AUDIT REPORT

Department of Education

April 2007

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

Arthur A. Hayes, Jr., CPA, JD, CFE
Director

Charles K. Bridges, CPA
Kandi B. Thomas, CPA, CFE
Assistant Directors

Debra D. Bloomingburg, CPA, CFE
Audit Manager

Christopher A. Risher, CFE
In-Charge Auditor

Benjamin Rogers
Kayla Shewcraft
Staff Auditors

Amy Brack
Editor

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 401-7897

Financial/compliance audits of state departments and agencies are available on-line at www.comptroller.state.tn.us/sa/reports/index.html.
For more information about the Comptroller of the Treasury, please visit our website at www.comptroller.state.tn.us.

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

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

John G. Morgan
Comptroller

April 10, 2007

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

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Department of Education for the period April 1, 2004, through April 30, 2006.

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

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/ddb
06/047

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

May 3, 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 Education for the period April 1, 2004, through April 30, 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 Education's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Department of Education is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

Our audit disclosed a certain finding which is detailed in the Objectives, Methodologies, and Conclusions section of this report. The department'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 Education's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/ddb

State of Tennessee

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

Comptroller of the Treasury Division of State Audit

Financial and Compliance Audit
Department of Education
April 2007

———

AUDIT SCOPE

We have audited the Department of Education for the period April 1, 2004, through April 30, 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 equipment, payroll and personnel, petty cash bank accounts, trust funds, contracts, the Coordinated School Health Program, and the Financial Integrity Act. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 FINDING

Inadequate Petty Cash Controls
Duties over the petty cash account were not segregated, the account was not reconciled and adequately monitored, documentation was not adequately maintained, and the Department of Finance and Administration's policies relating to imprest bank accounts were not followed, which increased the risk of potential fraud and abuse (page 7).

Financial and Compliance Audit
Department of Education

TABLE OF CONTENTS

Financial and Compliance Audit
Department of Education

INTRODUCTION

POST-AUDIT AUTHORITY

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

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

BACKGROUND

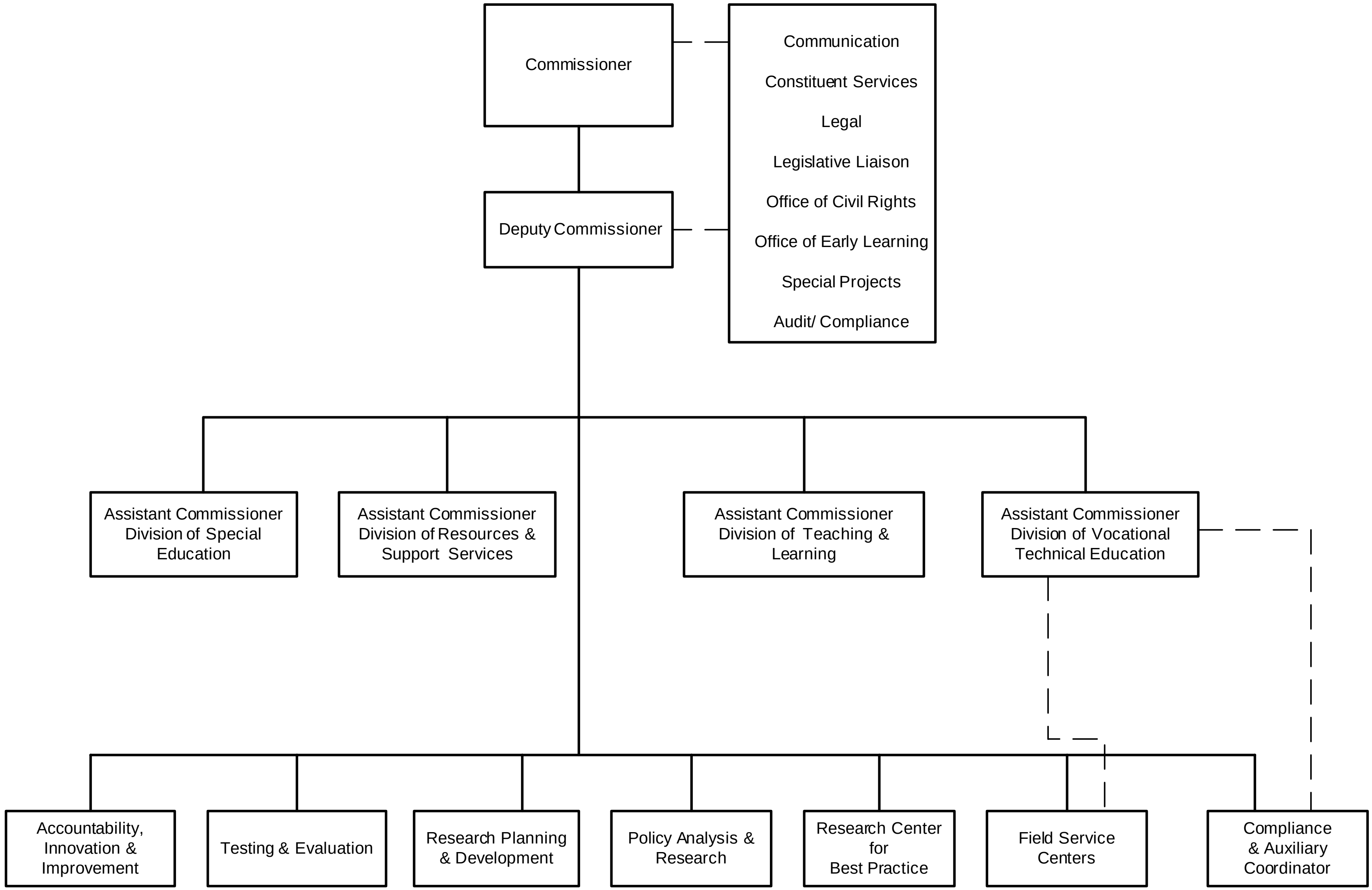
The mission of the Department of Education is to assist school districts in their efforts to ensure equal educational opportunities for all children in Tennessee and equip them with the skills necessary to succeed in higher education, the workplace, and society. The department fulfills this mission through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

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

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

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

Department of Education Organization Chart



AUDIT SCOPE

We have audited the Department of Education for the period April 1, 2004, through April 30, 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 equipment, payroll and personnel, petty cash bank accounts, trust funds, contracts, the Coordinated School Health Program, and the Financial Integrity Act. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. 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.

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 Education filed its report with the Department of Audit on May 31, 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 Education has corrected previous audit findings concerning inadequate equipment controls, performance evaluations not being performed, an unauthorized bank account at West Tennessee School for the Deaf, inadequate contract controls, and inadequate Coordinated School Health Program expenditure controls.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

EQUIPMENT

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

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

We interviewed key department personnel and reviewed supporting documentation to gain an understanding of the department's policies, procedures, and controls over equipment; to determine whether the policies, procedures, and controls over equipment were adequate; and to determine whether equipment was adequately safeguarded. We selected four nonstatistical samples of equipment from POST to determine whether the equipment information was properly recorded. Equipment information included state tag number, description, location, and serial number. We located or confirmed equipment items selected for testwork at the Andrew Johnson Building, Alvin C. York Institute in Jamestown, and the Tennessee School for the Deaf in Knoxville; Tennessee School for the Blind in Nashville; West Tennessee School for the Deaf in Jackson; Camp Clements; TPS Complex; Southeast Field Service Center in Cleveland; Southwest Field Service Center in Lexington; and TIPS Schools. We accessed POST to determine which employees were recognized users and to determine those employees' level of access. We reviewed the documentation authorizing these employees to determine whether the access appeared reasonable, based on the types of duties the employees performed. We examined the listing of equipment from POST to determine whether the lost or stolen equipment was reported to the Comptroller of the Treasury and that equipment had been removed from POST.

Based on our interviews and reviews of supporting documentation, we determined that the policies, procedures, and controls regarding equipment were adequate and that equipment was adequately safeguarded. Based on our testwork, we determined that equipment information was properly recorded in POST, equipment items selected for testwork were located or confirmed, and POST access granted to department employees was appropriately documented, approved, and appeared reasonable based on the types of duties the employees performed. Also, lost or stolen equipment was reported to the Comptroller of the Treasury and had been removed from POST.

PAYROLL AND PERSONNEL

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

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

We interviewed key department personnel and reviewed supporting documentation to gain an understanding of the department's procedures and controls over payroll and personnel. We also tested a nonstatistical sample of payroll transactions to determine whether payroll disbursements were authorized, adequately supported, and properly calculated; and whether annual, compensatory, and sick leave hours were earned and taken in accordance with Department of Personnel guidelines. We accessed SEIS to determine which employees were recognized users and to determine these employees' level of access. We reviewed the documentation authorizing these employees to access SEIS and compared the employees' level of access to the employees' job description to determine whether access was reasonable based on job duties. We also reviewed annual performance evaluations to determine whether they were given in accordance with Department of Personnel guidelines. We selected a nonstatistical sample of employees who received overtime pay to determine whether the overtime was approved. We reviewed temporary employment reports and timesheets related to state retirees who were rehired to determine whether their employment complied with applicable laws and regulations.

Based on our interviews and reviews of supporting documentation, we determined that policies and procedures regarding payroll and personnel were adequate. Based on our testwork, we determined that payroll disbursements were authorized, adequately supported, and properly calculated; leave was earned and taken in accordance with Department of Personnel guidelines;

SEIS access granted to department employees was appropriately documented, approved, and appeared reasonable based on the types of duties the employees performed; overtime was fully approved; annual performance evaluations were given in accordance with Department of Personnel guidelines; and retirees were rehired in compliance with applicable laws and regulations.

PETTY CASH BANK ACCOUNTS

Our objectives for reviewing the petty cash bank accounts controls and procedures at the Alvin C. York Institute in Jamestown, the Tennessee School for the Deaf in Knoxville, and the State Board of Education in Nashville were to determine whether

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

We interviewed key department personnel and reviewed supporting documentation to gain an understanding of the department's policies and procedures over petty cash bank accounts. We selected nonstatistical samples of receipts and disbursements to determine whether these operations were handled in accordance with F&A Policy 7. We selected and tested three bank statement reconciliations to determine whether management performed the reconciliations in accordance with F&A Policy 7. We tested all reimbursements to the petty cash bank accounts to determine whether the reimbursements complied with F&A Policy 7.

Based on our interviews and reviews of supporting documentation, we determined that the policies and procedures over the petty cash bank accounts were adequate. Based on our testwork, we determined that normal operations of the petty cash bank accounts (receipts, disbursements, and bank statement reconciliations) and reimbursement to the petty cash bank accounts at the Alvin C. York Institute in Jamestown and the Tennessee School for the Deaf in Knoxville were handled in accordance with F&A Policy 7. However, the normal operations and the reimbursement to the petty cash account at the State Board of Education were not handled in accordance with F&A Policy 7 (see the finding).

Controls over the petty cash account at the State Board of Education were inadequate, which increased the risk of potential fraud and abuse

Finding

State Board of Education management and staff did not ensure that controls over the petty cash account were adequate, which increased the risk of potential fraud and abuse associated with the account. Specifically, the Executive Director has not segregated duties for handling the account, staff independent of the account have not reconciled the account, staff have not adequately maintained bank statements, and management has not adequately monitored account activity to ensure compliance with the Department of Finance and Administration's (F&A) Policy 7 relating to impress bank accounts.

The State Board of Education has a departmental imprest petty cash account with an authorized balance of $500 which is maintained in a bank account. Management uses the account to pay for expenditures related to board meetings (e.g., refreshments or board members' parking), publications for the board members, framings for the board room, or plaques.

Based on our discussions with agency staff and examination of bank statements, invoices, receipts, and canceled checks, we determined that the account custodian had almost complete control over the account. Specifically, the custodian, the only authorized check signer, was responsible for any account disbursements, including signing the checks, and for requesting and receiving reimbursements for the account.

In addition to the lack of segregation of duties, we noted that the Executive Director had not ensured that the employee responsible for reconciling the account's bank balance to the authorized book balance was performing the reconciliations. In our review, we identified several problems that the Executive Director or other members of management would have found had they adequately monitored the account operations, the account custodian's activities, and the account reconciler's activities on an ongoing basis. F&A Policy 7, Section 07-02-404, "Account Reconciliation and Reporting," states, "it is the responsibility of the department or agency to ensure that proper internal controls over the operation of the departmental bank account and segregation of duties are established."

Because of the increased risk of fraud and abuse, we reviewed all account transactions for the period April 1, 2004, through March 9, 2006, and found the following problems:

- We reviewed four reimbursement requests for the period tested and found that although the Executive Director apparently reviewed the requests, the account custodian had requested more than the authorized account balance of $500.00 in two of the four reimbursement requests tested. The custodian stated that she was not aware that the account had a maximum balance of $500. In addition, we found that the custodian had included the same $34.30 amount in two different reimbursement requests. F&A Policy 7, Section 07-02-403, states that "reimbursement will be for the amount expended and documented up to the total of the authorized balance."

- Bank reconciliations were not performed as required by F&A Policy 7, Section 07-02-404, which states that "bank reconciliations are to be performed promptly each month upon receipt of the bank statement by an employee of the department or agency not responsible for cash receipts or disbursements." Although the employee who was responsible for preparing the reconciliation was independent of the receipting and disbursing functions, based on our review of the reconciliation process, we determined that one of the secretaries opened the bank statements before delivering them to the reconciler. As a result, the possibility of fraud is increased when someone other than the person responsible for the reconciliation opens the bank statement. Furthermore, the bank statements we reviewed did not include canceled checks or scanned images of the checks. Since the reconciler did not request a copy of the canceled checks or scanned images of those checks, we requested the checks from the bank so that we could examine the canceled checks, including the endorsement side of the check, to determine whether the checks were negotiated by the payee. We found no evidence of any impropriety.

- As a result of our bank reconciliation testwork, we found that one disbursement check written by the custodian for $286.44 to purchase framing for pictures in the board room was returned by the bank because the account had insufficient funds. Since no one was performing reconciliations, management did not realize that a deposit of a reimbursement check for $484.89 was not received by the bank until the check was returned for insufficient funds, 54 days after the deposit was mailed to the bank. According to the custodian, she mailed the deposit rather than making the deposit in person, and the deposit never reached the bank. After the custodian realized the deposit was not received by the bank, she contacted the Department of Treasury and they canceled the first account reimbursement check and reissued the reimbursement check. The custodian deposited that check in person.

- The reconciler did not always properly maintain bank statements, and the custodian did not adequately protect unused checks. The reconciler could not provide two monthly bank statements, and unused checks were stored in an unlocked drawer. F&A Policy 7, Section 07-02-404, states that "documentation of all transactions (including but not limited to all monthly bank statements, receipts, cancelled checks, and reimbursement requests) must be retained by the department for audit purpose."

- We determined that the Executive Director did not notify the Cash Management Division of the Department of Treasury, did not request an increase in the maximum authorized balance, and did not use the excess balance to reduce the next reimbursement request or deposit the excess balance with the state treasurer when the petty cash account's book balance exceeded the authorized amount of $500.00. F&A Policy 7, Section 07-02-501, states:

> in order to assure sufficient collateralization, the department or agency should immediately report to the Cash Management Division any occasions in which the account book balance exceeds the maximum authorized account balance. The department or agency has three options when an overage occurs: 1) request an increase in the maximum authorized balance, 2) use the overage to reduce the next replenishment check, or 3) deposit the overage with the State Treasurer.

As of May 3, 2006, management had taken no action on the petty cash overage of $149.69.

- The custodian did not consider bank service charges and earnings when requesting reimbursement of the account. F&A Policy 7, Section 07-02-405, states that "to the extent that earnings on balances in imprest type accounts exceed service charges, the earnings should be used to reduce the amount of the reimbursement and replenishment request." Not considering the effect of bank service charges and earnings on reimbursement requests contributed to the overage of the petty cash balance.

Our extensive review of the activity in the account did not disclose any evidence of fraud or abuse; however, we cannot be certain that fraud or abuse did not occur. Management's failure to ensure controls over the account activity, account reconciliations, and account reimbursements increases the risk that fraud or abuse could occur and not be detected. Their failure also causes the external auditor to commit additional audit resources to review what should have already been subject to better controls.

Recommendation

The Executive Director of the State Board of Education should ensure that staff follow established policies over the petty cash account. The Executive Director should monitor compliance with those policies. The Executive Director should at a minimum ensure the following:

- the reconciler performs prompt monthly bank reconciliations;
- the Executive Director performs sufficient review of the reimbursement requests;
- that all critical documentation, either the canceled checks or the scanned images, is obtained and retained for audit purposes;
- account activities and duties are properly segregated, including a second authorized check signer;

- that unused checks are adequately secured to prevent unauthorized access;

- that staff notify the Cash Management Division of the Department of Treasury if the book balance exceeds the authorized amount, and take appropriate action as directed by policy for any excess balance; and

- that bank service charges and earnings are considered when requesting reimbursement of the account.

The Executive Director 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 adequately mitigate those assessed risks and to ensure compliance with applicable requirements. Management should assign staff to be responsible for ongoing monitoring of the risks and mitigating controls and take action if deficiencies occur.

Management's Comment

We concur with the finding as it relates to controls over the petty cash account at the State Board of Education and have taken the following steps to correct the cause of such findings:

1. The Executive Director has segregated duties among two staff for handling the account, ensuring that staff follow established policies, including monitoring of compliance with such policies by the Executive Director.

2. The Executive Director has designated three authorized check signers, inclusive of the fiscal budget officer and himself.

3. The reconciler monthly performs prompt bank reconciliations and receives bank account statements, keeping track of such reconciliations via an electronic spreadsheet.

4. The Executive Director reviews and signs off on reimbursement requests related to the petty cash fund.

5. All critical documentation for audit purposes, such as cancelled checks, is retained electronically via scanned images for the petty cash bank account.

6. The staff will notify the Cash Management Division of the Department of Treasury if the bank balance exceeds the authorized amount of $500 and will take appropriate action for any excess balance.

7. Bank service charges and earnings are now considered when requesting reimbursement of the account.

We are confident implementation of the described measures herein corrects the cause of the audit finding.

TRUST FUNDS

Our objectives for reviewing trust funds were to determine whether

- corrective action was taken on the prior audit finding;
- policies and procedures regarding the trust funds at the Tennessee School for the Deaf in Knoxville were adequate;
- normal operations of the trust funds (receipts, disbursements, and bank statement reconciliations) were handled in accordance with Finance and Administration (F&A) Policy 7, "Petty Cash and Departmental Bank Accounts"; and
- policies and procedures regarding allocating interest to the various trust fund accounts were adequate and in accordance with F&A Policy 7.

We discussed management's corrective action, reviewed bank statements, and confirmed the bank balance related to the previous audit finding concerning the unauthorized bank account at the West Tennessee School for the Deaf. We interviewed key department personnel and reviewed bank statements, reconciliations, canceled checks, receipts, deposit slips, "Deposits to Student Account" forms, check registers, and invoices to gain an understanding of the department's policies and procedures regarding trust fund accounts at the Tennessee School for the Deaf in Knoxville. We selected a nonstatistical sample of receipts and disbursements to determine whether these transactions were handled in accordance with F&A Policy 7. We selected and tested one bank statement reconciliation to determine whether staff complied with F&A Policy 7. We interviewed key department personnel and reviewed the department's interest allocation worksheet to gain an understanding of the procedures and process of allocating interest to the various trust fund accounts. We selected and tested one interest allocation at the Tennessee School for the Deaf in Knoxville to determine whether the department allocated interest in accordance with F&A Policy 7.

Based on our interviews and reviews of bank statements and the bank confirmation, we determined that management had corrected the prior audit finding and closed the unauthorized bank account. We determined that the policies and procedures regarding the trust funds and interest allocation to the various trust fund accounts were adequate. Based on our testwork, we determined that management handled trust fund transactions (receipts, disbursements, and bank statement reconciliations) and interest allocation to the various trust fund accounts in accordance with F&A Policy 7.

CONTRACTS

Our objectives for reviewing contracts were to determine whether policies and procedures for contracts were adequate.

We interviewed key department employees to determine whether policies and procedures for contracts were adequate.

Based on our interviews and reviews of supporting documentation, we determined that the policies and procedures regarding contracts were adequate.

COORDINATED SCHOOL HEALTH PROGRAM

Our objectives for reviewing the Coordinated School Health Program were to determine whether

- policies and procedures concerning the Coordinated School Health Program (CSHP) expenditures were adequate, and

- program expenditures were appropriate and properly supported.

We interviewed key department personnel and reviewed program standards, guidelines, and state laws to gain an understanding of the department's policies and procedures concerning the program's expenditures and operations. We examined the expenditure population for unusual items and selected a nonstatistical sample of expenditure transactions to determine whether program expenditures were appropriate and properly supported.

Based on interviews and reviews of program standards, guidelines, state laws, invoices, timesheets, and travel claims, we determined that policies and procedures concerning CSHP expenditures were adequate, and program expenditures were appropriate and properly supported.

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 for reviewing the Financial Integrity Act was to determine whether the department's June 30, 2005, and June 30, 2004, responsibility letters were filed in compliance with Section 9-18-104, *Tennessee Code Annotated*.

We reviewed the 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.

We determined that the Financial Integrity Act responsibility letters were submitted to the Comptroller of the Treasury and the Department of Finance and Administration in a timely manner.

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, 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 Education filed its compliance reports and implementation plans on July 8, 2005, and June 30, 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.

APPENDIX

ALLOTMENT CODES

Department of Education divisions and allotment codes:

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