but the test is, what should the management of an organization know about the operations and integrity of their organization? What good-faith steps did they take to obtain pertinent information? What did they know, and how did they utilize that knowledge to meet their responsibilities to the taxpayers? And that information includes findings and other weaknesses identified by all parties, including auditors, internal and external, as well as the results of their own risk assessment. Such an assessment may be facilitated by staff, but it has to be, in the final analysis, the independent assessment of management. They have to fully understand what the assessment involved, whether it was comprehensive enough and what it found. And they have to implement effective mitigating controls and ensure that these controls are functioning as planned. Finally, in Tennessee this responsibility has long been recognized. *Tennessee Code Annotated*, Section 9-18-101, requires each agency of state government to establish, maintain, and periodically evaluate adequate internal accounting and administrative controls. Neither the statute nor the public should expect that this knowledge should just be passive. The excuse from Wall Street to Main Street is always ignorance of the facts. Unfortunately, it has been too easy for responsible parties to turn their heads to avoid seeing the problem. This is true even when management concurs with audit findings, particularly when they promise that their corrective actions will include compensating controls, such as management overview, when there are not enough staff to adequately segregate duties. Such a commitment is not just made to the auditors; it is made to the taxpayers as well.

Included in our recommendations is the point that management of the school and the Department of Education should take appropriate steps to ensure that they have assessed the risk of fraud, waste, and abuse as they should, considering the responsibilities of their positions. Hopefully, the additional audit work that was required due to the operation of this unauthorized bank account will help management and staff to take a sober look at their operations and be proactive in their pursuit of good internal controls and integrity in government.

Test work related to the receipt, disbursement, and bank statement reconciliation processes revealed some internal control deficiencies. First, receipts were only completed when checks were delivered in person. Second, supporting documentation was not available for 11 of 25 disbursements tested (44%). One of the 11 disbursements was for an advance to a school employee. A receipt could not be provided to support the actual amount spent and to determine whether any excess amount should have been returned to the account. Third, no supporting documentation could be provided to indicate whether this account had ever been reconciled to the bank statements. During the months of February 2003 through December 2003, the account was charged approximately $80.00 in service charges. According to the bank statements, these were the only service charges during the audit period. Fourth, cancelled checks were not received with the bank statements. However, the bank statements included scanned copies of the front of the checks. Fifth, interest was not being earned on this account.

According to the Department of Finance and Administration's Policy 7, "bank accounts are established in accordance with T.C.A. 9-4-302 when authorized by the Commissioner of Finance and Administration, upon the approval of the Governor and the Treasurer." Section 07-02-401, *Tennessee Code Annotated*, states that "making advances from any departmental bank account is prohibited." Section 07-02-302, *Tennessee Code Annotated*, states that the account will "have a maximum balance on hand necessary to meet normal activity and to provide for liquidity needs. Balances in excess of normal monthly activity and liquidity needs are to be invested by the department." In addition, according to Section 07-02-404, "Account Reconciliation and Reporting,"

> it is the responsibility of the department or agency to ensure that proper internal controls over the operation of the departmental bank account and segregation of duties are established. Documentation of all transactions (including but not limited to all monthly bank statements, receipts, cancelled checks, and reimbursement requests) must be retained by the department for audit purposes.

Furthermore, the section states that "bank reconciliations are to be performed promptly each month upon receipt of the bank statement by an employee of the department or agency not responsible for cash receipts or disbursements." Also, Section 07-02-405 allows and addresses the allocation of earned interest in trust accounts.

By having an unapproved account, there is no public accountability to the donors and constituents whom these funds are intended to serve.

Recommendation

The superintendent of the school should ensure that the business officer promptly completes the closing of the unauthorized bank account and the transfer of the funds from that account to the authorized trust account. The superintendent and top management of the school should use this finding as an example to all staff of the school of their responsibilities to prevent fraud, waste, and abuse and to ensure that their operations are being conducted pursuant to applicable laws, rules, regulations, and policies. This would include advising upper management of any circumventions or exceptions to internal controls, and establishing the proper controls over the trust bank account to, among other things, properly account for transactions and funds of individual students. The principal and other management of the school should establish a process for regularly assessing the risk of fraud, waste, and abuse at the school. They should document the process, its conclusions, and any steps necessary to address those risks.

The Department of Education staff responsible for the operations of the school should review the finding with the administration of the school and provide whatever technical assistance is necessary to address the issues raised in this audit.

The Department of Education staff responsible for other special schools in Tennessee should also take steps to immediately determine whether there are any other unauthorized bank accounts at any of the schools, or if there have been any such accounts at the schools. If there are or were such accounts, the department staff should determine the facts surrounding the approval, establishment, and operation of the bank accounts. The staff should examine the transactions of the bank account to determine whether there are indications of fraud, waste, or abuse. If any such accounts are active, they should be immediately closed, and the funds in the accounts should be appropriately accounted for. The staff should document their findings and recommendations relative to the accounts. The staff should advise the external auditors of their findings and recommendations. If the staff find indications of fraud, they should immediately notify the external auditors as required by state law.

The West Tennessee School for the Deaf should not maintain an unauthorized departmental bank account. The custodian should close this unofficial departmental bank account, and the transactions of this account should be handled through a subsidiary account of the trust account. WTSD’s Business Officer should ensure that any further transactions comply with the policies and procedures outlined in Department of Finance and Administration Policy 7.

Management’s Comment

We concur. The account has been closed and the funds are being accounted for in a subfund of the trust account. The department will also follow up with the other special schools to ensure there are no unauthorized bank accounts at the schools.

EXECUTIVE ORDER NO. 3

Executive Order No. 3 concerning ethics, conflict of interest, and acceptance of gifts was signed by Governor Phil Bredesen on February 3, 2003. Our objectives for reviewing the controls and procedures related to this executive order were to determine whether

- policies and procedures were adequate;
- executive service employees have completed the *State of Tennessee Ethics Policy Receipt Statement*; and
- the *State of Tennessee Ethics Policy Compliance Certification* was completed and submitted by January 31, 2004.

We interviewed key department personnel and reviewed supporting documentation to gain an understanding of the department's policies and procedures regarding this executive order. We selected a nonstatistical sample of executive service employees to determine whether the *State of Tennessee Ethics Policy Receipt Statement* had been completed. We also obtained the *State of Tennessee Ethics Policy Compliance Certification*, as completed by the Department of Education's Commissioner, to determine whether it was submitted timely.

Based on discussion with departmental employees, it was determined that policies and procedures related to Executive Order No. 3 were adequate. Based on our testwork, we determined that executive service employees completed the *State of Tennessee Ethics Policy Receipt Statement*, and the *State of Tennessee Ethics Policy Compliance Certification* was submitted timely.

GRANT CONTRACTS

Our objective for reviewing contracts was to determine whether policies and procedures for grant contracts are adequate and the grant contracts were fully approved before the effective date.

We interviewed key departmental employees to determine whether policies and procedures for grant contracts were adequate. We selected a nonstatistical sample of contracts to determine whether the contracts were fully approved before the effective date.

Based on our interviews and reviews of supporting documentation, we determined that the policies and procedures regarding grant contracts were adequate. Based on our testwork, we determined that contracts were not fully approved before the effective date (see finding 4).

4. <u>The department did not approve contracts before the beginning of the contract period</u>

Finding

The Department of Education did not approve contracts before the beginning of the contract period. Testwork revealed that the 25 contracts selected for review were approved 11 to 331 days after the beginning of the contract period (an average of 130 days late). According to management, these delays were caused by new program employees who were inexperienced in the contract awarding and approval process.

While no payments were made against a contract until it was fully approved, potential liabilities to the state occurred because the contracts were without proper authorization. Chapter 0620-3-3-.06(3) of the *Rules of the Department of Finance and Administration* states, "Upon approval by the Commissioner of Finance and Administration, a contract shall be fully approved." If contracts are not approved before the contract period begins and before services are rendered, the state could be obligated to pay for unauthorized services.

Recommendation

The Contract Officer should develop and provide an overview training session of the contract awarding and approval process for new and/or inexperienced program staff. The overview should emphasize using contract templates; beginning the awarding process earlier; and other ideas to quicken the contract awarding and approving process.

Management's Comment

We concur. During planning for the 2005-06 contract year, the department will provide an overview training session for new and inexperienced program staff.

COORDINATED SCHOOL HEALTH PROGRAM

Our objectives for reviewing Coordinated School Health Program (CSHP) controls and procedures were to determine whether

- policies and procedures concerning CSHP expenditures were adequate, and
- program expenditures were appropriate and had adequate supporting documentation.

We interviewed key department personnel and reviewed supporting documentation to gain an understanding of the department's policies and procedures concerning the program's expenditures and operations. We examined the expenditure population for unusual items and selected a nonstatistical sample of expenditure transactions to determine whether program expenditures were appropriate and had adequate supporting documentation.

Based on our interviews and reviews of supporting documentation, we determined that policies and procedures concerning the program's expenditures were adequate. Based on our testwork, we determined that program expenditures did not always contain adequate supporting documentation and were not always appropriate (see finding 5).

5. Expenditures were not always adequately supported or properly charged to the Coordinated School Health Program

Finding

The Coordinated School Health Program (CSHP) is a state-funded program that promotes the improvement of the overall health and wellness of students. It was created by Chapter No. 554 of the Public Acts of 2000 and involves ten pilot programs located throughout the state. A sample of CSHP expenditures during the fiscal year ended June 30, 2003, was examined. Sections 49-1-1003 and 49-1-1005, *Tennessee Code Annotated*, indicate that CSHP funds should be used for grants to the pilot projects or administrative purposes. Testwork revealed the following problems:

- Toward the end of the fiscal year ended June 30, 2002, management realized that a substantial amount of appropriations were available for use by the pilot projects. The original intent was to amend the fiscal year ended June 30, 2002, grant contract, but because it was too late in the year to create an amendment, management decided to set up a separate contract. Thus, during the fiscal year ended June 30, 2003, the 10 local education agencies (LEAs) included in the pilot projects received a separate contract for $40,000, which was in addition to their annual contract. The term for the $40,000 contract was July 1, 2002, through June 30, 2003. Contract paragraph C.3, concerning payment methodology, requires the LEA to "submit invoices, in form and substance acceptable to the State, with all of the necessary supporting documentation, prior to any reimbursement of allowable costs." This paragraph also states that the LEA "shall be compensated for actual, reasonable, and necessary costs." Therefore, the LEAs receive funds on a reimbursement basis through these grant contracts. However, the only supporting documentation for the $40,000 grant payments which were processed by the department on September 9, 2002, and September 10, 2002, was a letter from each LEA requesting the money. The LEAs never provided support that they had incurred $40,000 worth of reasonable and necessary costs for the program. In addition, Section 49-1-1004(b), *Tennessee Code Annotated*, states, "the amount that each LEA is eligible to receive [from CSHP] shall be subject to a local match." However, the $40,000 grant contracts did not mention this requirement, and the grant budgets did not indicate any local match. The $400,000 represents 35.7% of the money given to the LEAs for the entire fiscal year ended June 30, 2003. Expenditures which were charged against the other grant contracts were supported with an invoice and other supporting documentation from the LEA, and the other grant contracts indicated and gave regulations concerning the local match requirement.

- The Office of School Health coordinates the state and federal school health programs. No cost center exists to accumulate the shared administrative expenditures so these expenditures are either charged to the state or federal program. No reallocation of these expenditures is made. Personnel for both state and federal programs are located at the Tennessee Preparatory School (TPS). Examples of administrative expenditures charged to CSHP are the salary and benefits of the office's director, copier usage fees, water fees, and some postage. The total salary and benefits of the office's director, $83,538.32, was charged against CSHP. However, this individual's normal job duties related to various programs, one of which was CSHP. Secondly, all of the copier charges paid during the fiscal year ended June 30, 2003, were charged to the CSHP and totaled $2,705.58. Bottled water is provided at TPS because of the poor quality of water from the drinking fountains. Although most of the employees at the TPS location are paid through the federal program, most of the $316.27 bottled water charges were paid through CSHP. Only one month's worth of charges at $24.95 were paid through the federal program. Lastly, the printing and mailing of an informational briefing concerning the new *Guidelines for Use of Health Care Professionals and Health Care Procedures in a School Setting* were charged to CSHP. This informational briefing was mailed to principals, school health supervisors, board members, school nurses, parents, and other education and health professionals across the state and not just to personnel involved with the pilot projects.

- The postal billing for the month of November 2002 totaled $910.59, while the total cost of postal billings during the fiscal year was $5,005.39. Examples of the mailings or mail recipient listings could not be provided for the November 2002 postal charges. Therefore, it could not be determined whether this billing was charged to the correct program. In addition, the amount of postage appears excessive considering that the program only has 11 contracts (10 contracts for the pilot projects and 1 contract for a program evaluation).

- Motor Vehicle Management (MVM) billings and travel claim reimbursements for the same types of trips were not consistently charged to the same program. From July 2002 through January 2003, an individual used a personal vehicle, instead of an MVM vehicle, for authorized travel and was reimbursed for these mileage amounts with federal funds. Upon returning from the travel, the individual was reimbursed for the incurred travel expenses (i.e., lodging, meals, and incidentals) with federal funds. From February through June 2003, this same individual used a state vehicle from MVM for traveling. However, the MVM billings were charged to CSHP, even though some of the purposes of these trips were the same as those of trips taken earlier in the year. For example, one MVM billing for the month of May 2003 included a trip to a Centers for Disease Control conference in Atlanta, Georgia. The "Request for Out-of-State Travel Authority" form indicated that a state vehicle would be used and that this travel would be 100% federally funded. After returning from the conference, the lodging, meals, and incidentals were charged to the federal program, while the usage of the MVM vehicle was charged to CSHP. This MVM billing totaled $178.00. Also, for three days in June 2003, this same individual accumulated another MVM charge for $72.00, which was charged to CSHP. However, the purposes of the trips were not related to CSHP.

- One travel reimbursement request appeared to be overstated. The hotel invoice, showing room rates and taxes, indicated room charges for only one night, while three nights were claimed by, and reimbursed to, the employee. The two extra nights of room charges and taxes totaled $114.76.

Since this program was inappropriately charged with these expenditures, less money was available for disbursement to the pilot projects.

Recommendation

The Director of the Coordinated School Health Program should ensure that grant contracts comply with *Tennessee Code Annotated* and that related expenditures are accompanied by adequate supporting documentation. The Director of Fiscal Services should create a cost center to accumulate administrative expenditures for the Office of School Health and ensure that only program-related expenditures are charged against it. Supporting documentation should be obtained for the overstated travel claim or reimbursement should be obtained.

Management's Comment

We concur. The department will ensure grant contracts are in compliance with state law and that supporting documentation is maintained for all expenditures. The department has taken action to ensure administrative costs are charged to the correct program. The department will review the circumstances surrounding the travel claim and will make a final determination on the matter.

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. In addition, the head of each executive agency is required to conduct an evaluation of the agency's internal accounting and administrative control and submit a report by December 31, 1999, and December 31 of every fourth year thereafter.

Our objectives were to determine whether

- the department's June 30, 2003, and June 30, 2002, responsibility letters and December 31, 2003, internal accounting and administrative control report were filed in compliance with Section 9-18-104, *Tennessee Code Annotated;*

- documentation to support the department's evaluation of its internal accounting and administrative control was properly maintained; and
- procedures used in compiling information for the internal accounting and administrative control report were in accordance with the guidelines prescribed under Section 9-18-103, *Tennessee Code Annotated*.

We interviewed key employees responsible for compiling information for the internal accounting and administrative control report to gain an understanding of the department's procedures. We also reviewed the June 30, 2003, and June 30, 2002, responsibility letters and the December 31, 2003, internal accounting and administrative control report to determine whether they had been properly submitted to the Comptroller of the Treasury and the Department of Finance and Administration.

We determined that the Financial Integrity Act responsibility letters and internal accounting and administrative control report were submitted on time, support for the internal accounting and administrative control report was properly maintained, and procedures used were in compliance with *Tennessee Code Annotated.*

OBSERVATIONS AND COMMENTS

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 Department of Education filed its compliance report and implementation plan on June 27, 2003.

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 Human Rights Commission is the coordinating state agency for the 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

Department of Education divisions and allotment codes:

331.01 Division of Administration
331.02 Grants-in-aid
331.03 Title I, II and V
331.04 Technology Infrastructure and System Support
331.05 Training and Professional Development
331.06 Teaching and Learning
331.07 State Board of Education
331.09 Improving School Programs
331.10 Career Ladder Program
331.11 Accountability
331.25 Basic Education Program
331.35 School Nutrition Programs
331.36 Special Education Services
331.43 State Driver's Education
331.45 Vocational Education
331.90 Alvin C. York Agricultural Institute
331.91 Tennessee School for the Blind
331.92 Tennessee School for the Deaf – Knoxville
331.93 West Tennessee School for the Deaf – Jackson
331.95 Tennessee Infant and Parent Services
331.97 Major Maintenance