Audit Results From
CAFR and Single Audit Procedures

Department of Education

For the Year Ended
June 30, 2006

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

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

Kandi B. Thomas, CPA, CFE
Assistant Director

Debra D. Bloomingburg, CPA, CFE
Audit Manager

Debby Myers, CISA
In-Charge Auditor

Justin Daniel
Jeff McClanahan, CPA, CFE
Staff Auditors

Amy Brack
Editor

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0246
(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.

Department of Education
For the Year Ended June 30, 2006

TABLE OF CONTENTS

Department of Education
For the Year Ended June 30, 2006

EXECUTIVE SUMMARY

Finding

The department's Executive Director of the Office of Business Services did not adequately monitor expenditures charged to the 2003-2004 Carl D. Perkins Vocational and Technical Education Grant, and as a result, staff continued to incur grant expenditures and draw down federal funds totaling $29,680 after the federal period of availability ended. Federal questioned costs totaled $29,680 (page 5).

This report addresses reportable conditions in internal control and noncompliance issues found at the Department of Education during our annual audit of the state's financial statements and major federal programs. For the complete results of our audit of the State of Tennessee, please see the State of Tennessee *Comprehensive Annual Financial Report* for the year ended June 30, 2006, and the State of Tennessee *Single Audit Report* for the year ended June 30, 2006. The scope of our audit procedures at the Department of Education was limited. During the audit for the year ended June 30, 2006, our work at the Department of Education focused on the Education Trust Fund, a major fund in the *Tennessee Comprehensive Annual Financial Report* of the State of Tennessee. Our audit of the fund included determining whether the department had an adequate system of internal control over financial reporting. We also performed certain audit procedures to obtain reasonable assurance about whether the State of Tennessee's financial statements were fairly presented. In addition, our work at the Department of Education included one major federal program: Vocational Education. We audited this federally funded program to determine whether the department complied with certain federal requirements and whether the department had an adequate system of internal control over the program to ensure compliance. Management's response is included following the finding.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

April 24, 2007

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

Ladies and Gentlemen:

Transmitted herewith are the results of certain limited procedures performed at the Department of Education as a part of our audit of the *Comprehensive Annual Financial Report* of the State of Tennessee for the year ended June 30, 2006, and our audit of compliance with the requirements described in the U.S. Office of Management and Budget Circular A-133 Compliance Supplement.

Our review of management's controls and compliance with laws, regulations, and the provisions of contracts and grants resulted in a finding which is detailed in the Finding and Recommendation section.

Sincerely,

John G. Morgan

John G. Morgan
Comptroller of the Treasury

JGM/ddb
07/013

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

December 21, 2006

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have performed certain audit procedures at the Department of Education as part of our audit of the financial statements of the State of Tennessee as of and for the year ended June 30, 2006. The scope of our work included the Education Trust Fund, a major fund in the *Comprehensive Annual Financial Report* of the State of Tennessee. Our objective was to obtain reasonable assurance about whether the State of Tennessee's financial statements were free of material misstatement. We emphasize that this has not been a comprehensive audit of the Department of Education.

We also have audited certain federal financial assistance programs as part of our audit of the state's compliance with the requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement. The following table identifies one of the State of Tennessee's major federal programs administered by the Department of Education. We performed certain audit procedures on this program as part of our objective to obtain reasonable assurance about whether the State of Tennessee complied with the types of requirements that are applicable to this major federal program.

Major Federal Program Administered by the Department of Education For the Year Ended June 30, 2006 (in thousands)

CFDA Number	Program Name	Federal Disbursements
84.048	Vocational Education	$34,212

Source: State of Tennessee's Schedule of Expenditures of Federal Awards for the year ended June 30, 2006.

The Honorable John G. Morgan
December 21, 2006
Page Two

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

We have issued an unqualified opinion, dated December 21, 2006, on the State of Tennessee's financial statements for the year ended June 30, 2006. We will issue, at a later date, the State of Tennessee *Single Audit Report* for the same period. In accordance with *Government Auditing Standards*, we will report on our consideration of the State of Tennessee's internal control over financial reporting and our tests of its compliance with certain laws, regulations, and provisions of contracts and grants in the *Single Audit Report*. That report will also contain our report on the State of Tennessee's compliance with requirements applicable to each major federal program and internal control over compliance in accordance with OMB Circular A-133.

As a result of our procedures, we identified an internal control and compliance issue related to the major federal program at the Department of Education. This issue, along with management's response, is described immediately following this letter. 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.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/ddb

FINDING AND RECOMMENDATION

<u>The department incurred grant expenditures related to the 2003-2004 Carl D. Perkins Vocational and Technical Education Grant and charged the federal government $29,680 after the grant's period of availability ended, resulting in federal questioned costs</u>

Finding

The department's Executive Director of the Office of Business Services did not adequately monitor expenditures charged to the 2003-2004 Carl D. Perkins Vocational and Technical Education Grant, and as a result, staff continued to incur grant expenditures and draw down federal funds totaling $29,680 after the federal period of availability ended.

According to the U. S. Department of Education (ED), the period of availability for this grant was July 1, 2003, through September 30, 2005. ED's Office of Vocational and Adult Education sent a memo dated January 17, 2005, to the department reminding them that "Federal funds awarded to your state from the U.S. Department of Education appropriation for Fiscal Year (FY) 2003 will become unavailable for your state to make any further obligations after September 30, 2005, *the end of the time period established by the Tydings Amendment.*"

We reviewed all expenditures charged to the grant after September 30, 2005, to determine whether the funds were properly obligated before September 30, 2005. We determined that 6 of the 24 expenditures (25%) were obligated after September 30, 2005, and should not have been charged to the grant. Federal questioned costs totaled $29,680.

When the Executive Director does not adequately monitor expenditures to ensure only available federal funds are requested from grantors, the department must refund unauthorized drawdowns to the grantors, and the state may be forced to fund the additional expenditure if other funding cannot be secured.

Recommendation

The Executive Director of the Office of Business Services should ensure that only expenditures properly obligated during the period of availability are charged to grants. Also, the Executive Director should ensure that other risks are identified and assessed in management's documented risk assessment. Management should implement effective controls to ensure compliance with applicable requirements and should assign staff to be responsible for ongoing monitoring of the risks and mitigating controls. Management should take appropriate action if deficiencies occur.

Management's Comment

The department concurs that expenditures totaling $29,679.98 were paid with Fiscal Year 2003-2004 Carl D. Perkins Vocational and Technical Education federal grant funds for obligations made during October 2005, which was after the period of obligation that ended September 30, 2005.

The questionable costs of $29,679.98 were refunded against the FY 2003-2004 grant and paid with federal funds from the FY 2005-2006 Carl D. Perkins Vocational and Technical Education grant as they were allowable costs for that grant award and were obligated within the July 1, 2005, to September 30, 2007, period of the FY 2005-2006 grant.

To improve the internal controls for federal grant expenditures, the Office of Business Services has implemented additional procedures to address the issues. First, a process has been established for management to conduct monthly reviews to monitor the grant expenditure activity reports to ensure that expenditures are for obligations incurred within the appropriate grant period. Second, additional mandatory federal grants management training has been established for all accounting and financial support staff involved in the processing of grant payments. Third, the Office of Business Services has identified federal grants management risk factors in the department's Risk Assessment Plan and provided recommendations for mitigating controls that are being evaluated and implemented. The department believes these actions will provide the internal controls necessary to ensure compliance with the applicable requirements.

STATUS OF PRIOR AUDIT FINDINGS

State of Tennessee *Single Audit Report* for the year ended June 30, 2005

The audit resulted in no audit findings.

Most Recent Financial and Compliance Audit

Audit report number 06/047 for the Department of Education, issued in April 2007, contained an audit finding that was not included in the State of Tennessee *Single Audit Report*. This finding was not relevant to our current audit and, as a result, we did not pursue its status as a part of this audit.

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 commissioner.

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.