

AUDIT REPORT

Tennessee Regulatory Authority

August 2014



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit
Division of State Audit



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August 28, 2014

The Honorable Bill Haslam, Governor
Members of the General Assembly
Mr. Earl Taylor, Executive Director

Ladies and Gentlemen:

Transmitted herewith is the audit of the Tennessee Regulatory Authority for the period January 1, 2012, through December 31, 2013.

The review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements resulted in a finding that is detailed in the Objectives, Methodologies, and Conclusions section of this report.

Sincerely,

Deborah V. Loveless, CPA
Director

14/075

Audit Report
Tennessee Regulatory Authority
For the Period January 1, 2012, Through December 31, 2013

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State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Tennessee Regulatory Authority

For the Period January 1, 2012, Through December 31, 2013

Audit Scope

We have audited the Tennessee Regulatory Authority for the period January 1, 2012, through December 31, 2013. Our audit scope included a review of internal control and compliance with laws and regulations in the areas of the Do Not Call Program, the Cable Certificates of Franchise Authority, the Lifeline Telephone Assistance Program, the Telecommunications Devices Access Program, Utilities Inspection Fees, travel expenses, payment cards, payroll and personnel, and the Audit Committee Act. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

Audit Finding

The Tennessee Regulatory Authority does not have a functioning audit committee

The Tennessee Regulatory Authority has not established an audit committee as required by the State of Tennessee Audit Committee Act of 2005, Section 4-35-101 et seq., *Tennessee Code Annotated*. The requirements of the Act include the creation of an audit committee as a standing committee of a state governing board, council, commission, or equivalent body and the adoption of an audit committee charter addressing the committee's purpose, powers, duties, and mission.

Audit Report
Tennessee Regulatory Authority
For the Period January 1, 2012, Through December 31, 2013

INTRODUCTION

Post-Audit Authority

This audit of the Tennessee Regulatory Authority was conducted pursuant to Section 8-4-109, *Tennessee Code Annotated*, which 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 Regulatory Authority was created by statute in 1995 to meet the challenge of the changing telecommunications and utility environment. The authority is charged with the responsibility of setting the rates and service standards of privately owned telephone, natural gas, electric, and water utilities. The authority's responsibilities also include consumer complaints, the Do Not Call Program, the Do Not Fax Program, the Telecommunications Devices Access Program, the Lifeline Telephone Assistance Program, and gas pipeline safety. The authority's mission is "to promote the public interest by balancing the interests of utility consumers and providers while facilitating the transition to a more competitive environment."

The authority has five part-time director positions and an executive director. The directors are appointed as follows: one director is appointed by the Governor, one director is appointed by the Speaker of the Senate, one director is appointed by the Speaker of the House of Representatives, and two directors are appointed by joint agreement among the Governor, the Speaker of the Senate, and the Speaker of the House of Representatives. Directors serve six-year, staggered terms.

AUDIT SCOPE

We have audited the Tennessee Regulatory Authority (the authority) for the period January 1, 2012, through December 31, 2013. Our audit scope included a review of internal control and compliance with laws and regulations in the areas of the Do Not Call Program, the Cable Certificates of Franchise Authority, the Lifeline Telephone Assistance Program, the Telecommunications Devices Access Program, Utilities Inspection Fees, travel expenses, payment cards, payroll and personnel, and the Audit Committee Act. The audit was conducted

in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

Do Not Call Program

The objectives of our review of the Do Not Call (DNC) Program controls and procedures were to determine whether

- the DNC register was properly updated during the audit period;
- the DNC register only included residential telephone numbers, and individual names and addresses were excluded;
- the solicitors paid the appropriate DNC registration fees;
- DNC complaints received during the audit period were handled according to authority procedures; and
- any identified DNC violators during the audit period were properly fined (not to exceed \$2,000 per violation).

We reviewed the applicable laws and regulations, interviewed key personnel, and reviewed supporting documentation to gain an understanding of the authority's procedures and controls over the DNC Program. We reviewed the DNC database to ensure that the DNC register was updated properly and that the register included only residential telephone numbers and excluded individual names and addresses. We obtained a listing of the solicitors registered with the authority during the audit period. We tested a nonstatistical sample¹ of 25 registered solicitors from a population of 655 for the period January 1, 2012, through December 31, 2013, to determine whether the appropriate DNC registration fees were paid. We obtained a listing of the DNC complaints cases received during the audit period. We tested a nonstatistical sample² of 25 DNC complaint case files from a population of 843 cases for the period January 1, 2012, through December 31, 2013, to determine whether DNC complaints received during the audit period were handled according to authority procedures. We also obtained and reviewed a listing of all

¹ For our sample design, we used nonstatistical audit sampling, which was the most appropriate and cost-effective method for concluding on our audit objectives. Based on our professional judgment, review of authoritative sampling guidance, and careful consideration of underlying statistical concepts, we believe that nonstatistical sampling provides sufficient appropriate audit evidence to support the conclusions in our report. This sample was selected in such a manner as to permit the results to be projected to the population from which the sample was drawn.

² See footnote 1.

identified DNC violations during the audit period to ensure that fines were levied and did not exceed \$2,000 per violation.

Based on our interviews, review of supporting documentation, and testwork performed, we determined that the DNC register was properly updated during the audit period; the register only included residential telephone numbers and excluded individual names and addresses; the appropriate DNC registration fees were paid; DNC complaints received during the audit period were handled according to authority procedures; and identified DNC violators were appropriately fined.

Cable Certificates of Franchise Authority

The objectives of our review of the Cable Certificates of Franchise Authority program controls and procedures were to determine whether

- cable certificates of franchise authority applications submitted during the audit period were complete;
- fees for certificates of franchise authority issued during the audit period were correctly calculated and paid;
- annual administrative fees were correctly calculated and paid;
- total administrative fees did not exceed \$107,000; and
- each cable franchise submitted its annual Minority-Owned Business Participation Plan for each fiscal year ended in the audit period, and the plans were properly reviewed by authority personnel.

We reviewed the applicable laws and regulations, interviewed key personnel, and reviewed supporting documentation to gain an understanding of the controls and procedures over the Cable Certificates of Franchise Authority program. We obtained a listing of all cable certificates of franchise authority applications submitted during the audit period. We tested the three applications submitted during the period January 1, 2012, to December 31, 2013, to determine if the applications were complete based on requirements listed in Section 7-59-305, *Tennessee Code Annotated*. We also reviewed documentation to determine if fees for new certificates of franchise authority issued during the audit period were calculated correctly and paid. We obtained and reviewed annual administrative fees calculations for all active certificates of franchise authority during the period January 1, 2012, through December 31, 2013, to ensure that fees were calculated correctly. (There were 13 active certificates in 2012 and 14 in 2013.) We also reviewed documentation to determine if the administrative fees were paid and that total administrative fees did not exceed \$107,000. In addition, we obtained and reviewed the Minority-Owned Business Participation Plans for each fiscal year ended in the audit period to determine whether the plans were properly reviewed.

Based on our interviews, review of supporting documentation, and testwork performed, we determined that cable certificates of franchise authority applications submitted during the audit

period were complete; fees for certificates issued during the audit period and annual administrative fees were correctly calculated and paid; total administrative fees did not exceed \$107,000; and each cable franchise submitted its annual Minority-Owned Business Participation Plan, and the plans were properly reviewed by authority personnel.

Lifeline Telephone Assistance Program

The objectives of our review of the Lifeline Telephone Assistance Program controls and procedures were to determine whether

- Lifeline applicants' eligibility based on participation in a public assistance program (i.e., the Supplemental Nutrition Assistance Program, Medicaid, Supplemental Security Income, Temporary Assistance for Needy Families, the Low Income Home Energy Assistance Program, the National Free School Lunch Program, or Section 8 federal housing) was verified through the Department of Human Services (DHS) Eligibility System;
- Lifeline wireline (i.e., landline) applications approved during the audit period were reviewed, signed, and dated by a representative of the authority;
- Lifeline wireline applicants who were approved based on income met the income guidelines (135% of the federal poverty level); and
- invoices sent to telephone providers were correctly calculated.

We reviewed the applicable laws and regulations, interviewed key personnel, and reviewed supporting documentation to gain an understanding of the authority's procedures and controls over the Lifeline Program. We obtained a listing of Lifeline applicants who were approved based on participation in one of the allowable public assistance programs during the period November 1, 2013, through December 31, 2013. We tested a nonstatistical sample³ of 25 of these applicants from a population of 15,692 to determine whether the applicants' eligibility had been verified through the DHS Eligibility System. We obtained a listing of Lifeline wireline applicants who were approved based on income during the period January 1, 2012, through December 31, 2013. We tested a nonstatistical sample⁴ of 25 of these applicants from a population of 798 to determine whether the applications were reviewed, signed, and dated by a representative of the authority and whether the applicants met the income guidelines for the program. We performed analytical procedures to determine if amounts invoiced to telephone providers for Lifeline eligibility verifications were correctly calculated during the period November 1, 2013, through December 31, 2013.

Based on our interviews, review of supporting documentation, and testwork performed, we determined that Lifeline applicants' eligibility based on participation in an allowable public assistance program was verified through the DHS Eligibility System; Lifeline wireline applications approved during the audit period were reviewed, signed, and dated by a

³ See footnote 1.

⁴ See footnote 1.

representative of the authority; Lifeline wireline applicants who were approved based on income met the income guidelines; and invoices to telephone service providers were correctly calculated.

Telecommunications Devices Access Program

The objectives of our review of the Telecommunications Devices Access Program (TDAP) controls and procedures were to determine whether

- the authority's application procedures for TDAP were followed;
- revenues collected for TDAP were only used for that program; and
- the reserve fund exceeded the \$1,000,000 limit established in Section 65-21-115(a), *Tennessee Code Annotated*.

We reviewed the applicable laws and regulations, interviewed key personnel, and reviewed supporting documentation to gain an understanding of the controls and procedures over TDAP. We obtained a list of applications submitted from January 1, 2012, through December 31, 2013. We tested a nonstatistical sample⁵ of 25 application files from a population of 2,179 to determine if application procedures were followed. We obtained a TDAP revenue transactions listing from Edison for the period July 1, 2012, through June 30, 2013. We performed analytical procedures to determine if revenues collected for TDAP were only used for that program. We reviewed the balance in the reserve fund to determine if it exceeded the \$1,000,000 limit.

Based on our interviews, review of supporting documentation, testwork performed, and analytical procedures, we determined that the authority's application procedures for TDAP were followed with one exception noted for failure to document approval on two applications tested; revenues collected for TDAP were only used for that program; and the balance of the reserve fund exceeded the \$1,000,000 limit by \$209,426 at June 30, 2013. Based on discussions with management, when the reserve exceeds the limit in one year, billings in the following year are adjusted to reduce the reserve.

Utilities Inspection Fees

The objectives of our review of the utilities inspection fees controls and procedures were to determine whether

- utility rate increase cases were heard and completed timely;
- the appropriate fees were collected from utilities; and
- revenues collected for inspection fees were correctly recorded in Edison.

⁵ See footnote 1.

We reviewed the applicable laws and regulations, interviewed key personnel, and reviewed supporting documentation to gain an understanding of the controls and procedures over utilities inspection fees. We obtained a listing of utility rate increase cases from January 1, 2012, through December 31, 2013. We reviewed all six utility rate increase cases to determine if the cases were heard and completed timely. We performed analytical procedures to determine if utility fees were properly calculated from January 1, 2012, through December 31, 2013. We tested a nonstatistical sample⁶ of 25 utility companies from a population of 454 to determine if the appropriate inspection fees were collected and correctly recorded in Edison from January 1, 2012, through December 31, 2013.

Based on our interviews, review of supporting documentation, testwork performed, and analytical procedures, we determined that utility rate increase cases were heard and completed timely; the appropriate fees were collected from utilities except for three utility companies that did not pay the appropriate inspection fees and did not receive delinquent notices, and two utility companies that were not properly assessed late fees; and revenues collected for inspection fees were correctly recorded in Edison with one minor exception. The total fees due from the three companies that had not paid were \$735.

Travel Expenses

The objective of our review of the authority's travel controls and procedures was to determine whether payments to directors and office employees for travel were made in accordance with the Comprehensive Travel Regulations issued by the state's Department of Finance and Administration.

We interviewed key personnel and reviewed supporting documentation to gain an understanding of the authority's procedures and controls over travel. We tested a nonstatistical sample⁷ of travel expenses paid totaling \$10,951 from a population of \$167,447 during the period January 1, 2012, through December 31, 2013, to determine whether travel expenses were adequately supported and complied with regulations.

Based on our reviews, interviews, and testwork performed, we determined that payments for travel were made in accordance with the Comprehensive Travel Regulations, with the following exceptions:

- one travel claim tested did not include documentation supporting the hotel conference rate; and
- two travel claims tested were reimbursed for hotel room rates higher than allowable under the Comprehensive Travel Regulations.

⁶ See footnote 1.

⁷ See footnote 1.

Payment Cards

The objectives of our review of the payment card controls and procedures were to determine whether

- cardholders were properly approved;
- purchases made using payment cards were adequately supported and recorded on the transaction log;
- payment card purchases appeared reasonable and necessary to conduct state business and did not exceed the single-purchase dollar limit;
- payment card purchases complied with the Department of General Services' purchasing policies and procedures; and
- payment card transaction logs were properly approved and reconciled to the statements and receipts.

We interviewed key personnel and reviewed supporting documentation to gain an understanding of the controls and procedures over payment cards. We obtained a listing of cardholders and reviewed documentation to determine if the cardholders had received the required approvals to be valid cardholders. We tested a nonstatistical sample⁸ of payment card purchases totaling \$4,290 from a population of \$18,619, plus unusual items totaling \$361, for the period January 1, 2012, through December 31, 2013, for adequate documentation and compliance with the Department of General Services' purchasing policies and procedures for payment cards. We also tested the purchases in the sample to determine whether they appeared reasonable and necessary and whether they exceeded the single-purchase dollar limit. We reviewed all 32 transaction logs for the period July 1, 2012, through December 31, 2013, for proper approvals and evidence of reconciliation to the statements and receipts.

Based on our interviews, review of supporting documentation, and testwork performed, we determined that

- cardholders were properly approved;
- purchases were adequately supported and recorded on the transaction log;
- purchases appeared reasonable and necessary to conduct state business and did not exceed the single-purchase dollar limit;
- card purchases complied with the Department of General Services' purchasing policies and procedures except one transaction in which a payment card was used to modify an authority vehicle (payment cards cannot be used for modifications to vehicles leased from the Department of General Services' Division of Motor Vehicle Management); and
- transaction logs were properly approved and reconciled to the statements and receipts.

⁸ See footnote 1.

Payroll and Personnel

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

- payroll transactions were properly approved, within the authority's guidelines, and properly supported;
- payroll disbursements were made for work performed by employees of the authority;
- documentation indicated that newly hired employees or employees who changed positions during the audit period were qualified for their positions;
- the initial wage was correct for newly hired employees; and
- terminated employees' final pay was accurate.

We interviewed key personnel and reviewed supporting documentation to gain an understanding of the authority's procedures and controls over payroll and personnel. We tested a nonstatistical sample⁹ of payroll transactions totaling \$15,343.06 from a population of \$9,745,080.37 for the period January 1, 2012, through December 31, 2013, to determine whether payroll transactions were adequately supported, were properly approved, and complied with regulations. For newly hired employees or employees who changed positions from January 1, 2012, through December 31, 2013, we reviewed personnel files to determine if they contained documentation indicating the employees met the job qualifications. For newly hired employees, we recalculated the employees' initial pay to determine if their initial wage was correct. For terminated employees, we reviewed personnel files and final payroll registers to determine if the employees' final pay was accurate.

Based on our interviews, review of supporting documentation, and testwork performed, we determined that

- payroll transactions were properly approved, within the guidelines of the authority, and properly supported;
- payroll disbursements were made for work performed by employees of the authority;
- documentation indicated that newly hired employees and employees who changed positions during the audit period were qualified for their positions;
- the initial wage was correct for newly hired employees; and
- terminated employees' final pay was accurate.

⁹ See footnote 1.

Audit Committee Act

The objective of our review of the authority's activities regarding the establishment of an audit committee was to determine compliance with the State of Tennessee Audit Committee Act of 2005. On May 19, 2005, the Tennessee General Assembly enacted this legislation, which requires the creation of audit committees for those entities that have governing boards, councils, commissions, or equivalent bodies that can hire and terminate employees or are responsible for the preparation of financial statements. Pursuant to the act, entities are required to appoint the audit committee and develop an audit committee charter in accordance with the legislation.

We interviewed key personnel to determine whether an audit committee charter had been adopted or an audit committee established. As of June 30, 2014, no audit committee has been established, nor has a charter been created. See finding below.

The Tennessee Regulatory Authority does not have a functioning audit committee

Finding

The Tennessee Regulatory Authority has not established an audit committee as required by the State of Tennessee Audit Committee Act of 2005, Section 4-35-101 et seq., *Tennessee Code Annotated*. The requirements of the Act include the creation of an audit committee as a standing committee of a state governing board, council, commission, or equivalent body and the adoption of an audit committee charter addressing the committee's purpose, powers, duties, and mission. The Act also prescribes certain responsibilities of the audit committee which include

- a. overseeing the financial reporting and related disclosures, especially when financial statements are issued;
- b. evaluating management's assessments of the entity's system of internal controls;
- c. formally reiterating, on a regular basis, to the governing board and management their responsibility for preventing, detecting, and reporting fraud, waste, and abuse;
- d. serving as a facilitator of any audits or investigations of the entity, including advising auditors and investigators of any information it may receive pertinent to audit or investigative matters;
- e. informing the Comptroller of the Treasury of the results of risk assessments and controls to reduce the risk of fraud;
- f. promptly notifying the Comptroller of the Treasury of any indications of fraud; and
- g. establishing a process by which employees, taxpayers, or other citizens may confidentially report suspected illegal, improper, wasteful, or fraudulent activity.

Furthermore, the Act required the Comptroller of the Treasury to establish guidelines for the creation of an audit committee charter. Those guidelines require the audit committee to create or review a code of conduct and conflict-of-interest policy for the entity.

Section 4-35-101 et seq., *Tennessee Code Annotated*, applies to any governing body that has the “authority to hire and terminate its employees.” Based on our review of state law, we determined that according to Section 65-1-109, the Executive Director will be hired and can be terminated by the directors of the authority. Section 65-1-109, *Tennessee Code Annotated*, states

- (a) The executive director shall be appointed by joint agreement among the governor, the speaker of the senate and the speaker of the house of representatives for the initial term. Thereafter, the directors of the authority shall appoint the executive director.
- (b) The authority may remove the executive director by a majority vote of the directors.

In response to our recommendation to establish an audit committee, the Executive Director requested an exemption to the Audit Committee Act in a letter to the Comptroller of the Treasury dated June 18, 2014. The director’s basis for an exemption involved a self-assessment of authority fraud risk as low. In response to the exemption request, the Comptroller of the Treasury denied the authority’s request in a letter dated July 7, 2014. The Comptroller’s letter reiterated that the audit committee is important to oversee management’s performance in regard to internal control and financial accountability and should serve as an aid to achieving both accountability and transparency in state government.

Recommendation

The directors of the authority should establish an audit committee and create a charter based on guidelines from the Comptroller of the Treasury. The audit committee should then carry out the responsibilities as described in the charter.

Management’s Comment

We concur with the finding and recommendation. We have drafted an audit committee charter that will be presented to the directors of the authority for adoption on August 11, 2014. Once the authority has adopted a charter, it will be presented to the Comptroller of the Treasury for approval in accordance with Section 4-34-103(c), *Tennessee Code Annotated*. After such approval, the audit committee will carry out the mission and responsibilities as described in the charter.