

# AUDIT REPORT

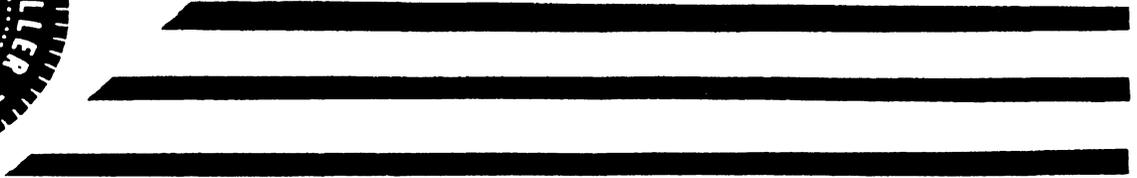
Office of the Comptroller of the Treasury

September 2006



STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY

Department of Audit  
Division of State Audit



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COMPTROLLER OF THE TREASURY  
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September 19, 2006

Members of the General Assembly  
and  
The Honorable John G. Morgan  
State Capitol  
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Office of the Comptroller of the Treasury for the year ended June 30, 2005.

Since we are not independent with respect to the Office of the Comptroller of the Treasury, we do not express any assurance on internal control and on compliance. The consideration of the internal control structure and tests of compliance disclosed one deficiency which is detailed in the Objectives, Methodologies, and Conclusions section of this report.

Sincerely,

Arthur A. Hayes, Jr., CPA  
Director

AAH/th  
06/049

State of Tennessee

# Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit  
Office of the Comptroller of the Treasury  
September 2006

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## AUDIT SCOPE

We have audited the Comptroller of the Treasury for the period July 1, 2004, through June 30, 2005. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of the State Board of Equalization, Ad Valorem Tax Equity Payments, the Financial Integrity Act, Title VI of the Civil Rights Act of 1964, and Title IX of the Education Amendments Act of 1972.

The auditors are not considered independent of the audited entity because they are employees of the Comptroller of the Treasury.

## AUDIT FINDING

### Internal Control Finding

#### **The Risk of Misappropriation of Funds Is Not Mitigated by Adequate Compensating Controls Over the Property Value Appeals Process**

Management has not taken necessary steps to ensure adequate controls are in place over the property value appeal process for cash receipts and refunds (page 5).

# Audit Report

## Office of the Comptroller of the Treasury

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# Office of the Comptroller of the Treasury

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## INTRODUCTION

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### POST-AUDIT AUTHORITY

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

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

### BACKGROUND

The Comptroller of the Treasury is a constitutional officer elected by the General Assembly for a two-year term. The functions and duties of the office are assigned through various legislative enactments.

The Office of the Comptroller of the Treasury is organized into several divisions to discharge its statutory duties. The basic functions of each division are described below.

The Division of Administration provides direction, coordination, and supervision to the various divisions within the Comptroller’s Office and represents the Comptroller on various boards and commissions.

The Office of Management Services provides administrative and support services to the divisions of the Comptroller’s Office in areas of accounting, budgeting, payroll and personnel, information systems, and printing. The office assists the Comptroller in policy and contract matters and provides staff support for several boards and commissions.

The Division of State Audit conducts financial and compliance and performance audits, conducts investigations, and performs special studies to provide the General Assembly, the Governor, and citizens of Tennessee with information about the state’s financial condition and the performance of the state’s many agencies and programs.

The Division of County Audit is responsible for annual audits of all 95 counties in the state. The division establishes standards for county audits conducted by public accounting firms. The division assists local governments with financial administration questions.

The Division of Municipal Audit ensures that municipalities, designated school system funds, utility districts, and government-funded non-profit agencies are audited as required by state statute. The division investigates and issues reports on allegations of misconduct, fraud, or waste in local government, often referring findings to other agencies for appropriate action.

The Division of Bond Finance manages the state debt, including issuance of all bonds and notes and payment of such debt. This division serves as staff for the State Funding Board, State School Bond Authority, Tennessee Local Development Authority, and Bond Finance Committee of the Tennessee Housing Development Agency.

The Offices of Research and Education Accountability prepare reports at the request of the Comptroller and the General Assembly on various state and local government issues. The Office of Education Accountability monitors the performance of Tennessee's elementary and secondary school systems and provides the General Assembly with reports on selected education topics.

The Division of Local Finance approves certain debt obligations of local governments, approves budgets of local governments which have certain debt obligations outstanding, and assists local governments with other debt and financial management issues.

The Office of State Assessed Properties annually appraises and assesses all public utility and transportation properties as prescribed in Section 67-5-1301, *Tennessee Code Annotated*. These assessments are certified to counties, cities, and other taxing jurisdictions for the billing and collection of property taxes.

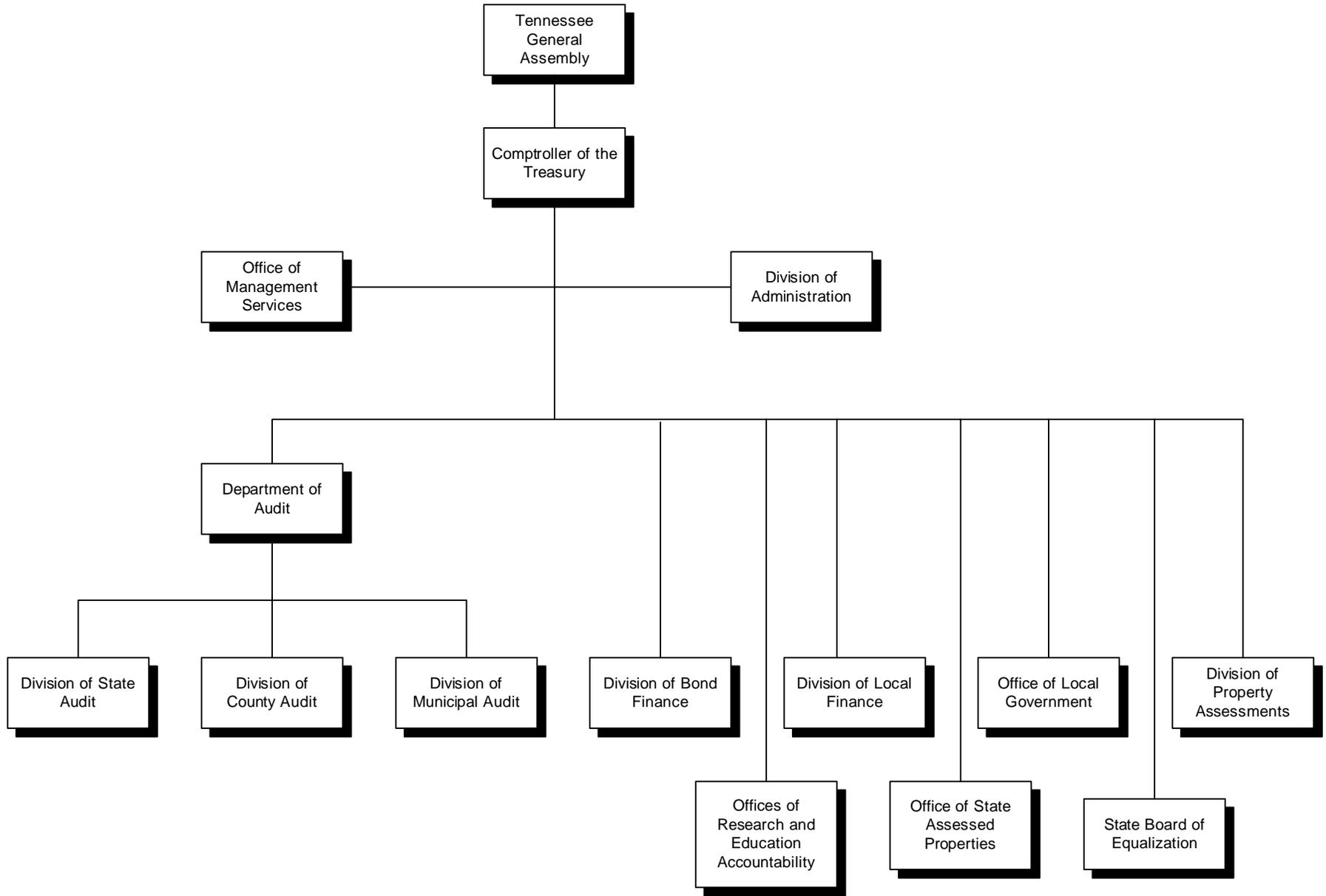
The Office of Local Government provides technical assistance to local governments in redistricting efforts and in establishing precincts, maintains county precinct information, and provides mapping services.

The State Board of Equalization is responsible for assuring constitutional and statutory compliance in assessments of property for ad valorem taxes. The board establishes rules and hears appeals for property value, property exemption and public utility assessments.

The Division of Property Assessments assists local governments in assessment of property for tax purposes and administers the property tax relief program, which provides reimbursements to low-income elderly or disabled persons and certain disabled veterans or their surviving spouses.

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

# Comptroller of the Treasury Organization Chart



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## **AUDIT SCOPE**

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We have audited the Comptroller of the Treasury for the period July 1, 2004, through June 30, 2005. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of the State Board of Equalization, the Ad Valorem Tax Equity Payments Program, and compliance with the Financial Integrity Act, Title VI of the Civil Rights Act of 1964, and Title IX of the Education Amendments Act of 1972.

The auditors are not considered independent of the audited entity because they are employees of the Comptroller of the Treasury.

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## **OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS**

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### **STATE BOARD OF EQUALIZATION**

Our objectives in reviewing the State Board of Equalization were to determine whether

- controls over receiving, depositing, recording and reconciling fees and hearing costs and controls over refunding hearing costs were adequate;
- reconciliations between receipts and recorded revenue were proper;
- property appeals system controls were adequate and system edits ensured that required information was present; and
- changes to system data were properly documented.

We interviewed key personnel and reviewed supporting documentation to gain an understanding of the board's controls over receipting, depositing, recording, and reconciling fees and hearing costs and refunds of hearing costs. We used computer-assisted audit techniques to confirm that system controls and edits were in place and that system information was present. We reviewed system database controls to determine whether changes to data were properly documented.

Based on our interviews and reviews of supporting documentation, we determined that controls over the property appeals system were adequate, required information was present in the system, and changes to system data were adequately documented. However, controls over the property value appeals cash receipting, depositing, recording, reconciling, and cash refunding process were not adequate as noted in the finding.

## **Controls over the property value appeals process do not adequately mitigate the risk of misappropriation of funds**

The Executive Secretary of the State Board of Equalization has not taken all steps necessary to ensure adequate controls are in place over the property value appeal process regarding cash receipts and disbursements. Cash receipts are not reconciled to deposits or to the accounting records, and segregation of duties has not been established to provide assurance that refunds are accurate and not stolen.

### **Receipts and Deposits**

Persons appealing their property appraisals must pay the State Board of Equalization a fixed, non-refundable filing fee of \$5 per parcel and prepay an amount for hearing costs ranging between \$12.50 and \$50.00 per parcel based on the property's assessed value prior to the instigation of the appeal review process. The board recognizes the filing fee as revenue upon receipt. The hearing costs are deposited, recorded as contingent revenue, and held pending the appeal outcome. Based upon the outcome of the appeal, hearing costs may be fully or partially refunded on a prorated basis. The refund is transferred from contingent revenue and paid to the appellant, and the non-refunded portion of the hearing costs is transferred from contingent revenue to the board's revenue account.

Our review revealed that funds collected by the State Board of Equalization are logged and forwarded to the Office of Management Services, where deposits are prepared and made, and the accounting entries are recorded. The State Board of Equalization has not performed independent reconciliations of the cash receipts logs to the deposit slip and accounting records to ensure that all funds submitted to the Office of Management Services were deposited and that the deposits were recorded in the appropriate revenue and contingent revenue accounts. Although controls are deficient, we did not identify any problems with receipting or recording deposits within either the Office of Management Services or the State Board of Equalization. However, if independent reconciliations are not performed by the State Board of Equalization, Office of Management Services personnel could fail to make deposits, and errors in either the deposits or the accounting records could go undetected.

### **Refund Process**

Finally, the Legislative Legal Secretary for Property Value Appeals initiates and executes each step of the refund process. Specifically, the employee enters initial appeal data into the Property Value Appeal System, monitors the progress of appeals, updates the status of appeals in the system, manually adjusts the prepaid hearing cost to reflect refunds when applicable, receives the appellants' refund warrants from the Department of Finance and Administration, and mails the refund warrants to the designated property owner. While the approval of refund requests by the Executive Secretary of the Board of Equalization provides some degree of control over the transactions, management could further mitigate any risk of fraud or errors by precluding the person initiating the request for the appellant refund from having access to the refund warrant. While no instance of malfeasance has been identified, the current process may provide an

employee the ability to initiate an improper refund and obtain the refund warrant without detection.

### **Recommendation**

Reconciliations between the database and financial transactions should be developed, performed, and documented by someone independent of database entry. The Executive Secretary of the State Board of Equalization should develop procedures to ensure that staff duties for initiating the refund request, processing, and distributing refund warrants are properly segregated.

In addition, management should ensure that risks such as these noted in this finding are adequately identified and addressed in their documented risk assessment activities. Management should identify specific staff to be responsible for the design and implementation of internal controls to prevent and detect exceptions timely. Management should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt action should exceptions occur.

### **Management's Comment**

We concur. The State Board of Equalization will revise procedures to provide proper cash receipts reconciliation. The State Board of Equalization will also appropriately clarify procedures and ensure all staff understand and carry out the disbursement of refunds with adequate segregation of duties.

In addition, Management has begun the process of risk assessment and a formal risk assessment plan will be developed.

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### **AD VALOREM TAX EQUITY PAYMENTS**

Our objectives in reviewing the ad valorem tax equity payments program were to determine whether

- requests for tax reduction payments were in writing and submitted timely,
- a notarized statement of the property taxes paid by jurisdiction was attached to the request for payment, and
- tax reduction payments were paid correctly.

We tested a nonstatistical sample of tax reduction payments to verify the payment requests were in writing and submitted timely. We tested requests to ensure they were notarized. We reviewed the calculations used to determine the tax reduction payments and tested payments.

Our review indicated that the tax reduction payment requests were written and submitted timely. Furthermore, our tests indicated that tax reduction payment requests were properly notarized and payments were correct.

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## **FINANCIAL INTEGRITY ACT**

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

Our objective was to determine whether the entity's June 30, 2005, responsibility letter was filed in compliance with Section 9-18-104, *Tennessee Code Annotated*.

We reviewed the June 30, 2005, responsibility letter submitted to the Comptroller of the Treasury and to the Department of Finance and Administration to determine adherence to the submission deadline. We determined that the Financial Integrity Act responsibility letter was submitted on time.

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## **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.

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*, which is required to be issued annually by the Comptroller of the Treasury. The Department of Audit has compiled reports for June 30, 2002, through June 30, 2006, to be published in 2006.

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## **TITLE IX OF THE EDUCATION AMENDMENTS ACT OF 1972**

Section 4-4-123, *Tennessee Code Annotated*, requires each state governmental entity subject to the requirements of Title IX of the Education Amendments Act of 1972 to submit an annual Title IX compliance report and implementation plan to the Department of Audit by June 30 each year. The Department of Audit is required to publish and distribute a cumulative report

of its findings and recommendations to the Governor, each member of the General Assembly, and to each library designated as a depositor of state reports and documents at least once each year. The Department of Audit has compiled reports for June 30, 2002, through June 30, 2006, to be published in 2006.

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## **OBSERVATIONS AND COMMENTS**

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### **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 increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We also 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.

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## APPENDIX

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### DIVISIONS AND ALLOTMENT CODES

Office of the Comptroller of the Treasury divisions and allotment codes:

307.01	Division of Administration
307.02	Office of Management Services
307.03	Capitol Print Shop
307.04	Division of State Audit
307.05	Division of County Audit
307.06	Division of Municipal Audit
307.07	Division of Bond Finance
307.08	Office of Local Government
307.09	Division of Property Assessments
307.10	Tax Relief Program
307.11	State Board of Equalization
307.12	Division of Local Finance
307.14	Offices of Research and Education Accountability
307.15	Office of State Assessed Properties
307.50	Ad Valorem Tax Equity Payments

The Comptroller is a member of the following:

Access Improvement Project Committee  
Advisory Commission on Intergovernmental Relations  
Advisory Committee to Monitor Internet  
Baccalaureate Education System Trust  
Board of Claims  
Board of Equalization  
Board of Standards  
Building Commission  
Child Care Facilities Corporation  
Consolidated Retirement System Board of Trustees  
Council on Pensions and Insurance  
Emergency Communications Board  
Funding Board  
Governor's Council on Health and Physical Fitness  
Health Services and Development Agency  
Higher Education Commission  
Housing Development Agency  
Industrial Development Authority  
Industrial Finance Corporation  
Information Systems Council  
Library and Archives Management Board  
Local Development Authority  
Local Education Insurance Committee  
Local Government Insurance Committee  
Public Records Commission  
Publications Committee  
Review Committee  
School Bond Authority  
Sports Festivals, Inc.  
State Capitol Commission  
State Government Improvement Task Force  
State Insurance Committee  
State Trust of Tennessee Board of Directors  
Student Assistance Corporation  
Tuition Guaranty Fund Board  
Utility Management Review Board  
Water/Wastewater Financing Board  
Workers Compensation Insurance Fund Board