

# AUDIT REPORT

Department of the Treasury

For the Year Ended  
June 30, 2012



STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY

Department of Audit  
Division of State Audit



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[www.comptroller.tn.gov/sa/AuditReportCategories.asp](http://www.comptroller.tn.gov/sa/AuditReportCategories.asp).  
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STATE OF TENNESSEE  
**COMPTROLLER OF THE TREASURY**  
DEPARTMENT OF AUDIT  
DIVISION OF STATE AUDIT

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December 13, 2012

Members of the General Assembly  
and  
Members of the Board of Trustees  
Baccalaureate Education System Trust  
and  
Members of the Board of Trustees  
Chairs of Excellence Trust  
and  
Members of the Board of Claims  
and  
Members of the State Funding Board  
and  
The Honorable David H. Lillard, Jr., Treasurer  
State Capitol  
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Department of the Treasury for the year ended June 30, 2012.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

Arthur A. Hayes, Jr., CPA  
Director

AAH/cd  
12/097

State of Tennessee

# Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit  
**Department of the Treasury**  
For the Year Ended June 30, 2012

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## AUDIT OBJECTIVES

The objectives of the audit were to consider the department's internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing opinions on the basic financial statements of the Baccalaureate Education System Trust – Educational Services Plan, the Chairs of Excellence Fund, the Criminal Injuries Compensation Fund, the Flexible Benefits Plan, the Risk Management Fund, and the State Pooled Investment Fund; to determine compliance with certain provisions of laws, regulations, contracts, and grant agreements; to perform certain limited procedures at the Department of the Treasury as a part of our audit of the *Comprehensive Annual Financial Report* of the State of Tennessee for the year ended June 30, 2012; and to recommend appropriate actions to correct any deficiencies.

## AUDIT FINDINGS

The audit report contains no findings.

**Audit Report**  
**Department of the Treasury**  
**For the Year Ended June 30, 2012**

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# Department of the Treasury For the Year Ended June 30, 2012

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## INTRODUCTION

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### POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Department of the Treasury. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes 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 State Treasurer is a constitutional officer elected every two years by a joint session of both houses of the General Assembly. The Treasurer is charged with various responsibilities and duties, most relating to the financial operations of state government.

Among the duties of the State Treasurer are accounting for the receipt and disbursement of public funds; investing available cash balances; administering the Tennessee Consolidated Retirement System; investing the pension fund; operating the state’s Unclaimed Property Program; administering the State Employees’ Deferred Compensation Program; operating the State Employees’ Flexible Benefits Plan; administering the Baccalaureate Education System Trust program; administering the Small and Minority-Owned Business Assistance Program; administering the Chairs of Excellence Trust; and directing the staff of the Division of Claims Administration and the Risk Management Division.

The Treasurer is also a member of the following entities:

Baccalaureate Education System Trust Board  
Board of Claims  
Board of Equalization  
Chairs of Excellence Trust  
Collateral Pool Board  
Commission to Purchase Federal Property

Council on Pensions and Insurance  
Public Records Commission  
Sick Leave Bank Board  
State Building Commission  
State Capitol Commission  
State Funding Board  
State Insurance Committee  
State School Bond Authority  
State Teacher Insurance Committee  
State Trust of Tennessee  
Tennessee Consolidated Retirement System Board of Trustees  
Tennessee Higher Education Commission  
Tennessee Housing Development Agency  
Tennessee Local Development Authority  
Tennessee Sports Hall of Fame  
Tennessee Student Assistance Corporation  
Tuition Guaranty Fund Board  
Volunteer Public Education Trust  
Workers' Compensation Fund Board

## **ORGANIZATION**

The various duties and responsibilities of the Treasurer's office are administered and organized in the following manner:

**Policy and Staff Services:** This division provides the administrative services necessary to direct and support policy, legislative, and human resource functions of the Department of the Treasury. This division also provides representation and support to the various boards and commissions on which the Treasurer serves.

**Legal and Compliance Services:** This division provides legal counsel, internal audit, and compliance services to the department. It also provides administration for the Advisory Council on Workers' Compensation and the Old Age and Survivors Insurance Program.

**Division of Claims Administration:** The division is responsible for handling claims filed with the state including workers' compensation claims, claims against the state for negligent acts, and claims filed under the Criminal Injuries Compensation Program.

**Division of Risk Management:** The division is responsible for maintaining adequate insurance against damage or loss for all state-owned property through a combination of a self-insurance program and other insurance policies. This division is also responsible for providing a systematic program for the control and prevention of injuries and losses.

**Division of Unclaimed Property:** Under the Unclaimed Property Program, the state takes custody of abandoned property (bank accounts, insurance policies, utility deposits, etc.) and attempts to locate the rightful owners or their heirs. Until the owners claim the property, it is used for the benefit of all the citizens of the state. Property, or its monetary equivalent, is available to be claimed by owners at any future time.

**Baccalaureate Education System Trust:** This division is responsible for administration of the state's 529 college prepaid plan and 529 college savings plan.

**Small and Minority-Owned Business Assistance Program:** This program is responsible for supporting outreach to new, expanding, and existing businesses unable to derive benefit from conventional means of monetary resources and insight provided by traditional lenders and financial advisors.

**Division of Retirement:** This division administers the Tennessee Consolidated Retirement System, a defined benefit pension plan for teachers, higher education employees, state employees, and local government employees. It serves over 210,000 active members and 122,000 retirees with an annual payroll exceeding \$1.8 billion. The Tennessee Consolidated Retirement System is audited and reported on separately.

**Deferred Compensation Division:** This division oversees the administration of the State of Tennessee Deferred Compensation Program, which allows state employees to accumulate tax-deferred savings to supplement retirement income. In addition, the division oversees the operation of the Optional Retirement Program for higher education employees.

**Investment Division:** This division has two primary functions: investing the \$34.9 billion pension fund to protect the assets of the system and maximize return and managing and investing \$8 billion of state and local government cash balances. These investments help finance, from non-tax sources, the various programs of state and local governments.

**Accounting Division:** This division reconciles all state depository bank accounts, provides accounting support, and maintains subsidiary and general ledger accounting for programs administered by the Treasurer's office, including the Tennessee Consolidated Retirement System, the Local Government Investment Pool, the Division of Claims Administration, and the Investment Division.

**Management Services Division:** This division is responsible for coordinating the department's budget and for performing procurement, payroll, accounts payable, records management, communications, facilities management, remittance processing, funds transfer, and other administrative support functions.

**Information Systems Division:** This division provides information technology support to the Treasury Department. The division is composed of the following areas: 1) Infrastructure Support and Security, 2) Business Analysis and Relationship Management, 3) Application Development and Support, and 4) Project Management.

An organization chart for the Department of the Treasury is on the following page.

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## **AUDIT SCOPE**

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The audit was limited to the period July 1, 2011, through June 30, 2012, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards.

The operations of the Department of the Treasury are accounted for in the general fund of the State of Tennessee. The department administers the Tennessee Consolidated Retirement System, pension trust funds; the Criminal Injuries Compensation Fund, a special revenue fund; the Risk Management Fund, an internal service fund; the Chairs of Excellence Fund, a permanent fund; the Baccalaureate Education System Trust – Educational Services Plan, a private-purpose trust fund; the Flexible Benefits Plan, an employee benefit trust fund; and the State Pooled Investment Fund, an external investment pool (which includes the Local Government Investment Pool). This audit included all of the above funds except for the Tennessee Consolidated Retirement System, which is reported on in a separate audit report.

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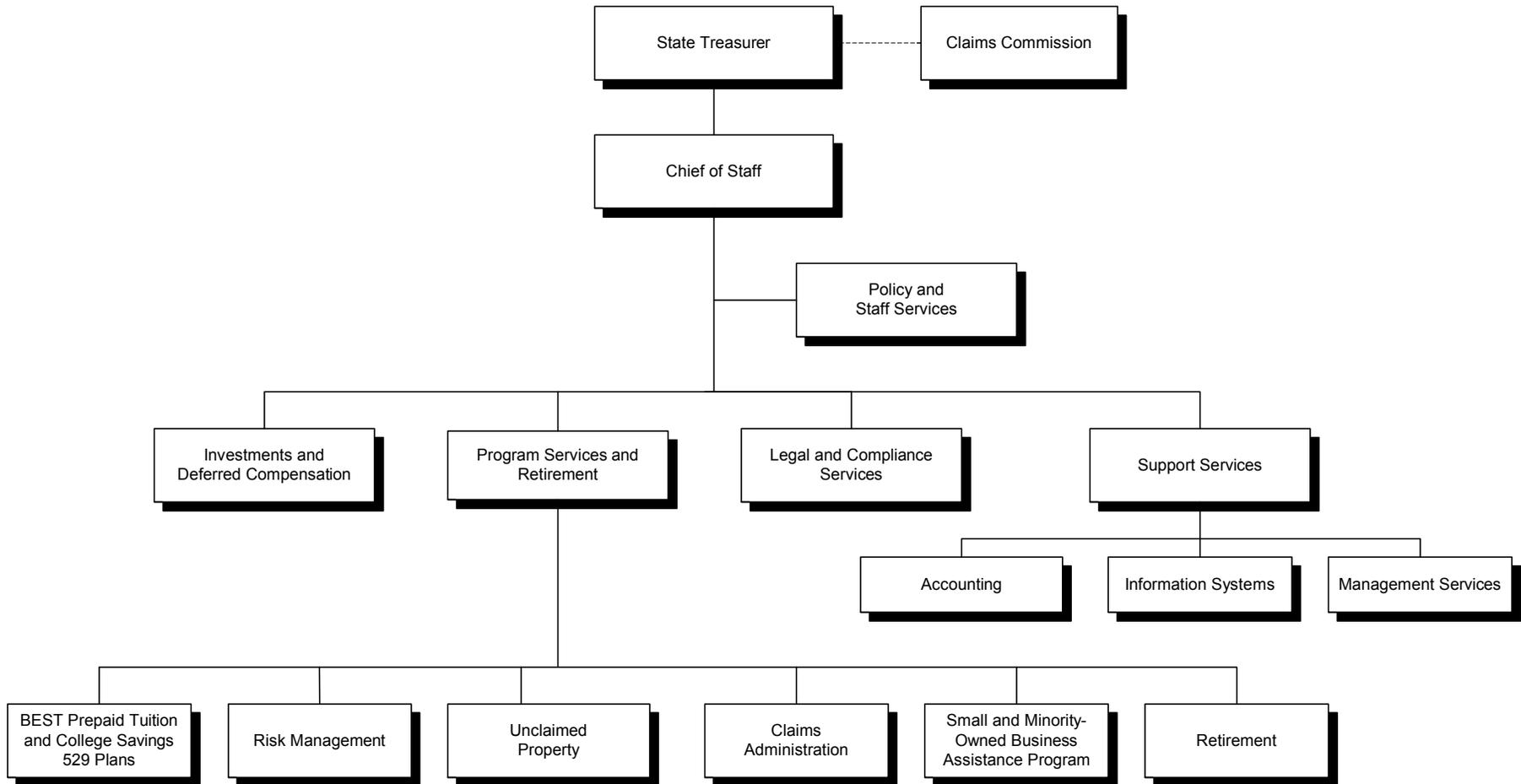
## **OBJECTIVES OF THE AUDIT**

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The objectives of the audit were

1. to consider the Department of the Treasury's internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing opinions on the financial statements of the Baccalaureate Education System Trust – Educational Services Plan, the Chairs of Excellence Fund, the Criminal Injuries Compensation Fund, the Flexible Benefits Plan, the Risk Management Fund, and the State Pooled Investment Fund;
2. to determine compliance with certain provisions of laws, regulations, contracts, and grant agreements;
3. to perform certain limited procedures at the Department of the Treasury as a part of our audit of the *Comprehensive Annual Financial Report* of the State of Tennessee for the year ended June 30, 2012; and
4. to recommend appropriate actions to correct any deficiencies.

# Department of the Treasury Organization Chart



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## **PRIOR AUDIT FINDINGS**

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There were no findings in the prior audit report.

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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. 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.

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## **RESULTS OF THE AUDIT**

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### **AUDIT CONCLUSIONS**

#### Internal Control

As part of the audit of the financial statements of the Baccalaureate Education System Trust – Educational Services Plan, the Chairs of Excellence Fund, the Criminal Injuries Compensation Fund, the Flexible Benefits Plan, the Risk Management Fund, and the State Pooled Investment Fund for the year ended June 30, 2012, we considered internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing opinions on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. Consideration of internal control over financial reporting disclosed no material weaknesses.

In addition to our audit of the financial statements of the funds noted above, we also performed certain limited procedures at the Department of the Treasury as a part of our audit of the *Comprehensive Annual Financial Report* of the State of Tennessee for the year ended June 30, 2012. For the complete results of our audit of the State of Tennessee, please see the

*Tennessee Comprehensive Annual Financial Report* for the year ended June 30, 2012, and the *State of Tennessee Single Audit Report* for the year ended June 30, 2012.

Compliance and Other Matters

The results of our audit tests disclosed no instances of noncompliance or other matters that are required to be reported under generally accepted government auditing standards.



STATE OF TENNESSEE  
**COMPTROLLER OF THE TREASURY**  
DEPARTMENT OF AUDIT  
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**Report on Internal Control Over Financial Reporting and on  
Compliance and Other Matters Based on an Audit of  
Financial Statements Performed in Accordance With  
*Government Auditing Standards***

December 6, 2012

Members of the General Assembly  
and  
Members of the Board of Trustees  
Baccalaureate Education System Trust  
and  
Members of the Board of Trustees  
Chairs of Excellence Trust  
and  
Members of the Board of Claims  
and  
Members of the State Funding Board  
and  
The Honorable David H. Lillard, Jr., Treasurer  
State Capitol  
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have audited the financial statements of the Baccalaureate Education System Trust – Educational Services Plan, the Chairs of Excellence Fund, the Criminal Injuries Compensation Fund, the Flexible Benefits Plan, the Risk Management Fund, and the State Pooled Investment Fund as of and for the year ended June 30, 2012, and have issued our reports thereon dated December 6, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards.

Internal Control Over Financial Reporting

Management of the Department of the Treasury is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the department's internal control over financial reporting as a basis for designing our auditing procedures

for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the department's internal control over financial reporting.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the department's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under generally accepted government auditing standards.

We noted certain matters that we reported to management of the Department of the Treasury in a separate letter.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee, the audit committees, management, and others within the entity 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/cd