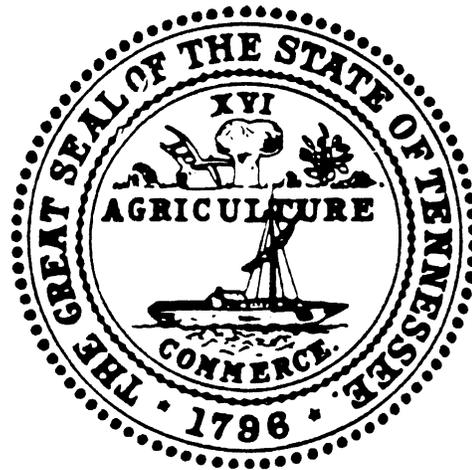


AUDIT REPORT

Office of the Comptroller of the Treasury

December 2006



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit
Division of State Audit



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STATE OF TENNESSEE
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December 14, 2006

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

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 period July 1, 2005, through June 30, 2006.

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 resulted in no audit findings.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/th
07022

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
Office of the Comptroller of the Treasury
December 2006

AUDIT SCOPE

We have audited the Comptroller of the Treasury for the period July 1, 2005, through June 30, 2006. Our audit scope included a review of internal control and compliance with policies, procedures, laws, and regulations in the areas of the State Board of Equalization, the Capitol Print Shop, Title VI of the Civil Rights Act of 1964, Title IX of the Education Amendments Act of 1972, and the Financial Integrity Act.

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

AUDIT FINDING

The audit report contains no findings.

**Financial and Compliance Audit
Office of the Comptroller of the Treasury**

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Financial and Compliance Audit Office of the Comptroller of the Treasury

INTRODUCTION

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 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 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.

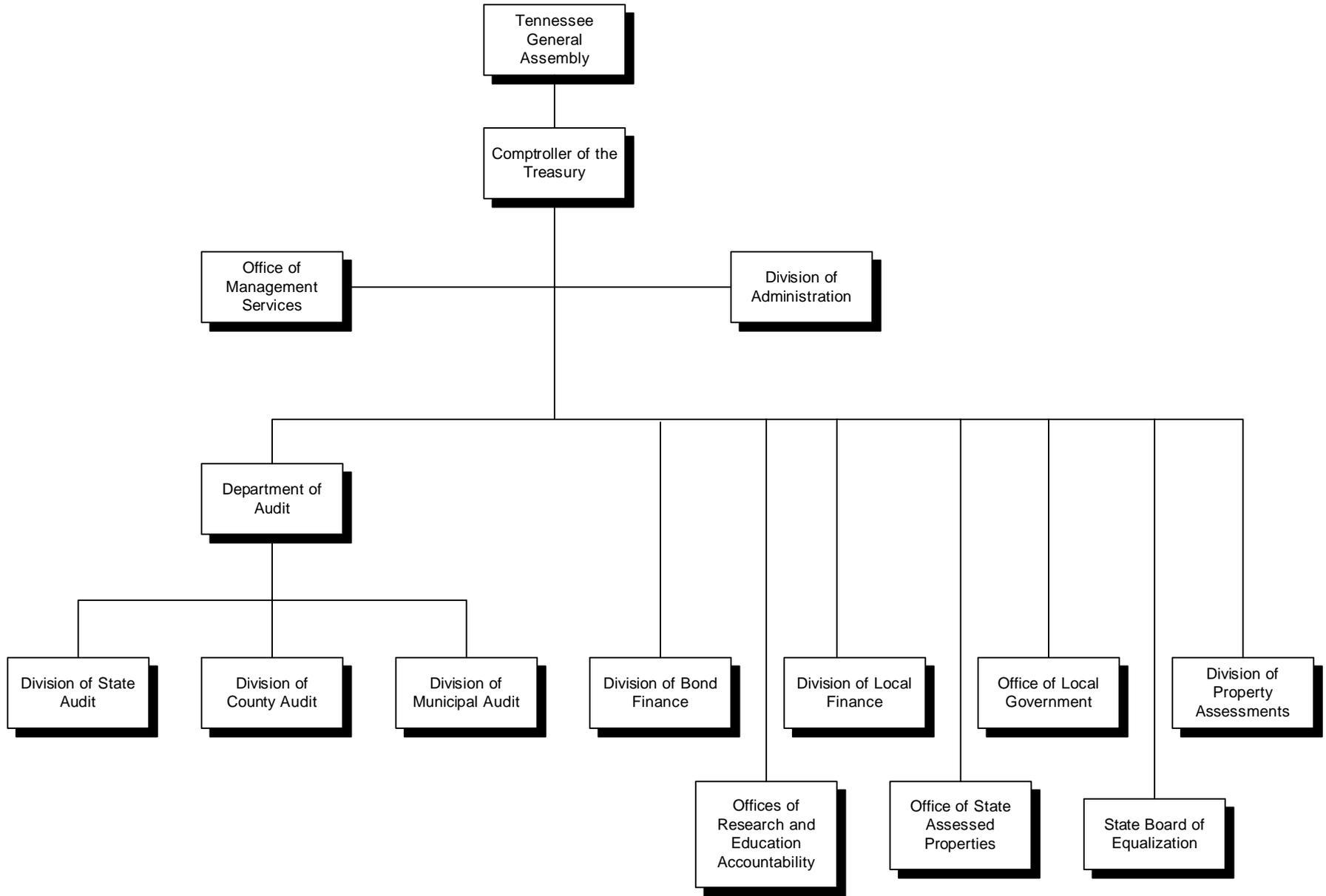
The Office of Local Government provides technical assistance to local governments in redistricting efforts and in establishing precincts, maintains county precinct information, and provides mapping services.

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



AUDIT SCOPE

We have audited the Comptroller of the Treasury for the period July 1, 2005, through June 30, 2006. Our audit scope included a review of management's control and compliance with policies, procedures, laws, and regulations in the areas of the State Board of Equalization, the Capitol Print Shop, Title VI of the Civil Rights Act of 1964, Title IX of the Education Amendments Act of 1972, and compliance with the Financial Integrity Act.

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

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 Office of the Comptroller of the Treasury is due to file its report with the Department of Audit in January 2007. A follow-up of the prior audit finding was conducted as part of the current audit.

RESOLVED AUDIT FINDING

The current audit disclosed that the Office of the Comptroller of the Treasury has made changes in order to correct the previous audit finding concerning controls over the property value appeals process not mitigating the risk of misappropriation of funds.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

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 were adequate, 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 over 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 fees and hearing costs were adequate, controls over the property appeals systems were adequate, required information was present in the system, and changes to system data were adequately documented.

CAPITOL PRINT SHOP

Our objectives in reviewing the Capitol Print Shop were to determine whether

- controls over receiving, storing, and removing inventory were adequate;
- reconciliations between inventory on hand and inventory records were performed;
- controls related to approving, processing, and billing print jobs were adequate; and
- controls over mailroom processes were adequate.

We interviewed key personnel and reviewed supporting documentation to gain an understanding of the Capitol Print Shop's controls and reconciliations related to inventory, print jobs, and mailroom procedures. Based on our interviews and reviews of supporting documentation, we determined that controls over inventory, print jobs, and mailroom processes were adequate.

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.

Our objectives were to determine whether the entity's June 30, 2006, responsibility letter was filed in compliance with Section 9-18-104, *Tennessee Code Annotated*.

We reviewed the June 30, 2006, 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.

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, and the report was published October 17, 2006.

TITLE IX OF THE EDUCATION AMENDMENTS OF 1972

Section 4-4-123, *Tennessee Code Annotated*, requires each state governmental entity subject to the requirements of the 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, and the report was published October 17, 2006.

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.

AUDIT COMMITTEE

On May 19, 2005, the Tennessee General Assembly 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. Entities, pursuant to the act, are required to appoint the audit committee and develop an audit committee charter in accordance with the legislation. The ongoing responsibilities of an audit committee include, but are not limited to:

1. overseeing the financial reporting and related disclosures, especially when financial statements are issued;
2. evaluating management’s assessment of risk and the agency’s system of internal controls;
3. formally reiterating, on a regular basis, to the board, agency management, and staff their responsibility for preventing, detecting, and reporting fraud, waste, and abuse;
4. serving as a facilitator of any audits or investigations of the agency, including advising auditors and investigators of any information it may receive pertinent to audit or investigative matters;
5. informing the Comptroller of the Treasury of the results of assessment and controls to reduce the risk of fraud; and
6. promptly notifying the Comptroller of the Treasury of any indications of fraud.

Subsequent to the completion of fieldwork, the State Board of Equalization created a three-member audit committee at its meeting on November 20, 2006. On December 6, 2006, the board approved the audit committee charter. The audit committee charter was approved by the Comptroller of the Treasury on December 7, 2006.

APPENDIX

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:

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 Finance Corporation
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