AUDIT REPORT

Executive Department

October 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

October 4, 2007

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

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Executive Department for the period February 1, 2005, through June 30, 2007.

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

Sincerely,

John G. Morgan

John G. Morgan
Comptroller of the Treasury

JGM/ddb
07/099

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COMPTROLLER OF THE TREASURY
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July 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 Executive Department for the period February 1, 2005, through June 30, 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 Executive Department's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Executive Department 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.

We have reported certain less significant matters involving the department's internal control to the Executive Department's management in a separate letter.

Sincerely,

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
Executive Department
October 2007

AUDIT SCOPE

We have audited the Executive Department for the period February 1, 2005, through June 30, 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 revenues, expenditures, equipment, payroll and personnel, 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 FINDINGS

The audit report contains no findings.

Financial and Compliance Audit
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INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Executive Department. 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 Governor is the chief executive of the state and holds the office for a four-year term. The Tennessee Constitution permits the Governor to serve two consecutive four-year terms.

The Governor's constitutional duties, in addition to being chief executive, include serving as commander-in-chief of the Army and Navy of the state; considering requests for executive clemency; convening the General Assembly in extraordinary sessions by proclamation; reporting to the General Assembly information on the state of the government and recommending for their consideration such measures as he judges expedient; sealing and signing all grants and commissions in the name and by the authority of the State of Tennessee; and signing or vetoing bills passed by both houses of the General Assembly.

Effective July 1, 2007, the Office of Homeland Security was transferred from the Executive Department to the Department of Safety in accordance with Executive Order 48.

AUDIT SCOPE

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PRIOR AUDIT FINDING

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 Executive Department filed its report with the Department of Audit on September 12, 2005. A follow-up of the prior audit finding was conducted as part of the current audit.

The current audit disclosed that the Executive Department corrected the previous audit finding concerning noncompliance with the Financial Integrity Act.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

REVENUES

The objectives of our review of the controls and procedures over revenues were to determine whether

- revenue transactions were properly coded and accurately recorded in the accounting records and were properly documented;
- cash collected during the audit period was deposited timely and intact;
- auditee records were reconciled to the State of Tennessee Accounting and Reporting System (STARS) reports;
- reimbursement of personal cell phone usage was in compliance with departmental policy; and

- the petty cash fund was approved and appropriately reimbursed.

We interviewed key personnel and reviewed departmental and applicable Department of Finance and Administration policies to gain an understanding of the department's procedures and controls over revenues and personal cell phone usage. We selected a nonstatistical sample of 25 revenue transactions for the period February 1, 2005, through April 30, 2007, to determine if revenue transactions were properly coded. We selected another nonstatistical sample of 25 revenue transactions for the period February 1, 2005, through April 30, 2007, to determine if the transactions were accurately recorded in the accounting records and properly documented and to determine if cash collected during the audit period was deposited timely and intact. We discussed the procedures used to reconcile auditee records to STARS and reviewed a reconciliation to ensure that auditee records were reconciled to STARS reports. We reviewed cash deposits for cell phone reimbursements to determine if reimbursement of personal cell phone usage was in compliance with departmental policy. We also reviewed approval for the petty cash account and performed a petty cash test count to determine if the petty cash fund was approved and appropriately reimbursed.

Based on our interviews, reviews of supporting documentation, and testwork, we determined that revenue transactions were properly coded and accurately recorded in the accounting records and were properly documented; cash collected during the audit period was deposited timely and intact; auditee records were reconciled to STARS reports; reimbursement of personal cell phone usage was in compliance with departmental policy; and the petty cash fund was approved and appropriately reimbursed.

EXPENDITURES

The objectives of our review of the controls and procedures over expenditures were to determine whether

- expenditures were for goods and services authorized and received;
- expenditures were properly recorded by account, budget category, period, and amount;
- expenditures were made in a timely manner;
- expenditures for travel were paid in accordance with the state's Comprehensive Travel Regulations;
- contracts were properly approved;
- contract expenditures were properly supported and in compliance with applicable policies, procedures, and contract terms;
- the purpose of state aircraft usage appeared proper; and

- voucher registers were reconciled to Department of Finance and Administration reports.

We interviewed key personnel and reviewed the Department of General Services' purchasing rules and applicable Department of Finance and Administration policies to gain an understanding of the Executive Department's procedures and controls over expenditures. We selected a nonstatistical sample of 25 expenditure transactions for the period February 1, 2005, through April 30, 2007, and reviewed invoices, journal vouchers, and travel claims to determine if expenditures for goods and services were authorized and received; expenditures were properly recorded by account, budget category, period, and amount; expenditures were made in a timely manner; and expenditures for travel were paid in accordance with the state's Comprehensive Travel Regulations. We also selected a nonstatistical sample of 25 contract expenditures for the period February 1, 2005, through April 30, 2007, and reviewed contracts, invoices, and journal vouchers to determine if the contracts were properly approved and if contract expenditures were properly supported and in compliance with applicable policies, procedures, and contract terms. In addition, we reviewed all state aircraft usage by the Governor for the period February 1, 2005, through April 30, 2007, to determine if the usage appeared proper. We reviewed voucher registers to determine if they were reconciled to Department of Finance and Administration reports.

Based on our interviews, reviews of supporting documentation, and testwork, we determined that expenditures for goods and services were authorized and received; expenditures were properly recorded by account, budget category, period, and amount; expenditures were made in a timely manner; and expenditures for travel were paid in accordance with the state's Comprehensive Travel Regulations. We also determined that contracts were properly approved and contract expenditures were properly supported and in compliance with applicable policies, procedures, and contract terms. In addition, we determined that the purpose of the state aircraft usage appeared proper. We determined that voucher registers were reconciled to Department of Finance and Administration reports.

EQUIPMENT

The objectives of our review of the controls and procedures over equipment were to determine whether

- equipment items were adequately safeguarded;
- the department's property and equipment listed in the Property of the State of Tennessee (POST) system represented an accurate and complete listing of assets on hand;
- equipment purchased during the audit period was properly recorded in POST; and

- lost or stolen equipment was properly reported to the Comptroller's Office and deleted from POST.

We interviewed key personnel and reviewed the Department of General Services' equipment procedures to gain an understanding of the Executive Department's procedures and controls over equipment. We discussed the security of equipment items with departmental personnel and observed security of the building and equipment to determine if equipment items were adequately safeguarded. We selected a nonstatistical sample of 25 equipment items from POST as of April 30, 2007, and observed or confirmed the items to determine if the department's property and equipment listed in POST represented an accurate and complete listing of assets on hand. We also selected a nonstatistical sample of 25 equipment purchases for the period February 1, 2005, through April 30, 2007, from STARS to determine if equipment purchased during the audit period was properly recorded in POST. We inquired of management, reviewed State Audit's correspondence file for the department, and reviewed POST to determine if lost or stolen equipment was properly reported to the Comptroller's Office and deleted from POST.

Based on interviews, reviews of supporting documentation, and testwork, we determined that equipment items were adequately safeguarded; the department's property and equipment listed in POST represented an accurate and complete listing of assets on hand; equipment purchased during the audit period was properly recorded in POST; and lost or stolen equipment was properly reported to the Comptroller's Office and deleted from POST.

PAYROLL AND PERSONNEL

The objectives of our review of controls and procedures over payroll and personnel were to determine whether

- payroll disbursements were made only for work authorized and performed by employees of the department;
- payroll disbursements were computed using rates and other factors in accordance with relevant laws and regulations;
- payroll disbursements were recorded correctly as to amount and properly by account, fund, and budget category;
- employees hired during the audit period were properly approved prior to appointment; and
- supplemental pay was reasonable, adequately documented, and correctly computed.

We interviewed key personnel and reviewed personnel files, time sheets, and payroll registers to gain an understanding of the department's procedures and controls over payroll and personnel. We tested a nonstatistical sample of 25 payroll transactions for the period February 1, 2005, through April 15, 2007, and reviewed personnel files and time sheets to determine if payroll disbursements were made only for work authorized and performed by employees of the department; payroll disbursements were computed using rates and other factors in accordance with relevant laws and regulations; payroll disbursements were recorded correctly as to amount and properly by account, fund, and budget category; and employees hired during the audit period were properly approved prior to appointment. We also sent confirmations to all employees in the sample to confirm they were employed during the audit period. In addition, we selected a nonstatistical sample of 25 supplemental payroll payments for the period February 1, 2005, through April 15, 2007, to determine if supplemental pay was reasonable, adequately documented, and correctly computed.

Based on our interviews, reviews of supporting documentation, and testwork, we determined that payroll disbursements were made only for work authorized and performed by employees of the department; payroll disbursements were computed using rates and other factors in accordance with relevant laws and regulations; payroll disbursements were recorded correctly as to amount and properly by account, fund, and budget category; employees hired during the audit period were properly approved prior to appointment; and supplemental pay was reasonable, adequately documented, and correctly computed.

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 Executive Department's June 30, 2006, and June 30, 2005, responsibility letters were filed in compliance with Section 9-18-104, *Tennessee Code Annotated.*

We reviewed the June 30, 2006, and June 30, 2005, 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 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.

APPENDIX

ALLOTMENT CODES

Executive Department allotment codes:

315.01 Governor's Office
315.02 Intergovernmental Conference
315.04 Gubernatorial Transition Office
315.05 Office of Homeland Security