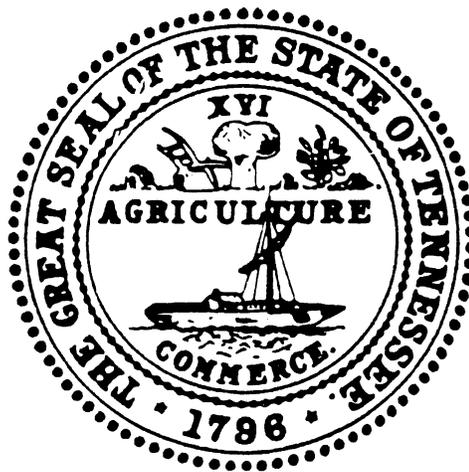


AUDIT REPORT

Department of Commerce and Insurance

August 2008



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit
Division of State Audit



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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

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John G. Morgan
Comptroller

August 28, 2008

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and

The Honorable Leslie A. Newman, Commissioner
Department of Commerce and Insurance
500 James Robertson Parkway
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Department of Commerce and Insurance for the period July 1, 2004, through May 31, 2006.

The review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements resulted in a finding which is detailed in the Objectives, Methodologies, and Conclusions section of this report.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/ddm
06/041



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June 29, 2006

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 Commerce and Insurance for the period July 1, 2004, through May 31, 2006.

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 Commerce and Insurance's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Department of Commerce and Insurance 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 a finding which is detailed in the Objectives, Methodologies, and Conclusions section of this report. The Department of Commerce and Insurance's management has responded to the audit finding; we have included the response following the finding. We will follow up the audit to examine the application of the procedures instituted because of the audit finding.

We have reported other less significant matters involving the department's internal control and instances of noncompliance to the Department of Commerce and Insurance's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/ddm

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Department of Commerce and Insurance
August 2008

AUDIT SCOPE

We have audited the Department of Commerce and Insurance for the period July 1, 2004, through May 31, 2006. 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 the Employee Leasing Program, Modular Housing, Manufactured Housing, Consumer Affairs, Insurance Division Travel Expenditures, the Emergency Communications Board, Conflicts of Interest, 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 FINDING

As Noted in the Prior Audit, Management of the Employee Leasing Program Has Failed to Effectively Regulate the Employee Leasing Agencies to Ensure That These Agencies Submit Required Documentation as Evidence That the Agencies Have Paid the Appropriate Payroll Taxes and Insurance Premiums for Their Employees; Has Not Maintained Accurate Records of Agencies With Active Licenses; and Has Not Collected Penalties Due From Agencies That Have Failed to Comply With Requirements*

The Employee Leasing Program was not ensuring that leasing agencies provided the required certifications from independent certified public accountants, proof of workers' compensation insurance, and other required documentation. In addition, the program's records improperly showed four leasing agencies as having active licenses (page 6).

* This finding is repeated from the prior audit.

Financial and Compliance Audit Department of Commerce and Insurance

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Financial and Compliance Audit Department of Commerce and Insurance

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Department of Commerce and Insurance. 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 Department of Commerce and Insurance was established to protect the public health and safety of Tennessee’s citizens. The mission of the department is to provide the leadership and support necessary to protect the public health and safety by

- maintaining public confidence in the integrity of the consumer and financial service industries and professions;
- safeguarding consumers from deceptive business practices;
- ensuring a fair and competitive marketplace in which businesses have the flexibility to operate in order to promote economic and community development within the state;
- requiring adherence to certain recognized and established standards of conduct in consumer and financial service industries and professions; and
- protecting life and property through fire prevention, education, investigation and enforcement, and access to enhanced emergency communications.

All programs support the central mission of the department and have a direct impact on the physical and financial health, education, and public safety of Tennessee’s citizens. The following are the department’s seven major programs:

Consumer Affairs – Protects consumers from deceptive business practices by enforcement of the Tennessee Consumer Protection Act and mediates or otherwise resolves more than 6,000 consumer complaints per year.

Fire Prevention – Protects life and property through the state’s building and safety codes enforcement operations, arson and explosives investigations, and training for volunteer and career firefighters and codes officials through the state’s Fire Service and Codes Enforcement Academy.

Insurance – Protects the public through oversight and administration of insurance statutes to ensure the financial integrity of companies operating in the state and ensure that companies and agents are acting in compliance with the state law.

Securities – Protects investors by enforcing the Tennessee Securities Act of 1980 and by maintaining the integrity of the securities market.

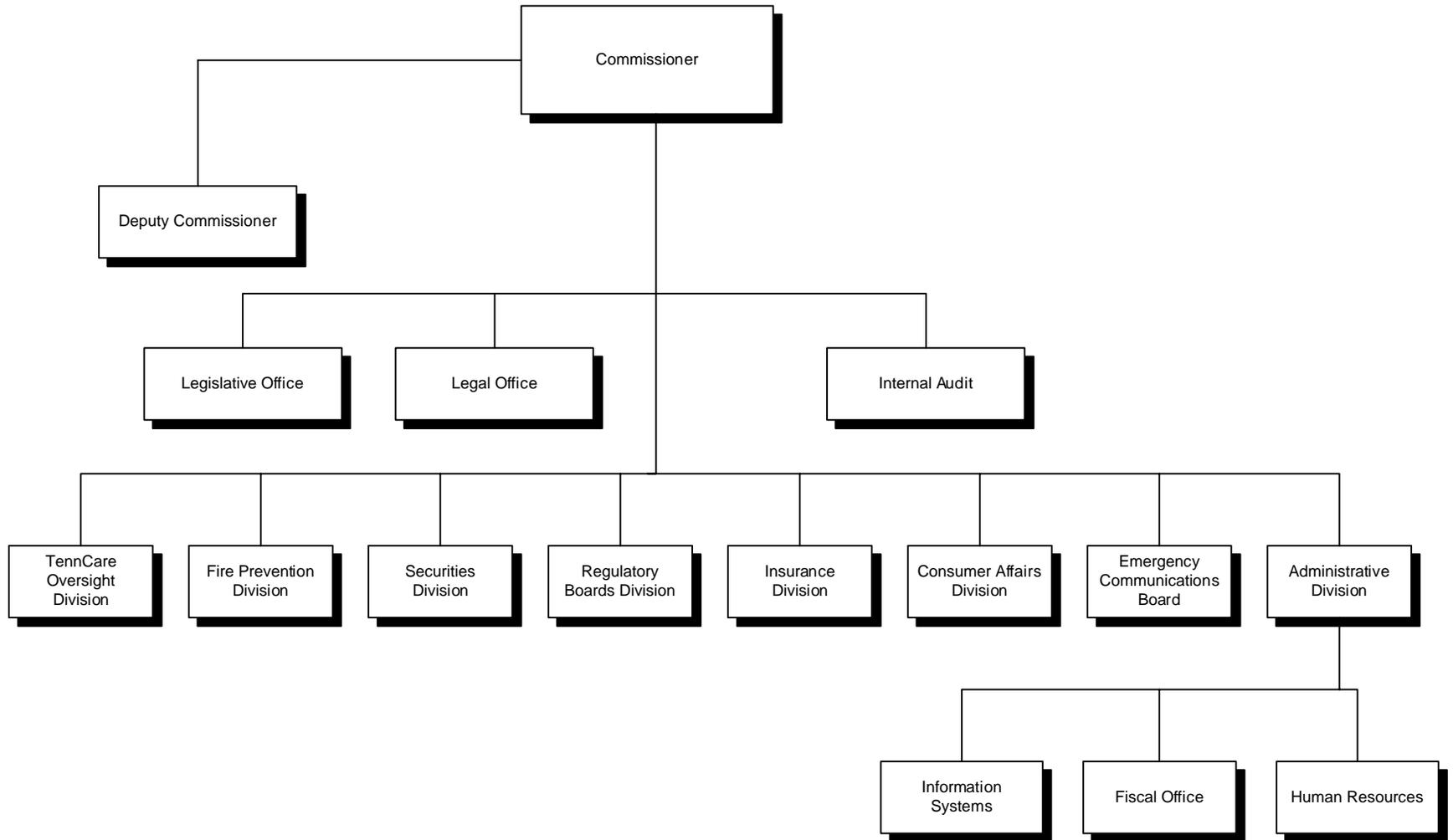
TennCare Oversight – Protects the public health and integrity of the TennCare Program by overseeing, examining, and monitoring the practices of the health maintenance organizations (HMOs), behavioral health organizations (BHOs), and other third-party administrators that contract to provide services to TennCare enrollees.

Emergency Communications Board – Protects the public through implementation of statewide enhanced 911 service for land and wireless lines.

Regulatory Boards – Protects the health and safety of citizens through boards and commissions, by ensuring that persons meet minimum professional standards, by responsively and timely handling complaints, and by providing consumer education on regulated professions and industries.

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

Department of Commerce and Insurance Organization Chart



AUDIT SCOPE

We have audited the Department of Commerce and Insurance for the period July 1, 2004, through May 31, 2006. 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 the Employee Leasing Program, Modular Housing, Manufactured Housing, Consumer Affairs, Insurance Division Travel Expenditures, the Emergency Communications Board, Conflicts of Interest, 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

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 Department of Commerce and Insurance filed its report with the Department of Audit on January 28, 2005. 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 Department of Commerce and Insurance has corrected the five previous audit findings concerning (a) license renewals and lack of monthly production reports for modular housing, (b) failing to document inspections for manufactured housing, (c) failing to take timely action on consumer complaints, (d) inadequate procedures for the preparation of the annual report for the Division of Regulatory Boards, and (e) lack of required conflict-of-interest disclosures for board members.

REPEATED AUDIT FINDING

The prior audit report also contained a finding concerning the lack of enforcement of required documentation on employee leasing agencies by the Employee Leasing Program. This finding has not been resolved and is repeated in the applicable section of this report.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

EMPLOYEE LEASING PROGRAM

The mission of the Employee Leasing Program is to protect consumers who use employee leasing services, to ensure that all employee leasing agencies are registered with the State of Tennessee, to ensure that the leasing agencies have adequate workers' compensation insurance, to ensure that the leasing agencies have properly paid and reported payroll taxes, to ensure that the leasing agencies have submitted evidence of the required net worth, and to ensure that the leasing agencies do not perform any unlicensed activity. The Employee Leasing Program is governed by Title 62, Chapter 43, *Tennessee Code Annotated*.

Our objectives in reviewing the Employee Leasing Program were to determine whether

- the leasing agencies paid the appropriate fees;
- out-of-state leasing agency applicants submitted a current license and notarized statement from their Secretary of State to show that they are in good standing in their domicile state;
- the leasing agency applicant provided the required financial statements or surety bond;
- the leasing agency submitted a certification from an independent certified public accountant (CPA), for every quarter, showing that payroll taxes were paid on a timely basis; and
- the leasing agency provided a certificate of insurance showing that all employees were covered by workers' compensation in accordance with the laws of the state.

To accomplish our objectives, we reviewed state laws and departmental policies relating to the Employee Leasing Program and interviewed key personnel to gain an understanding of procedures and controls over the program. We performed testwork on a sample of 25 employee leasing agency files from July 1, 2004, through February 28, 2006, to determine if the leasing agencies paid the appropriate fees and submitted the required documentation including current licenses and notarized statements for out-of-state agencies, financial statements, surety bonds, CPA certifications, and certificates of insurance.

Based on interviews, reviews, and testwork performed, we determined that the employee leasing agencies paid the appropriate fees and out-of-state agencies submitted a current license and notarized statement from their Secretary of State. However, our testwork revealed that the employee leasing agencies were not submitting all required financial statements, surety bonds, CPA certifications, and certificates of insurance of workers' compensation coverage. These problems are noted below in the finding.

As noted in the prior audit, management of the Employee Leasing Program has failed to effectively regulate the employee leasing agencies to ensure that these agencies submit required documentation as evidence that the agencies have paid the appropriate payroll taxes and insurance premiums for their employees; has not maintained accurate records of agencies with active licenses; and has not collected penalties due from agencies that have failed to comply with requirements

Finding

As noted in the prior audit finding, the management of the Employee Leasing Program has not ensured the employee leasing agencies submit required documentation and also failed to maintain accurate records of which employee leasing agencies have active licenses. In addition, we noted that the Employee Leasing Program's staff filed complaints with the Division of Regulatory Boards' (DRB) legal office, but the legal office did not promptly follow up and advise management on the appropriate course of action. As a result, the program may not receive all of the penalties to which it is entitled.

The Employee Leasing Program is responsible for licensing agencies that provide (through contractual arrangements) personnel functions for companies and industries in Tennessee. The Employee Leasing Program is attached to the Department of Commerce and Insurance's Division of Regulatory Boards. The Employee Leasing Program is a Commissioner-run program. The Commissioner of the department hires the director and supporting staff of the program. The Employee Leasing Program has a five-member advisory board appointed by the Governor.

The Employee Leasing Program issues licenses to applicants (employee leasing agencies) who have satisfied the requirements of Title 62, Chapter 43, *Tennessee Code Annotated*. These requirements include

- evidence that the agency has adequate workers' compensation insurance coverage for all leased employees subject to the Tennessee Workers' Compensation Law; and
- financial statements or a surety bond as evidence that the applicant has the minimum net worth required by the law.

Once agencies are licensed, they are required by law to

- notify the Employee Leasing Program when their insurance coverage lapses during their license periods; and
- submit payroll tax certifications prepared by independent certified public accountants within 90 days of the end of each calendar quarter in order to provide regular assurance to the department and consumers that the employee leasing agencies have paid all payroll taxes in a timely manner for leased employees.

Employee Leasing Program staff maintain files for each employee leasing agency which contain all required documentation. The department's procedures require that the Employee Leasing Program initiate complaints on employee leasing agencies who fail to comply with *Tennessee Code Annotated* requirements. Section 62-43-115 allows a civil penalty of up to one thousand dollars (\$1,000) for violations of the requirements. The Division of Regulatory Boards' policies require its legal office to review the complaints and make recommendations to the Commissioner regarding the revocation of an employee leasing agency's license and the assessment of penalties by the department.

The Commissioner and the Employee Leasing Program staff concurred with the prior finding and stated that employee leasing agencies that were not in compliance with *Tennessee Code Annotated* requirements would be sent notification letters. In addition, the Commissioner and the Employee Leasing Program staff stated that they would obtain affidavits from employee leasing agencies attesting that all applicable provisions of *Tennessee Code Annotated* were met. The Commissioner and the Employee Leasing Program staff also stated they would modify the Regulatory Boards System database to document the status of compliance for the agencies. We reviewed the Employee Leasing Program staff's actions taken since the prior audit, and we found that the program's staff initially took the actions listed above including modifying the Regulatory Boards System database. However, while performing our procedures in April 2006, we noted that the program's staff had not sent any notification letters since May 2005, which was shortly after the prior audit report was released. Also, as a result of our current audit inquiries, the program's staff again began to send notification letters to noncompliant agencies, which resulted in improved compliance by some of the leasing agencies. We also found that although an affidavit was added to the license renewal process, we observed that two leasing agencies did not complete the affidavits but the Employee Leasing Program still renewed the agencies' licenses. Therefore, while the Employee Leasing Program initially took the steps listed in its corrective action plan, management of the Employee Leasing Program did not ensure that the program's staff monitored the employee leasing agency files on an ongoing basis and denied license renewals when the leasing agencies failed to comply with all licensing requirements.

To determine whether the Employee Leasing Program had ensured employee leasing agencies' compliance with the *Tennessee Code Annotated* requirements, we tested a sample of 25 employee leasing agency files from the period July 1, 2004, through February 28, 2006. We noted the following problems:

- Nineteen of 25 employee leasing agencies tested (76%) did not provide at least one of the required CPA quarterly reports to verify that all payroll taxes had been paid timely. Specifically, agencies did not submit 62 of 106 (58%) of the total required CPA quarterly reports. Sixteen of these 19 employee leasing agencies did not submit any of the required CPA quarterly reports. Program staff only referred one of these 16 noncompliant agencies to the Division of Regulatory Board's legal office for follow-up.

- Fifteen of 25 employee leasing agencies tested (60%) either did not provide evidence of workers' compensation insurance during the application process or had allowed the Certificate of Liability Insurance to expire.
- Four of 25 employee leasing agencies tested (16%) did not provide their financial statements or surety bond during the application process, yet the Employee Leasing Program staff issued licenses to all four leasing agencies.
- Four of 25 employee leasing agencies tested (16%) had not renewed their licenses even though all four were still shown as "active" licensees in the Employee Leasing Program's records.

Based on our discussions with the Administrative Manager of the Employee Leasing Program, we also found that the Employee Leasing Program's staff initiated complaints on delinquent leasing agencies and referred the complaints to the legal office for the Division of Regulatory Boards (DRB), but the legal office did not promptly follow up and advise the Employee Leasing Program on the appropriate course of action. We reviewed these complaints and considered the dates that the Employee Leasing Program submitted the complaints to the DRB's legal office. All nine complaints referred to the legal office had been with the legal office for at least five months or longer. We discussed the problems noted in this finding with the Administrative Manager of the Employee Leasing Program, who stated that staffing changes at the Employee Leasing Program and in the legal office in the Division of Regulatory Boards have contributed to the cause of these problems. We observed that there were changes in staff during the audit period in the Employee Leasing Program office. However, this did not absolve the Commissioner and the Employee Leasing Program from the responsibility to ensure that the employee leasing agencies complied with the law.

If the legal office in the Division of Regulatory Boards does not follow up on the complaints of employee leasing agencies' noncompliance and make recommendations to the Commissioner, the lack of timely resolution of complaints permits employee leasing agencies to meet the requirements for an initial application or renewal but then violate *Tennessee Code Annotated* for the remainder of their two-year license periods by failing to continue submitting all required documentation. Without the required documentation and ongoing monitoring of the agencies' files for completeness, there can be no assurance that employee leasing agencies have provided adequate insurance and paid the appropriate payroll taxes and insurance premiums for their employees. Also, the department may not receive all of the penalties that should be collected. The Employee Leasing Program was created to ensure that employee leasing agencies are properly licensed and monitored.

Recommendation

The Commissioner and the Director over the Employee Leasing Program should enforce the requirements of *Tennessee Code Annotated* relating to the licensing of employee leasing agencies. All certifications regarding workers' compensation insurance and applicable payroll

taxes should be required to be filed in a timely manner. The Employee Leasing Program should monitor the submission of required documentation throughout each agency's license period. Also, the Commissioner should review the number of staff assigned to the Employee Leasing Program and determine if staff is adequate to achieve the Program's mission. The Commissioner should also ensure that there is a clear line of authority over the Employee Leasing Program staff and that staff are held accountable if they fail to continually monitor the employee leasing agencies' compliance with the law. In addition, the Commissioner should ensure that the Division of Regulatory Boards' legal office responds to complaints sent by the Employee Leasing Program in a timely manner. When an agency is not in compliance, the Commissioner and Employee Leasing Program should timely follow up to collect any penalty due. The problems noted in this finding should be included in management's documented risk assessment. The risk assessment should be approved by the Commissioner.

The Commissioner should ensure that other risks of improper accountability, noncompliance, fraud, waste, or abuse are adequately identified and assessed in management's documented risk assessment. Management should implement effective controls to ensure compliance with applicable requirements and should assign staff to be responsible for ongoing monitoring of the risks and mitigating controls. Management should take appropriate action if deficiencies occur.

Management's Comment

We concur. The individual issues noted in the finding are discussed below.

Issue: The management of the Employee Leasing Program has not ensured that employee leasing agencies submit required documentation.

Corrective Action: New management has developed a checklist for the hard-copy license file and is implementing a checklist for the RBS licensing/renewal system that along with fees, etc., will require proof of workers' comp insurance; financial statement or surety bond insurance; and quarterly payroll tax reports in each license file prior to the initial issuance or license renewal.

Issue: Employee Leasing management and staff failed to maintain accurate records of which employee leasing agencies have active licenses.

Corrective Action: New management is working with the department's Information Systems management to assure that no license is issued or renewed unless all license requirements are met and recorded as such in the system. Further, when license renewal dates are not met by the Employee Leasing agencies, the status of the license will automatically revert to a 'delinquent' status during the renewal grace period (unless licensing requirements are met). If renewal requirements are not met during the grace period, the license status becomes 'expired.' No license is to remain in an 'active' status if the licensee is delinquent with any license prerequisite.

Issue: The Employee Leasing Program's staff filed complaints with the Division of Regulatory Boards' (DRB) legal office, but the legal office did not promptly follow up and advise management on the appropriate course of action. As a result, the board may not receive all of the penalties to which it is entitled.

Corrective Action: The Employee Leasing Program's staff and Legal Section now comply with the Regulatory Boards' division-wide "Complaint Standard Operating Procedures." This licensing program currently has sixteen (16) open, pending complaints and only one (1) is more than 180 days old.

MODULAR HOUSING

The Codes Enforcement Section of the Division of Fire Prevention by statute has the responsibility of enforcing fire and building codes for the purpose of protecting the citizens of Tennessee from injury or death. One responsibility is to monitor the construction and installation of modular buildings used for educational, business, residential, storage, and other occupancy purposes. This is accomplished by licensing a third-party Construction Inspection Agency to conduct inspections of the modular housing manufacturer.

The Codes Enforcement Section is governed by *Tennessee Code Annotated*, Title 68, Chapters 102, 104, 105, 120, 126, and 135; and Title 62, Chapter 32. The Section also uses a booklet of Standard Operating Procedures, a set of rules and regulations, and a set of codes and standards as guides for their work.

The objectives of our review of modular housing procedures in the Codes Enforcement Section were to determine whether

- approvals of the third-party inspection agencies were obtained,
- inspection reports by the third-party inspection agencies were maintained,
- evidence of the manufacturers' licenses were available, and
- monthly inspection reports from the manufacturers were on file.

To accomplish our objectives, we interviewed key personnel and reviewed applicable *Tennessee Code Annotated* sections and departmental policies and procedures to gain an understanding of procedures and controls over modular housing. We performed testwork on a sample of 25 third-party inspection agencies and modular housing manufacturers' files from July 1, 2004, through March 10, 2006, to determine if approvals of the third-party inspection agencies were obtained, inspection reports by the third-party inspection agencies were maintained, evidence of the manufacturers' licenses were available, and monthly inspection reports from the manufacturers were on file.

Based on interviews, reviews, and testwork performed, we determined that

- approvals of the third-party inspection agencies were obtained,
- inspection reports by the third-party inspection agencies were maintained,
- evidence of the manufacturers' licenses were available, and
- monthly inspection reports from the manufacturers were on file, with only a minor exception noted.

MANUFACTURED HOUSING

The Division of Fire Prevention by statute has the responsibility of enforcing fire and building codes for the purpose of protecting the citizens of Tennessee from injury or death. The manufactured housing section of the Division of Fire Prevention is responsible for performing in-plant production line inspections of manufactured homes during the course of construction and performing inspections of completed manufactured homes on dealer lots.

The manufactured housing section is governed by *Tennessee Code Annotated* Title 68, Chapter 126, along with *Code of Federal Regulations*, Title 24, Part 3280 (Manufactured Home Construction and Safety Standards) and Part 3282 (Manufactured Home Procedural and Enforcement Regulations). This section also follows a booklet of Standard Operating Procedures and a set of departmental rules and regulations.

The objectives of our review of the manufactured housing section were to determine whether

- documentation on reviews of equipment testing, label storage records, quality assurance manual and approved designs, applicable performance tests, tests of materials in storage, and product certification reports was maintained; and
- documentation of production line inspections and monthly inspections on the monthly recap sheets by the inspectors was maintained.

To accomplish our objectives, we interviewed key personnel and reviewed applicable parts of *Tennessee Code Annotated*, *Code of Federal Regulations*, and departmental policies and procedures to gain an understanding of procedures and controls over manufactured housing. We performed testwork on a sample of 25 manufacturer files from July 1, 2004, through March 1, 2006, to determine whether documentation on reviews of equipment testing, label storage records, quality assurance manual and approved designs, applicable performance tests, tests of materials in storage, and product certification reports was maintained. We also tested the same sample to determine whether documentation on production line inspections and monthly inspections on the monthly recap sheets by the inspectors was maintained.

Based on interviews, reviews, and testwork performed, we determined that

- documentation on reviews of equipment testing, label storage records, quality assurance manual and approved designs, applicable performance tests, tests of materials in storage, and product certification reports was maintained; and
- documentation of production line inspections and monthly inspections on the monthly recap sheets by the inspectors was maintained, in all material respects.

CONSUMER AFFAIRS

The Division of Consumer Affairs' mission is to protect consumers and businesses affected by unfair business practices. The division is a resource to help consumers and businesses understand their rights and responsibilities, resolve consumer complaints through mediation, investigate and address violations of the Consumer Protection Act, and oversee registration of organizations. The division coordinates with other divisions, in addition to other state and federal agencies, to mediate or otherwise resolve consumer complaints. The division receives between 5,000 and 8,000 consumer complaints every year.

The objectives of our review of the complaint resolution system in the Division of Consumer Affairs were to determine whether

- division staff sent the initial letters to the complainant and business on which the complaint was filed (the respondent) within the required time limits,
- appropriate action was taken when the respondent failed to reply to the division's letter concerning the complaint in a timely manner, and
- data in the Complaint Management System agreed to the information in the complaint file.

To accomplish our objective, we interviewed key department personnel and observed internal controls to gain an understanding of the division's procedures and controls over complaint processing. We tested a nonstatistical sample of consumer complaints from July 1, 2004, through February 1, 2006, to determine if division staff sent the initial letters to the complainant and the respondent within the required time limits, appropriate action was taken when the respondent failed to reply to the department's letter concerning the complaint in a timely manner, and data in the Complaint Management System agreed to the information in the complaint file.

As a result of interviews, observations, and testwork performed, we determined that

- division staff sent the initial letters to the complainant and the respondent within the required time limits,
- appropriate action was taken when the respondent failed to reply to the division's letter concerning the complaint in a timely manner, and

- data in the Complaint Management System agreed to the information in the complaint file.

INSURANCE DIVISION TRAVEL EXPENDITURES

The Insurance Division is responsible for enforcing the state's insurance laws and supervising insurance companies authorized to do business in Tennessee. The Examination Unit performs examination of life, property and casualty, title, and captive companies as well as health maintenance organizations, governmental entity pools, self-insured groups, and risk retention groups domiciled in Tennessee. The duties and responsibilities of this section encompass examining company records including but not limited to the financial statements, bylaws, charter, contracts, agreements, conflict-of-interest, investment activities, dividends and distributions, and market conduct activities, and producing an examination report that addresses the company's compliance with state laws, rules, and regulations. Since the companies are located throughout the United States, the insurance examiners engage in extensive travel.

Our objective in reviewing travel claim expenditures for the insurance examiners in the Insurance Division was to determine whether expenditures for travel were paid in accordance with the Comprehensive Travel Regulations, including the U.S. General Services Administration CONUS (Continental United States) rates provided by the federal government for out-of-state travel.

To accomplish our objective, we interviewed key department staff and observed internal controls to gain an understanding of procedures and controls over travel expenditures. We also reviewed the Comprehensive Travel Regulations, including the U.S. General Services Administration CONUS rates. We tested all travel claims for six insurance examiners for the month of April 2005 to determine whether expenditures for travel were paid in accordance with the Comprehensive Travel Regulations, including the U.S. General Services Administration CONUS rates for out-of-state travel.

Based on our interviews, observations, and testwork performed, we determined that expenditures for the insurance examiners' travel were paid in accordance with the Comprehensive Travel Regulations, including the U.S. General Services Administration CONUS for out-of-state travel.

EMERGENCY COMMUNICATIONS BOARD

The Emergency Communications Board (E-911 Board) is responsible for ensuring wireless 911 service is implemented across the State of Tennessee in accordance with the Federal Communications Commission's regulations. The E-911 Board also provides financial, operational, and technical oversight to emergency communication districts in the state. The E-911 Board is governed by *Tennessee Code Annotated*, Title 7, Chapter 86, Part 3.

The objective of our review of the controls and procedures in the E-911 Board was to determine if board disbursements were adequately supported, properly recorded, properly approved, and in compliance with E-911 Board policies and state law.

To accomplish our objective, we interviewed key agency personnel and observed internal controls to gain an understanding of procedures and controls over the E-911 Board. We reviewed written policies and procedures and reviewed *Tennessee Code Annotated*, Title 7, Chapter 86, Part 3. We also tested a nonstatistical sample of disbursements from July 1, 2004, through November 30, 2005, to determine if disbursements were adequately supported, properly recorded, properly approved, and made in compliance with E-911 Board policies and state law.

As a result of our interviews, observations, and testwork performed, we determined that board disbursements were adequately supported, properly recorded, properly approved, and in compliance with E-911 Board policies and state law, in all material respects.

CONFLICTS OF INTEREST

Section 12-4-101, *Tennessee Code Annotated*, prohibits officers, board members, or directors of public entities from overseeing contracts in which they have a personal interest. The department has a conflict-of-interest policy and procedures to disclose any potential conflicts of interest.

Our objectives in reviewing the department's conflict-of-interest policy and compliance were to determine whether

- the department was in compliance with applicable state law regarding conflicts of interest, and
- board members and top management completed the required conflict-of-interest forms in accordance with policy.

To accomplish our objectives, we reviewed applicable state laws related to conflicts of interest. We interviewed key personnel to gain an understanding of management's policies for compliance with applicable state law regarding conflicts of interest. We also tested a nonstatistical sample of board members to determine if they completed the proper conflict-of-interest form. In addition, we reviewed the conflict-of-interest forms for the Commissioner, Deputy Commissioner, Assistant Commissioners, and General Counsel.

Based on interviews, observations, and testwork performed, we determined that

- the department was in compliance with applicable state law regarding conflicts of interest, and
- board members and top management completed the required conflict-of-interest forms in accordance with policy.

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 objective was to determine whether the department's June 30, 2005, and June 30, 2004, responsibility letters were submitted to the Comptroller of the Treasury and the Department of Finance and Administration by June 30.

We reviewed the department's June 30, 2005, and June 30, 2004, responsibility letters to determine whether they had been properly submitted to the Comptroller of the Treasury and the Department of Finance and Administration by June 30.

Based on our review of the June 30, 2005, and June 30, 2004, responsibility letters, we determined that the letters were submitted by June 30 and were in compliance with Section 9-18-104, *Tennessee Code Annotated*.

OBSERVATIONS AND COMMENTS

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

Auditors and management are required to assess the risk of fraud in the operations of the entity. The risk assessment is based on a critical review of operations considering what frauds could be perpetrated in the absence of adequate controls. The auditors' risk assessment is limited to the period during which the audit is conducted and is limited to the transactions that the auditors are able to test during that period. The risk assessment by management is the primary method by which the entity is protected from fraud, waste, and abuse. Since new programs may be established at any time by management or older programs may be discontinued, that assessment is ongoing as part of the daily operations of the entity.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. Management's responsibility is to design, implement, and monitor effective controls in the entity. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditor testing is limited and is usually targeted to test the effectiveness of particular controls. Even if controls appear to be operating effectively during the

time of the auditor testing, they may be rendered ineffective the next day by management override or by other circumventions that, if left up to the auditor to detect, will not be noted until the next audit engagement and then only if the auditor tests the same transactions and controls. Furthermore, since entity staff may be seeking to avoid auditor criticisms, they may comply with the controls during the period that the auditors are on site and revert to ignoring or disregarding the control after the auditors have left the field.

The risk assessments and the actions of management in designing, implementing, and monitoring the controls should be adequately documented to provide an audit trail both for auditors and for management, in the event that there is a change in management or staff, and to maintain a record of areas that are particularly problematic. The assessment and the controls should be reviewed and approved by the head of the entity.

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit*, promulgated by the American Institute of Certified Public Accountants requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.

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 Commerce and Insurance filed its compliance report and implementation plans on June 23, 2005, and June 28, 2004.

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

- 335.01 - Division of Administration
- 335.02 - Division of Insurance
- 335.03 - Division of Fire Prevention
- 335.04 - Division of TennCare Oversight
- 335.05 - Division of Securities
- 335.06 - Division of Consumer Affairs
- 335.07 - Fire Service and Codes Enforcement Academy
- 335.08 - 911 Emergency Communications
- 335.10 - Division of Regulatory Boards
- 335.15 - Real Estate Education and Recovery
- 335.16 - Auctioneer Education and Recovery
- 335.28 - Tennessee Commission on Fire Fighting Personnel