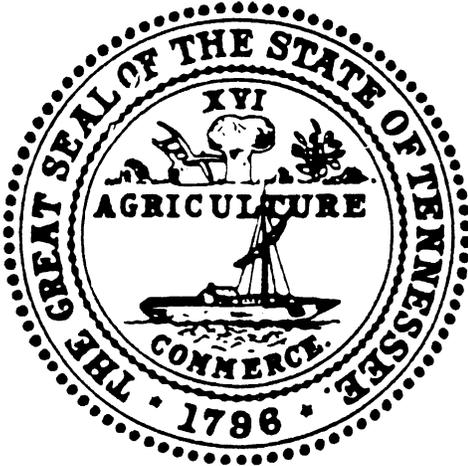


AUDIT REPORT

Court System

July 2006



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit
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COMPTROLLER OF THE TREASURY
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John G. Morgan
Comptroller

July 14, 2006

The Honorable William M. Barker
Chief Justice of the Supreme Court
Supreme Court Building
Nashville, Tennessee 37243
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Court System for the period March 1, 2003, through February 28, 2006.

The review of internal control and compliance with laws and regulations resulted in certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/th
06/045



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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March 27, 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 Court System for the period March 1, 2003, through February 28, 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 Court System's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Court System 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 office'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 office's internal control and/or instances of noncompliance to the Court System's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/th

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit

Court System

July 2006

AUDIT SCOPE

We have audited the Court System for the period March 1, 2003, through February 28, 2006. Our audit scope included a review of internal control and compliance with laws and regulations in the areas of appellate court clerk revenue, indigent defense payments, court reporter payments, the Board of Professional Responsibility, equipment, and the Council of Juvenile and Family Court Judges. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; participating in the negotiation and procurement of services for the state; and providing support staff to various legislative committees and commissions.

AUDIT FINDINGS

Cash Receipting Duties Are Not Appropriately Segregated or Reviewed, and the Office Has Not Adequately Mitigated the Risk of Theft of Cash Receipts

The Western Appellate Court System deputy clerk does not endorse checks immediately and does not maintain a log of checks received in the mail. Also, three different deputy clerks have access to the receipts before the information is entered into the tracking system. In addition, the Nashville Appellate Court Clerk's Office deputy cost clerks' duties are not adequately segregated (page 7).

The Board of Professional Responsibility Does Not Have Adequate Written Policies and Procedures to Address the Risks of Misappropriation of Cash Receipts, Checks, and Equipment

Significant deficiencies exist in internal control for revenue and expenditures for the Board of Professional Responsibility. These deficiencies include inadequate cash receipting documentation, a lack of segregation of duties related to revenue and expenditures cycles, incomplete written policies and procedures for expenditures, and inadequate written policies and procedures for revenue (page 11).

Financial and Compliance Audit Court System

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Financial and Compliance Audit Court System

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Court System. 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

Nineteen divisions are currently included within the Court System. The Administrative Office of the Courts administers 18 of these divisions, and the state Board of Law Examiners administers its own expenditures.

Administrative Office of the Courts

The Administrative Office of the Courts works under the supervision and direction of the Chief Justice of the Supreme Court of Tennessee, assists the Chief Justice in the administration of the judicial branch of government, serves as secretary to the Judicial Council, and attends to other duties assigned by the Supreme Court or Chief Justice.

The Administrative Office of the Courts has the additional duty of administering the accounts of the judicial branch of government by preparing, approving, and submitting budget estimates of appropriations necessary for the maintenance and operation of the state judicial system. The administrative director also draws and approves all requisitions for payment of judicial expenditures and submits vouchers to the Department of Finance and Administration. Additionally, the administrative director has the authority, within budgetary limits, to provide minimum law libraries to trial court judges.

In the performance of these duties, the administrative director of the Administrative Office of the Courts administers the following judicial appropriation codes:

a. Appellate and Trial Courts

Salaries and benefits are provided for all appellate court judges, circuit court judges, criminal court judges, chancellors, and special judges appointed by the Chief Justice as well as for the secretaries of these judges. The salaries and benefits for law clerks and certiorari attorneys employed by the appellate judges, the travel and office expenses for authorized judges, and the cost of law libraries for all appellate and trial judges are paid from this code.

b. Supreme Court Buildings

Funds for the operation, maintenance, and security of the Supreme Court Buildings in Nashville, Knoxville, and Jackson are disbursed through this code.

c. Child Support Referees

Funds are provided for hearings in child support cases to promote the timely fulfillment of parents' obligations to support their children.

d. Guardian ad Litem

This code provides payments to attorneys providing legal representation for children involved in dependency, neglect, or abuse cases.

e. Indigent Defendants' Counsel

This code provides payments to attorneys appointed to represent juveniles and adults who cannot afford attorneys in felony proceedings. The code also pays legal costs, including attorneys' fees, incurred by indigent patients during mental health hearings.

f. Civil Legal Representation

This code provides payments to agencies to represent defendants in civil matters. Certain taxes are levied on civil litigation to maintain a Civil Legal Representation of Indigents Fund for the purpose of providing legal representation of poor persons in civil matters. Pursuant to Rule 11, *Rules of the Supreme Court*, funds are distributed to Tennessee legal aid societies.

g. Verbatim Transcripts

This code provides salaries, benefits, travel costs, and miscellaneous expenses incurred by court reporters who provide trial transcripts for persons indicted for felonies.

h. Tennessee State Law Libraries

Law libraries are maintained in Nashville, Knoxville, and Jackson. Salaries and benefits for the law librarians and their assistants and funds to purchase the necessary books and materials to maintain the libraries are disbursed from this code.

i. Council of Juvenile and Family Court Judges

This conference provides assistance to juvenile courts concerning the impact of state and federal laws affecting the children and families and provides training for juvenile court judges and staff regarding issues affecting children and families who are brought before the court.

j. Judicial Conference

This code provides for travel and miscellaneous expenses incurred in connection with the annual Judicial Conference mandated by statute and the two judicial seminars for continuing legal education scheduled each year.

k. Judicial Programs and Committees

This code includes Uniform Laws and the state's annual dues to the National Conference of Commissioners on Uniform Laws. Travel expenses for members of the Judicial Selection Committee are also provided.

l. State Court Clerks' Conference

This code provides for the travel and supplies expenses incurred in connection with the State Court Clerk Conference mandated by statute. At least one annual educational conference is required to be held. The membership of the conference includes all circuit court clerks, clerks and masters, elected probate clerks, criminal court clerks, juvenile court clerks, and elected general sessions court clerks in the state. Deputies of these clerks are associate members of the conference.

m. Administrative Office of the Courts

The salaries and operating expenses of the Administrative Office of the Courts are disbursed through this code. The Administrative Director is the administrative officer responsible for the day-to-day operations and the administrative details of the courts.

n. Appellate Court Clerks

The offices of the clerks are in Nashville, Knoxville, and Jackson. Each office consists of the deputy clerk and assistants. The salaries of the deputy clerks and assistants are paid from fees collected by the clerk. Salaries of certain office personnel and general operating expenses are paid from funds appropriated to the clerks.

o. Board of Professional Responsibility

This board is responsible for reviewing and investigating allegations of attorney misconduct and for imposing disciplinary action as covered by *Supreme Court Rule nine*.

p. Tennessee Lawyers' Assistance Program

This program was established by *Supreme Court Rule 33* to provide education to the bench and bar, to protect the public, and to provide assistance to members of the legal profession suffering from physical or mental disabilities that impair their ability to practice or serve.

q. Tennessee Commission on Continuing Legal Education and Specialization

This commission is charged with the general supervisory authority over the administration of *Supreme Court Rule 21* governing mandatory continuing legal education.

r. Tennessee Lawyers' Fund for Client Protection

This fund was established by *Supreme Court Rule 25* to reimburse claimants for losses caused by any dishonest conduct committed by lawyers licensed to practice in this state.

State Board of Law Examiners

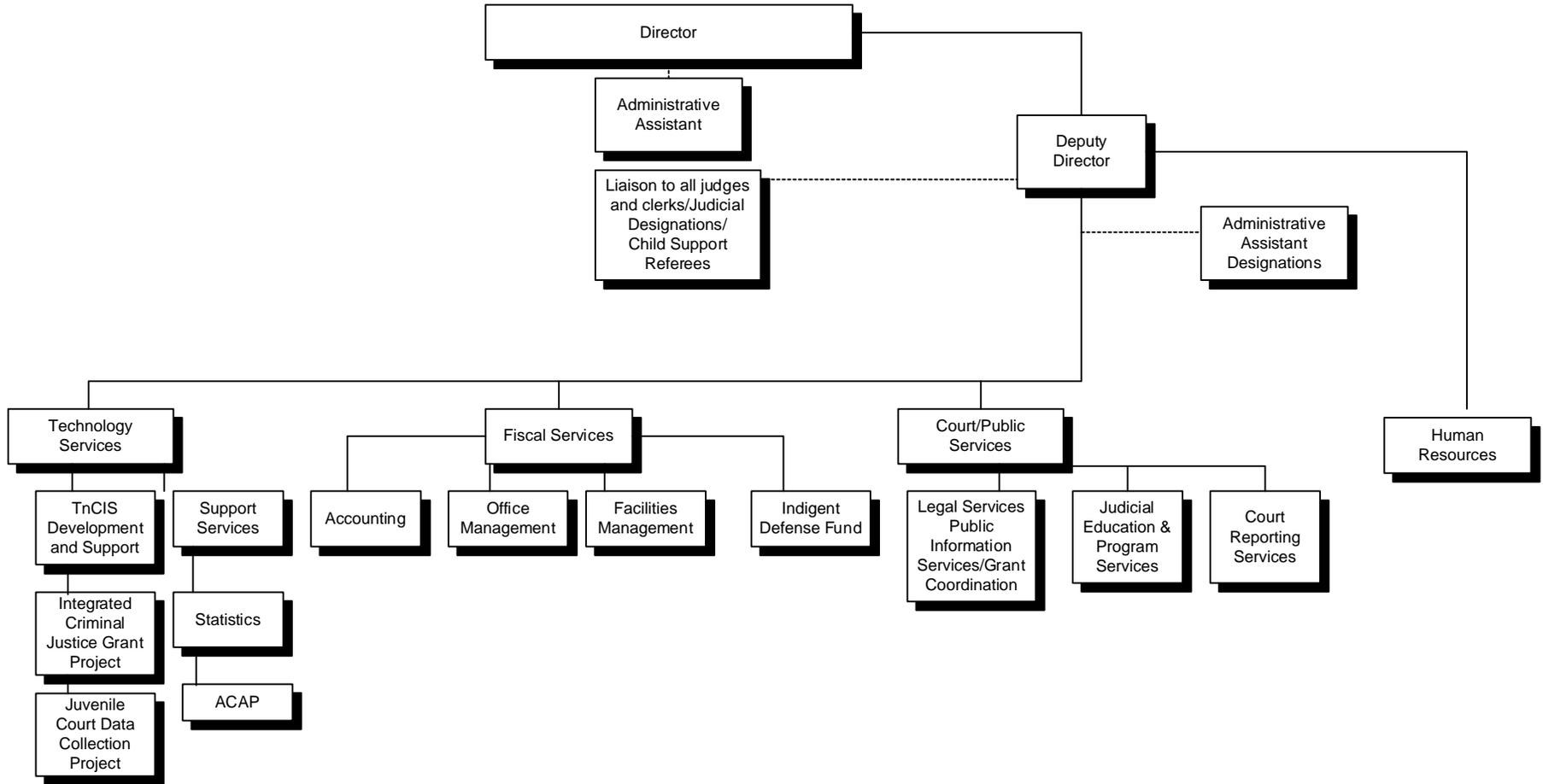
The State Board of Law Examiners is not administered by the Administrative Office of the Courts; it is responsible for administering its own expenditures. The State Board of Law Examiners consists of five members of the state bar who are appointed by the Supreme Court and serve staggered terms of three years. In addition, the board employs an executive secretary and necessary assistants. The executive secretary performs various administrative duties, keeps account of all fees paid to the board, records all examinations, and otherwise assists the board in the performance of its official duties. Board assistants are attorneys who are selected to write exam questions and grade examination papers.

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

AUDIT SCOPE

We have audited the Court System for the period March 1, 2003, through February 28, 2006. Our audit scope included a review of internal control and compliance with laws and regulations in the areas of appellate court clerk revenue, indigent defense payments, court reporter payments, the Board of Professional Responsibility, equipment, and the Council of Juvenile and Family Court Judges. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared

Administrative Office of the Courts Organization Chart



by the state's Department of Finance and Administration; approving certain state contracts; participating in the negotiation and procurement of services for the state; and providing support staff to various legislative committees and commissions.

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 Court System filed its report with the Department of Audit on December 29, 2003. 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 Court System has corrected previous audit findings concerning the ineffectiveness of the Indigent Defense Daily Report System, the lack of internal control over Indigent Defense payments, and the need for improvement in controlling equipment. Also, the Court System has corrected the previous audit findings reported to the Council of Juvenile & Family Court Judges regarding inadequate controls over the Executive Committee bank account, and program income not reported as required by grant guidelines.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

APPELLATE COURT CLERK REVENUE

Our objectives in reviewing the operation of the Jackson office of the Appellate Court Clerk were to gain an understanding of the operation and to determine whether

- procedures and controls over cash receipting were adequate and being followed,
- revenue or fees have been billed and recorded at the correct amount,
- revenue items were deposited timely and were properly coded in the state's accounting system, and
- records were reconciled with Department of Finance and Administration reports.

We interviewed key personnel at the appellate court clerks' office to gain an understanding of the billing system used and the controls over billing and cash receipting. We reviewed a sample of receipts for the period March 1, 2003, through December 28, 2005, to determine if the controls were operating as described. We reviewed the receipts to determine that appropriate amounts were recorded and that the items were deposited timely. We also examined how the revenue was coded and billed. In addition, we selected a sample of cash receipts for the period March 1, 2003, through January 23, 2006, to ensure all receipts were deposited timely. Also, we reviewed the process the Court System used to reconcile its records to reports issued by the Department of Finance and Administration.

Based on our testwork, we determined that revenue was billed and recorded correctly and was deposited timely. Reconciliations with the Department of Finance and Administration reports were performed. However, we determined that the procedures and controls over cash receipting were not adequate. Cash receipting duties were not appropriately segregated, and appropriate control was not in place over cash receipts.

1. **Cash receipting duties are not appropriately segregated or reviewed, and the office has not adequately mitigated the risk of theft of cash receipts**

Finding

The Western Appellate Court System does not have effective internal control regarding cash receipts. The deputy clerk does not endorse checks at the earliest point of receipt; the checks are not endorsed until the receipt is being prepared for deposit. Furthermore, the deputy clerk does not maintain a log of checks received in the mail. This creates a risk of theft of such receipts that could occur and go undetected. Three different deputy clerks have access to the receipts before the payments are processed within the Justice Information Tracking System (JITS). Because the receipts are not recorded and endorsed immediately when received, the chances of fraud increase with each additional employee handling the funds.

There is also a lack of segregation of duties within the Nashville Appellate Court Clerk's Office. The deputy cost clerk reconciles the daily receipt amounts, enters the amounts into the State of Tennessee Accounting and Reporting System (STARS), fills out a deposit slip, and performs the month-end reconciliation to compare STARS information to the deposit slips. In addition, the deputy cost clerk opening the mail and entering the information into JITS has access to the deposit information within the system. Again, the fraud risk is significant in this situation since the individuals with access to cash could also adjust the accounting records to conceal a theft. In the case of the deputy cost clerk, the reconciliation for STARS is not performed by a separate individual and funds could be diverted for personal use.

Because of the additional risk due to the lack of segregation of duties and inadequate cash receipt procedures, additional audit procedures were required to verify revenue and receipts. Based on these procedures, no additional problems were noted. Segregation of duties or adequate compensating controls are essential to prevent and detect misuse of funds.

Recommendation

The Director should assess the fraud risks related to cash receipts and design controls to mitigate those risks. Conflicting responsibilities should be adequately segregated. A mail log should be prepared or cash receipts should be written immediately as mail is opened by the deputy clerk. The checks should be immediately endorsed "For Deposit Only" when received. The information processed into the Justice Information Tracking System should be reviewed by someone other than the person who entered the information and should be reconciled back to the mail log or cash receipts.

Management's Comment

We concur. Due to this finding, fraud risks and the segregation of duties to mitigate the risk of theft of cash receipts have been reviewed. Appropriate controls have been designed and are in place at our appellate clerks' offices to appropriately mitigate risks. Under the new policies, the checks will be immediately endorsed "For Deposit Only," a receipt log will be completed and a reconciliation will be completed.

INDIGENT DEFENSE PAYMENTS

Our objectives in reviewing and testing indigent defense payments were to determine whether

- the Tennessee Indigent Expense System (TIES) reliably accumulates and calculates billing information from attorneys;
- exception dates identified by TIES were researched as necessary to detect irregular, duplicate, or excessive billings;
- the procedures used to process billings from attorneys for Indigent Defense work are adequate to prevent or detect overbillings; and
- billings were submitted timely and included all applicable information, including appropriate rates, and the billings were reasonable.

We interviewed key personnel to gain an understanding of the Administrative Office of the Courts' controls over the payment of indigents' defense attorneys. In order to determine if TIES reliably accumulated and calculated billing information, we obtained files from the TIES system from date of inception of July 1, 2004, through January 12, 2006, and performed computer-assisted audit techniques (CAATs). The CAATs performed were to search for attorney overclaims. We also obtained files from the previous system, the Daily Report System, for the period March 1, 2003, through June 30, 2004. We obtained these files so that a review of the two systems could be performed to see if any overclaims were made between the two systems. As seemingly unreasonable claims were identified, we reviewed to determine whether the Administrative Office of the Courts had substantiated the payments as valid. We also reviewed a

nonstatistical sample of claims for the period July 1, 2004, through January 10, 2005, that the TIES System had identified as over-claims to determine if the Administrative Office of the Courts reviewed these claims for validity in accordance with policies and procedures. In addition, we reviewed a nonstatistical sample of indigent defense claims paid for the period March 1, 2003, through November 30, 2005, to determine if the billings were submitted timely, were complete, and were reasonable.

Based on our interviews and testwork, we found that procedures and controls over the Tennessee Indigent Expense System were adequate and were being followed. TIES reliably accumulated and calculated billing information from the attorneys. Exception dates identified by the TIES system were researched as necessary to detect irregular, duplicate, or excessive billings. We determined that procedures used to process billings from attorneys for Indigent Defense work are adequate to prevent or detect overbillings. Billings were timely and included all applicable information, including appropriate rates, and the billings were reasonable.

COURT REPORTER PAYMENTS

The Administrative Office of the Courts pays official court reporters to record court proceedings and to prepare verbatim transcripts of criminal cases pursuant to court order. If such a state employee is not available, private court reporters may be hired to record court proceedings and prepare verbatim transcripts. A verbatim transcript is the official court record or transcript of a court proceeding. Judges typically order a verbatim transcript to be prepared when an appeal is filed. The Administrative Office of the Courts bears the cost of the verbatim transcript if the appellant is declared indigent by the court, pursuant to Section 40-14-312, *Tennessee Code Annotated*.

Our objectives in reviewing payment procedures for court reporters and verbatim transcripts were to determine whether

- the internal control system used to process verbatim transcripts for payment was adequate and in place,
- payments for verbatim transcripts and per diem charges were paid in accordance with established rates,
- total payments to individual state court reporters and individual private court reporters appeared reasonable for the work performed, and
- private court reporters had a properly approved contract.

We reviewed the applicable laws and regulations, interviewed key personnel, and reviewed supporting documentation to gain an understanding of the internal control system for verbatim transcript payments. We reviewed a nonstatistical sample of payments to state court reporters for verbatim transcripts for the period March 1, 2003, through December 28, 2005, to determine if the payments were mathematically accurate, authorized and approved by all the required parties, and paid in accordance with established rates. We reviewed a nonstatistical

sample of verbatim and per diem payments for the period March 1, 2003, through December 28, 2005, to private court reporters to determine if they were properly approved, mathematically accurate, and paid in accordance with established rates. We analyzed total payments to individual state court reporters and individual private court reporters to determine reasonableness based on a typical yearly workload. Also, we determined if existing private court reporters had an approved contract.

Based on our interviews and testwork, we determined that the Administrative Office of the Courts has adequate controls over the payments for verbatim transcripts. Per diem and verbatim payments to both state court reporters and private court reporters tested were accurate, authorized and approved by all the necessary parties, and paid in accordance with established rates. We determined that total payments to state court reporters and private court reporters appeared reasonable for the work performed. Also, the basic contract used for private court reporters was properly approved.

BOARD OF PROFESSIONAL RESPONSIBILITY

Our objectives in reviewing the Board of Professional Responsibility were to determine whether

- internal controls at the Board of Professional Responsibility were adequate and in place,
- expenditure amounts were supported and approved,
- expenditures were properly recorded for the appropriate amount,
- goods and services were received,
- cash collected has been deposited timely,
- revenue was billed and recorded at the correct amount, and
- revenue records were reconciled with Department of Finance and Administration reports.

We interviewed key personnel at the Board of Professional Responsibility to gain an understanding of the billing system used, the controls over billing and cash receipting, and the controls over expenses. To determine if expenditure amounts were supported, approved, and were for goods and services actually received, we tested a nonstatistical sample of expenditure transactions for the period of March 1, 2003, through December 31, 2005. We reviewed the same transactions for proper recording. To determine if cash collected was deposited timely and revenue was billed and recorded at the appropriate amounts, we tested a nonstatistical sample of revenue transactions for the period of March 1, 2003, through November 30, 2005. We also selected receipts from the available cash receipt records to determine if the cash was deposited. In addition, we performed tests to compare expected revenue to the total revenue recorded.

Also, we reviewed revenue reconciliations to determine if revenue records were reconciled with Department of Finance and Administration reports.

Based on the testwork performed, we determined that expenditures were supported and approved, and that goods and services were received. Expenditures were recorded at the proper amount, but not always to the appropriate accounts. We determined that cash collected was deposited timely, and revenue was billed and recorded at the proper amount. In addition, revenue reconciliations were performed. However, based on the review of internal control and certain errors noted in the testwork, we determined that internal controls at the Board of Professional Responsibility were not adequate and in place. Responsibilities related to revenues and expenses were inadequately segregated, written policies were not adequate, and cash receipting documentation was not complete.

2. **The Board of Professional Responsibility does not have adequate written policies and procedures to address the risks of misappropriation of cash receipts, checks, and equipment**

Finding

Significant deficiencies exist in internal control for revenue and expenditures for the Board of Professional Responsibility (BPR). These deficiencies include inadequate cash receipting documentation, a lack of segregation of duties related to revenue and expenditures cycles, incomplete written policies and procedures for expenditures, and inadequate written policies and procedures for revenue.

The Board of Professional Responsibility does not have adequate segregation of duties related to revenue and expenditures. The Administrative Assistant opens the mail, posts the cash receipts to the system, and prepares the daily deposit for Pro Hac Vice payments. At the end of every month, a State of Tennessee Accounting and Reporting System (STARS) report is sent to the same individual at BPR for reconciliation to the BPR records. By letting the same individual have access to cash receipts and have control of the accounting records without independent reconciliation by another individual, the board has not adequately reduced the risk of fraud. This situation is an invitation for fraud that could occur in large amounts and might not be detected.

Also, the board did not maintain a cash receipt book prior to July 2005 for registration fees. The secretary would photocopy the attorney's registration statement and stamp and initial the statement as received by BPR. The original statement and the cash would then be handed to the Registration Director for processing. No mail log or receipt book was retained to document the payments received each day. Without documentation of each cash receipt, there is no efficient way to determine if all funds received were eventually deposited. Even subsequent to July 2005, when a cash receipting system had been established, testwork through February 2006 showed that there were still several items that did not have a cash receipt written when the cash was received. Further, the cash receipt book was difficult to read because the handwriting had bled through from the previous receipts. The risk of theft of cash receipts without detection is increased in this environment, and that risk must be addressed by the board.

The administrative assistant approves invoices for payment, does occasional ordering, mails accounts payable checks, maintains inventory records, and performs the annual inventory. Further, purchase requisitions and purchase orders were not required. The Chief Disciplinary Counsel is to approve purchases prior to ordering; however, this approval is not documented. Because of this lack of controls, the administrative assistant could order goods for personnel use and exclude the items from the inventory records or could create and approve invoices for payment and cash the checks for personal use. Also, unauthorized purchases could be made. The board has multiple people authorized to make purchases for certain types of items. Since the person that does the purchasing is also usually the person that does the receiving, purchased goods could easily be diverted for personal use.

Because of the fraud risks identified due to the lack of segregation of duties, additional audit procedures were required to verify revenue and receipts, and to review the reasonableness of expenditures. No further problems were noted through the additional procedures.

The written policies and procedures for expenditures were incomplete. Policies and procedures should immediately be established to remedy the deficiencies noted for expenditures. Also, there were very few written policies and procedures related to the handling of cash receipts. The existing policies and procedures need to be modified to include all types of revenue received by the board and to include the proper segregation of duties and appropriate internal control regarding the handling of cash receipts. Written policies and procedures over expenditures and revenues are vital to maintenance of effective internal control.

Certain errors were noted during audit testwork that could be a result of the lack of written procedures:

- Certain invoices were coded into STARS under an incorrect transaction code.
- An overpayment on a travel claim resulting from a transposition error was not discovered during the review of the claim.
- An invoice was not canceled to preclude duplicate payment.

Due to the lack of written policies and the lack of segregation of duties for receipting and expenditures, internal control is not sufficient to protect the entity from fraud or from misstatements caused by carelessness. The board has not adequately assessed the risks associated with cash receipts and cash disbursements and has not ensured that resources are safeguarded.

Recommendation

The Board of Professional Responsibility should assess the fraud risks for the entity and design written policies and procedures to address significant risks. The risk assessments should be reviewed for adequacy by an audit committee of the board. The written policies and procedures should instruct personnel concerning how each employee is expected to perform significant cash receipting, cash disbursement, and accounting tasks. Where duties cannot be

appropriately segregated, compensating controls should be developed and included in the policies. The policies and procedures should include all types of receipts and should also include instructions regarding purchasing responsibilities.

The Chief Disciplinary Counsel should ensure that existing policies and procedures are followed. Cash receipts should be written for all payments received, and the cash receipt book should be legible. Cash receipts should be compared to the amount recorded in the accounting system and the deposit received at the bank by a party not involved with the cash receipting process.

For expenditures, purchase orders should be developed to show written approval of purchases by the Chief Disciplinary Counsel. The purchase order should be given to a receiving clerk, without ordering authority, who should be responsible for receiving, checking accuracy of the order, documenting receipt of all goods ordered, and ensuring that sensitive items were added to the equipment listing. In addition, the accounts payable checks should not be returned to the administrative assistant prior to mailing.

Management's Comment

We concur. The Board of Professional Responsibility is assessing the roles for their operation and designing written policies and procedures to address significant risks. The Chief Disciplinary Council now ensures that cash receipts are written for all payments received and the cash receipts book is legible. Reconciliations of the cash receipts to the accounting system are now required and proper segregation of duties has been assigned. A purchase order system will be implemented to strengthen internal controls over purchasing.

EQUIPMENT

Our objectives in reviewing equipment controls and procedures at the Administrative Office of the Courts were to determine whether

- the information on the property listing was accurate, and
- property and equipment were adequately safeguarded.

We interviewed key Administrative Office of the Courts personnel to gain an understanding of procedures and controls for safeguarding and accounting for equipment. We tested a nonstatistical sample of equipment items on the state's property listing for the downtown Nashville Administrative Office of the Courts location as of December 28, 2005, to determine if the items agreed by description, tag number, and location with the equipment listing, and to determine whether the items were adequately safeguarded. Also, we tested a nonstatistical sample of equipment items on the state's property listing for all other court system buildings as

of March 13, 2006, to determine if the items agreed by description, tag number, and location with the equipment listing, and to determine whether the items were adequately safeguarded.

Based on the testwork performed, we determined that property and equipment were adequately safeguarded and that information on the property listing was accurate.

COUNCIL OF JUVENILE AND FAMILY COURT JUDGES

Our objectives in reviewing the Council of Juvenile and Family Court Judges were to determine whether

- policies and procedures regarding revenue and expenses are adequate;
- cash collected has been deposited timely;
- revenue was recorded at the correct amount;
- revenue and expense records are reconciled with the Department of Finance and Administration reports;
- recorded expenditures are for goods or services properly authorized, received, and procured in accordance with the applicable regulations or requirements; and
- recorded expenditures for goods or services are adequately supported and have been recorded correctly in the state's accounting records.

We interviewed key department personnel to gain an understanding of procedures and controls over the Council of Juvenile and Family Court Judges revenues and expenditures. We tested a nonstatistical sample of revenue transactions for the period January 1, 2005, through November 30, 2005, for adequate support, timely deposits, agreement of amounts receipted and deposited, correct recording, and proper approval. We reviewed reconciliations of revenues and expenditures to Department of Finance and Administration reports. To determine if expenditures were authorized and procured appropriately, we tested a nonstatistical sample of expenditure transactions for the period January 1, 2005, through November 30, 2005. We also tested those transactions for proper recording, support, and evidence of receipt.

Based on interviews and our review of controls, we determined that policies and procedures related to revenue and expenditures in the state account were adequate. Also, based on testwork performed, we determined that cash collected during the audit period was deposited timely, revenue was recorded at the correct amount, and revenue transactions were complete. Revenue and expenditure records were reconciled with Department of Finance and Administration reports. In addition, based on review of supporting documentation and expenditure testwork, we determined that expenditures were properly authorized, adequately supported, and recorded correctly, and that goods and services were received and procured in accordance with applicable regulations or requirements.

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. It is management's responsibility 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 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 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, and 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.

AUDIT COMMITTEE RECOMMENDED

As a result of the fraud-related business failures of companies such as Enron and WorldCom in recent years, Congress and the accounting profession have taken aggressive measures to try to detect and prevent future failures related to fraud. These measures have included the signing of the *Sarbanes-Oxley Act of 2002* by the President of the United States and the issuance of Statement on Auditing Standards No. 99 by the American Institute of Certified Public Accountants. This new fraud auditing standard has not only changed the way auditors perform audits but has also provided guidance to management and boards of directors on creating antifraud programs and controls. This guidance has included the need for an independent audit committee.

In recognition of the benefits of audit committees for government, the Tennessee General Assembly has enacted legislation known as the "State of Tennessee Audit Committee Act of 2005." This legislation requires the creation of audit committees for those entities that have governing boards, councils, commissions, or equivalent bodies that can hire and terminate employees and/or are responsible for the preparation of financial statements. Applicable entities are required to develop an audit committee charter and appoint the audit committee in accordance with the legislation. The specific activities of any audit committee will depend on, among other things, the mission, nature, structure, and size of each agency. In establishing the audit committees and creating the charter, each board should examine its particular circumstances. Anti-fraud literature notes that there are two categories of fraud: fraudulent financial reporting and misappropriation of assets. The audit committees should consider the

risks of fraud in general as well as the history of each entity with regard to prior audit findings, previously disclosed weaknesses in internal control, and compliance issues. The audit committees should consider both the risk of fraudulent financial reporting and the risk of fraud due to misappropriation or abuse of assets. Also, the boards and the audit committees should keep in mind that entities receiving public funding should have a lower threshold of materiality than private sector entities with regard to fraud risks.

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

At a minimum, audit committees should:

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

fraudulent or misleading financial reports or other information; to protect assets from fraud, waste, and abuse; to comply with all relevant laws, rules, policies, and procedures; and to avoid engaging in activities which would otherwise bring dishonor to the entity.

The charters of the audit committees should include, at a minimum, the following provisions:

1. The audit committee should be a standing committee of the board.
2. The audit committee should be composed of at least three members. The chair of the audit committee should preferably have some accounting or financial management background. Each member of the audit committee should have an adequate background and education to allow a reasonable understanding of the information presented in the financial reports of the agency and the comments of auditors with regard to internal control and compliance findings and other issues.
3. The members of the audit committee must be independent from any appearances of other interests that are in conflict with their duties as members of the audit committee.
4. An express recognition that the board, the audit committee, and the management and staff are responsible for taking all reasonable steps to prevent, detect, and report fraud, waste, and abuse.
5. The audit committee should meet regularly throughout the year. The audit committee can meet by telephone, if that is permissible for other committees. However, the audit committee is strongly urged to meet at least once a year in person. Members of the audit committee may be members of other standing committees of the board, but the audit committee meetings should be separate from the meetings of other committees of the board.
6. The audit committee should record minutes of its meetings.

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

TITLE VI OF THE CIVIL RIGHTS ACT OF 1964

Section 4-21-901, *Tennessee Code Annotated*, requires each state governmental entity subject to the requirements of Title VI of the Civil Rights Act of 1964 to submit an annual Title VI compliance report and implementation plan to the Department of Audit by June 30 each year.

The Court System filed its compliance reports and implementation plans on June 28, 2005, June 21, 2004, and June 20, 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 Tennessee Title VI Compliance Commission is responsible for monitoring and enforcement of Title VI.

APPENDIX

ALLOTMENT CODES

302.01	Appellate and Trial Courts
302.05	Supreme Court Buildings
302.08	Child Support Referees
302.09	Guardian ad Litem
302.10	Indigent Defendants' Counsel
302.11	Civil Legal Representation
302.12	Verbatim Transcripts
302.15	Tennessee State Law Libraries
302.16	Council of Juvenile & Family Court Judges
302.18	Judicial Conference
302.20	Judicial Programs and Committees
302.22	State Court Clerks' Conference
302.27	Administrative Office of the Courts
302.30	Appellate Court Clerks
302.35	State Board of Law Examiners
302.40	Board of Professional Responsibility
302.50	Tennessee Lawyers' Assistance Program
302.60	Tennessee Commission on Continuing Legal Education and Specialization
302.65	Tennessee Lawyers' Fund for Client Protection