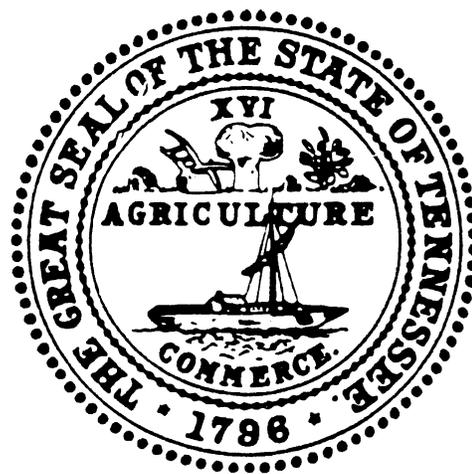


AUDIT REPORT

Tennessee Higher Education Commission

July 2007



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit
Division of State Audit



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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

State Capitol
Nashville, Tennessee 37243-0260
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John G. Morgan
Comptroller

July 12, 2007

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

and
Dr. Richard G. Rhoda, Executive Director
Tennessee Higher Education Commission
Suite 1900, Parkway Towers
404 James Robertson Parkway
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Higher Education Commission for the period May 26, 2004, through May 31, 2007.

The review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements resulted in no audit findings.

Sincerely,

A handwritten signature in black ink that reads "John G. Morgan".

John G. Morgan
Comptroller of the Treasury

JGM/ddb
07/088



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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June 5, 2007

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 Tennessee Higher Education Commission for the period May 26, 2004, through May 31, 2007.

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 Tennessee Higher Education Commission's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Tennessee Higher Education Commission 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 resulted in no audit findings.

Sincerely,

A handwritten signature in black ink, appearing to read "Arthur A. Hayes, Jr." with a stylized flourish at the end.

Arthur A. Hayes, Jr., CPA
Director

AAH/ddb

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Tennessee Higher Education Commission
July 2007

AUDIT SCOPE

We have audited the Tennessee Higher Education Commission for the period May 26, 2004, through May 31, 2007. 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 financial related issues 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 serving as a member of the board of directors of the Tennessee Higher Education Commission; approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; participating in the negotiation and procurement of services for the state; and providing support staff to various legislative committees and commissions.

AUDIT FINDINGS

The audit report contains no findings.

Financial and Compliance Audit Tennessee Higher Education Commission

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Financial and Compliance Audit Tennessee Higher Education Commission

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Tennessee Higher Education Commission. 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 Tennessee Higher Education Commission was created in 1967 by the General Assembly. The purpose of the coordinating board is to create cooperation and unity among the state institutions of higher education. The commission coordinates two systems of higher education: the University of Tennessee campuses, governed by the University of Tennessee Board of Trustees; and the state universities, community colleges, technical institutes, and technology centers, governed by the Tennessee Board of Regents.

The commission’s mission is to carry out the statutory responsibilities through a board consisting of nine lay members representing Tennessee’s congressional districts and appointed by the Governor; as well as the State Comptroller; State Treasurer; Secretary of State; Executive Director of the Board of Education; and two student members, one from the University of Tennessee system and one from the Tennessee Board of Regents system.

The statutory responsibilities mandate that the commission develop a master plan for Tennessee postsecondary education, public and private; develop formulae and recommend the operating and capital budgets for public higher education; review and approve new academic programs; provide data and information to the public, institutions, the legislature, and state government; and license and regulate private vocational postsecondary institutions operating within the state.

The underlying principles of the policies developed by the commission are equity, excellence, accessibility, and accountability.

An organization chart of the Tennessee Higher Education Commission is on the following page.

AUDIT SCOPE

We have audited the Tennessee Higher Education Commission for the period May 26, 2004, through May 31, 2007. 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 financial related issues 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 serving as a member of the board of directors of the Tennessee Higher Education Commission; 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.

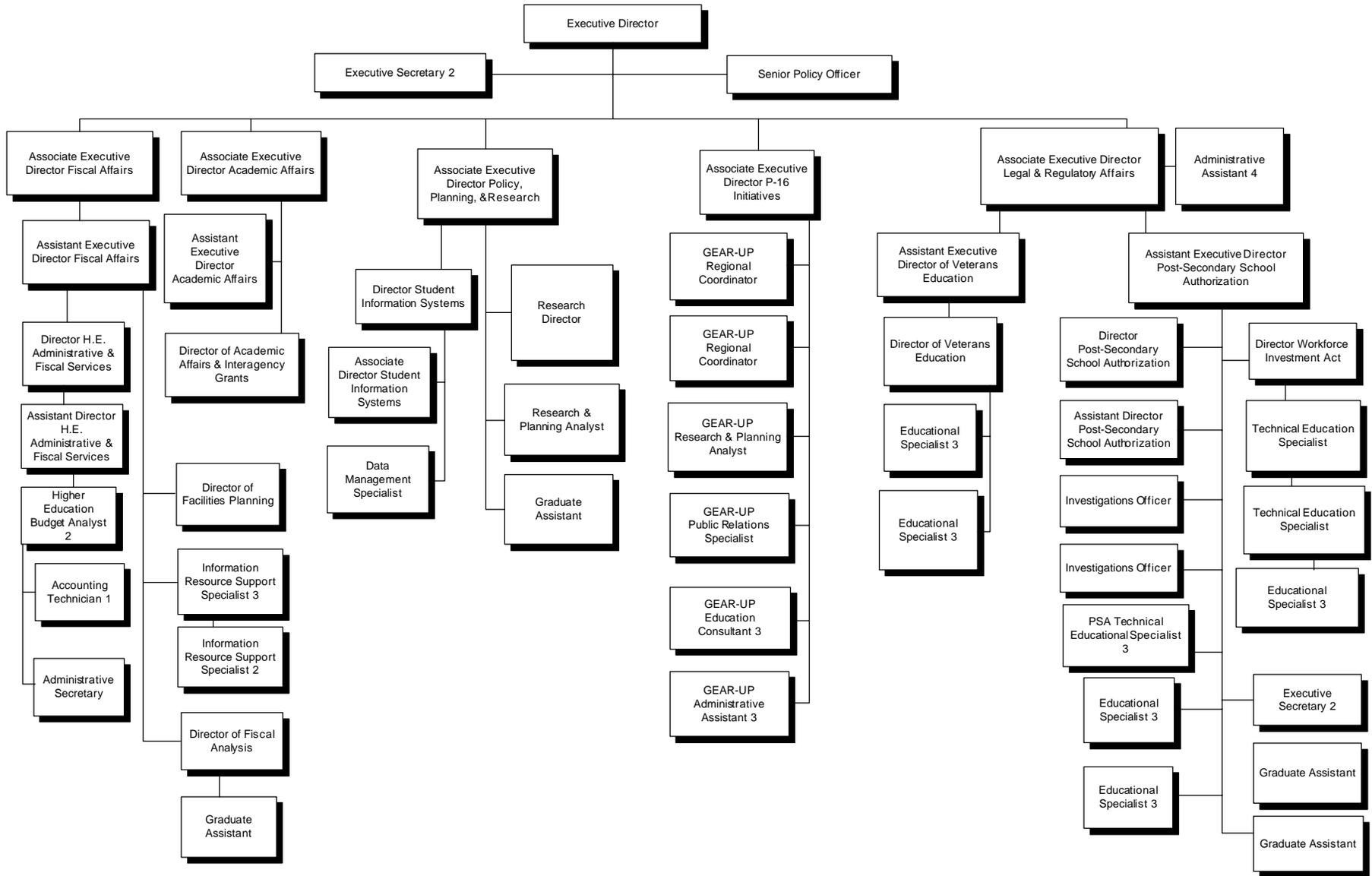
PRIOR AUDIT FINDINGS

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 Tennessee Higher Education Commission filed its report with the Department of Audit on February 18, 2005. 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 Tennessee Higher Education Commission has corrected the previous audit finding concerning the preparation and submission of the required Financial Integrity Act Letter.

Tennessee Higher Education Commission Organizational Chart



OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

FINANCIAL RELATED ISSUES

Our objectives for reviewing financial related issues were to document internal controls and determine whether

- the commission's controls over financial related issues were adequate;
- expenditures and travel claims were adequately supported, properly approved, properly classified in the accounting records, paid in a timely manner, and in compliance with State Travel Regulations;
- proper purchasing procedures were followed;
- deposits were properly recorded and reconciled to the State of Tennessee Accounting and Reporting System (STARS);
- revenue transactions were properly recorded, adequately supported, properly processed, and reconciled to STARS; and
- funds from the Tuition Guaranty Fund were properly disbursed.

To accomplish our objectives, we interviewed key personnel and documented the commission's internal controls over financial related issues. We selected a nonstatistical sample of expenditures and travel claims and tested these transactions to determine if adequate supporting documentation was maintained, if proper approval was obtained for the expenditure, if proper purchasing procedures were followed, if the transaction was properly classified in the accounting records, if payment was made in a timely manner, and if travel expenditures complied with State Travel Regulations. We tested revenues by selecting a month of cash receipts and tracing the receipts to certificates of deposit to ensure the deposit was properly recorded and reconciled to STARS. We also selected a nonstatistical sample of revenues and tested these transactions to determine if the revenue was properly recorded, adequately supported, properly processed, and reconciled to STARS. We reviewed the Tuition Guaranty Fund procedures and reviewed the payouts to one institution to determine if the funds were properly disbursed.

As a result of our interviews and testwork performed, we determined that the commission's controls over financial related issues were adequate and expenditures and travel claims were adequately supported, properly approved, properly classified in the accounting records, paid in a timely manner, and in compliance with State Travel Regulations. We determined that proper purchasing procedures were followed. Based on our testwork, we determined that deposits were properly recorded and reconciled to STARS, and revenue transactions were properly recorded, adequately supported, properly processed, and reconciled to

STARS. We also determined that funds from the Tuition Guaranty Fund were properly disbursed.

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 was to determine whether the Tennessee Higher Education Commission's June 30, 2006; 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, 2006; June 30, 2005; and June 30, 2004, responsibility letters submitted to the Comptroller of the Treasury and the Department of Finance and Administration to determine adherence to the submission deadline. We determined that the Financial Integrity Act responsibility letters were submitted on time.

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, *Consideration of Fraud in a Financial Statement Audit*, 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 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.

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.

The board of the Tennessee Higher Education Commission appointed a three-member audit committee on November 17, 2005. The audit committee charter was approved by the Comptroller of the Treasury on May 8, 2006. The audit committee met its requirements as outlined in the charter except for reviewing management's risk assessment. Management's risk assessment report has not been completed but will be forwarded to the audit committee for review upon completion.

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 Tennessee Higher Education Commission filed its compliance reports and implementation plans on June 30, 2006; June 30, 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. 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*, issued annually by the Comptroller of the Treasury.

APPENDIX

ALLOTMENT CODES

Tennessee Higher Education Commission allotment codes:

- 332.01 Higher Education Commission
- 332.02 Contract Education Program
- 332.08 Centers of Excellence
- 332.09 THEC Grants
- 332.11 Campus Centers of Emphasis
- 332.13 Geier Desegregation Settlement