

# AUDIT REPORT

Office of the Comptroller of the Treasury

December 2008



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**  
DEPARTMENT OF AUDIT  
DIVISION OF STATE AUDIT

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December 30, 2008

The Honorable Phil Bredesen, Governor  
and

Members of the General Assembly  
State Capitol  
Nashville, Tennessee 37243

and

The Honorable John G. Morgan  
Comptroller of the Treasury  
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, 2007, through June 30, 2008.

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 internal control and tests of compliance resulted in no audit findings.

Sincerely,

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

Arthur A. Hayes, Jr., CPA  
Director

AAH/aj  
09/022

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 2008

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## **AUDIT SCOPE**

We have audited the Office of the Comptroller of the Treasury for the period July 1, 2007, through June 30, 2008. Our audit scope included a review of internal control and compliance with policies, procedures, laws, and regulations in the areas of Revenues/Expenditures, Property Tax Relief, and the Financial Integrity Act.

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

## **AUDIT FINDINGS**

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

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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 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 the 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 TennCare section of the

Division of State Audit, under an agreement with the Department of Finance and Administration, performs certain audit and rate-setting functions for the state's TennCare program.

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 and telecommunications ad valorem tax equity payments 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.

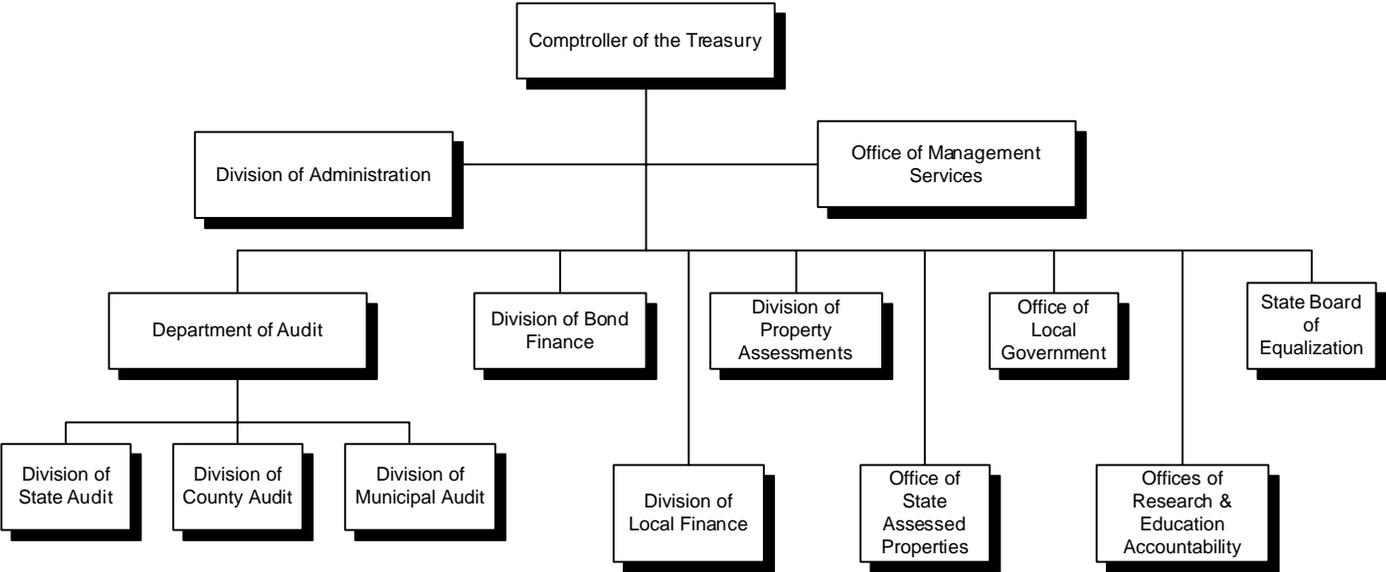
The Office of Local Government provides technical assistance to local governments in redistricting efforts and in establishing precincts, maintains county precinct information, and provides mapping services.

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 values, 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 Office of the Comptroller of the Treasury for the period July 1, 2007, through June 30, 2008. Our audit scope included a review of internal control and compliance with policies, procedures, laws, and regulations in the areas of Revenues/Expenditures, Property Tax Relief, and the Financial Integrity Act.

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

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## **PRIOR AUDIT FINDINGS**

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There were no audit findings in the prior audit report.

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

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### **REVENUES/EXPENDITURES**

Our objectives in reviewing Revenues and Expenditures were to determine whether

- the office experienced significant or unusual fluctuations in revenues which required management explanations;
- the office experienced significant or unusual fluctuations in operating expenditures, including salary expenditures, which required management explanations;
- procurement card transaction logs were maintained and reconciled to the credit card statements;
- procurement cards were used for any unusual purchases and to determine, in such cases, that the related expenditures were properly approved and supported;
- travel expenditures incurred by key employees and the Comptroller were necessary and reasonable;
- management routinely reviewed the State of Tennessee Accounting and Reporting System (STARS) reports for evidence of duplicate travel claims;

- the office paid appropriate in-state mileage costs for employees in the Division of County Audit;
- the cost of leasing office space in the Bank of America Plaza was less than the Facilities Revolving Fund rate and was approved by the Commissioner of the Department of Finance and Administration; and
- applicable policies and procedures were followed in the acquisition of the contract for the IMPACT system that will be used for Property Tax Administration.

To determine if the office experienced significant or unusual fluctuations in revenues, we obtained a summary of revenue by both division and source for both the current year and prior year. We compared the revenue received by each division and source for the two years. To determine if the office experienced significant or unusual fluctuations in operating expenditures, including salary expenditures, we obtained a summary of operating expenditures, including salaries, by both division and object code for both the current and prior year. We compared the expenditures reported by each division and object code for the two years. We obtained explanations and evaluated corroborating evidence from management for differences considered significant or unusual. We interviewed key personnel and reviewed supporting documentation to determine that procurement card transaction logs were maintained and reconciled to the credit card statements. To determine whether procurement cards were used to acquire unusual purchases and that those related expenditures were properly approved and supported, we reviewed procurement card logs and statements for unusual purchases. We reviewed receipts, reviewed additional support as necessary, and obtained explanations from management for unusual purchases that were noted. We reviewed travel claims and the related support for key employees and the Comptroller to determine if the travel expenditures incurred were necessary and reasonable. We interviewed key personnel and reviewed supporting documentation to determine that management routinely reviewed STARS reports for evidence of duplicate travel claims. To determine if the office paid appropriate in-state mileage to Division of County Audit employees, we talked to staff to determine the procedures for claiming in-state mileage. We totaled the amount of in-state mileage claimed by each employee for the fiscal year. For the two individuals with the highest amounts of mileage claimed, we calculated the average daily miles traveled and compared the results to our expectations based on our understanding of policy. We interviewed key personnel and reviewed supporting documentation to determine that the cost of leasing office space in the Bank of America Plaza was less than the Facilities Revolving Fund rate and was approved by the Commissioner of the Department of Finance and Administration. To determine if applicable policies and procedures were followed in the acquisition of the contract for IMPACT, we interviewed key personnel and reviewed supporting documentation; we reviewed the contract for IMPACT, as well as the Request for Proposal and the related bid documentation.

As a result of our review of revenues and expenditures, we determined that

- there were no significant or unusual fluctuations in revenues requiring explanation by management;

- the office experienced significant fluctuations in operating expenditures for which management had reasonable explanations, and there were no significant variances in salary expenditures;
- procurement card transaction logs were maintained and reconciled to the credit card statements;
- procurement card transactions were properly approved and supported for unusual purchases;
- travel expenditures incurred by key employees and the Comptroller were necessary and reasonable;
- management routinely reviewed STARS reports for evidence of duplicate travel claims;
- the office paid Division of County Audit employees appropriate in-state mileage costs;
- the cost of leasing office space in the Bank of America Plaza was less than the Facilities Revolving Fund rate and was approved by the Commissioner of the Department of Finance and Administration; and
- applicable policies and procedures were followed in the acquisition of the contract for the IMPACT system that will be used for Property Tax Administration.

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## **PROPERTY TAX RELIEF**

Our objectives in reviewing the Property Tax Relief Program were to determine whether

- controls existed to verify critical information entered in the Tax Relief Approval Information Network (TRAIN);
- management has configured the TRAIN system to store an audit trail of all eligibility decisions resulting from the review and examination of applications;
- management has configured the TRAIN system to prohibit employees from serving as both reviewer and examiner on the same property tax relief application; and
- tax relief employees with access to TRAIN did not bypass TRAIN approval controls by entering payments directly in the State of Tennessee Accounting and Reporting System (STARS).

We interviewed key personnel to determine that controls exist to verify critical information entered in the TRAIN system and that tax relief employees with access to TRAIN cannot bypass TRAIN approval controls by entering payments directly in STARS. To determine that management had configured the TRAIN system to store an audit trail of all eligibility decisions resulting from the review and examination of applications, we observed the various screens for evidence of employee approval on the TRAIN system that must be checked “OK to

pay” for an application to be approved. To determine that management has configured the TRAIN system to prohibit employees from serving as both reviewer and examiner on the same property tax relief application, we observed an employee’s attempt to review an application that the same employee had examined earlier in the day and noted that the system would not allow the employee to make changes to any of the screens. To determine that tax relief employees with access to TRAIN cannot bypass TRAIN approval controls by entering payments directly in STARS, we obtained a listing from management of all Property Tax Relief employees that had access to STARS. For those employees on the listing, we searched the STARS history file for any transactions initiated by the employee during the audit period.

As a result of our review of the Property Tax Relief program, we determined that

- management had controls to verify critical information entered in the TRAIN system;
- management configured the TRAIN system to store an audit trail of all eligibility decisions resulting from the review and examination of applications;
- management configured the TRAIN system to prohibit employees from serving as both reviewer and examiner on the same application; and
- tax relief employees with access to TRAIN did not bypass TRAIN approval controls by entering payments directly in STARS.

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## **FINANCIAL INTEGRITY ACT**

Section 9-18-104, *Tennessee Code Annotated*, requires the head of each executive agency to conduct an evaluation of the agency’s internal accounting and administrative control and submit a report to the Commissioner of Finance and Administration and the Comptroller of the Treasury by December 31, 1999, and December 31 of every fourth year thereafter.

Our objectives were to determine whether

- the office’s December 31, 2007, internal accounting and administrative control report was filed in compliance with Section 9-18-104, *Tennessee Code Annotated*;
- documentation to support the office’s evaluation of its internal accounting and administrative control was properly maintained; and
- procedures used in compiling information for the internal accounting and administrative control report were in accordance with the guidelines prescribed under Section 9-18-103, *Tennessee Code Annotated*.

We interviewed key employees responsible for compiling information for the internal accounting and administrative control report to gain an understanding of the office’s procedures. We also reviewed the December 31, 2007, internal accounting and administrative control report to determine whether it had been properly submitted to the Comptroller of the Treasury and the

Department of Finance and Administration. We also reviewed the supporting documentation for the office's evaluation of its internal accounting and administrative control.

We determined that the Financial Integrity Act internal accounting and administrative control report was submitted on January 7, 2008; support for the internal accounting and administrative control report was properly maintained; and procedures used were in accordance with *Tennessee Code Annotated*.

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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. Management's responsibility is 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 entity 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.

## **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 October 1 each year beginning with the Title VI compliance report and implementation plan due in 2007. Prior to 2007, the Title VI compliance report and implementation plan was due 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*, issued annually by the Comptroller of the Treasury. The Department of Audit published its most recent report on June 6, 2008.

## **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 of each year. At least once 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 each library designated as a depositor of state reports and documents. The Department of Audit released its most recent report on June 6, 2008.

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## APPENDICES

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### 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 Payments

### BOARDS AND COMMISSIONS

The Comptroller of the Treasury is a member of the following:

- Access Improvement Project Committee
- Board of Claims
- Board of Standards
- Contracts for State Service Review Committee
- Council on Pensions and Insurance
- Emergency Communications Board
- Governor's Council on Health and Physical Fitness
- Health Services and Development Agency
- Information Systems Council
- Local Education Insurance Committee
- Local Government Insurance Committee
- Public Records Commission
- State Board of Equalization
- State Building Commission
- State Capitol Commission
- State Funding Board

State Government Quality Improvement Task Force  
State Insurance Committee  
State and Local Government Advisory Committee to Monitor Internet Use  
State Trust of Tennessee Board of Directors  
Tennessee Advisory Commission on Intergovernmental Relations  
Tennessee Baccalaureate Education System Trust  
Tennessee Child Care Facilities Corporation  
Tennessee Consolidated Retirement System Board of Trustees  
Tennessee Higher Education Commission  
Tennessee Housing Development Authority  
Tennessee Industrial Development Authority  
Tennessee Industrial Finance Corporation  
Tennessee Local Development Authority  
Tennessee State School Bond Authority  
Tennessee Student Assistance Corporation  
Tuition Guaranty Fund Board  
Utility Management Review Board  
Water/Wastewater Financing Board  
Workers Compensation Insurance Fund Board Review Committee