

AUDIT REPORT

Department of the Treasury

For the Year Ended
June 30, 2014



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit
Division of State Audit



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DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT

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December 29, 2014

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

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Department of the Treasury for the year ended June 30, 2014.

Consideration of internal control over financial reporting and tests of compliance disclosed a deficiency, which is detailed in the Finding and Recommendation section of this report. The department's management has responded to the audit finding; the response is included following the finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit finding.

Sincerely,

A handwritten signature in cursive script that reads "Deborah V. Loveless".

Deborah V. Loveless, CPA
Director

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Audit Report
Department of the Treasury
For the Year Ended June 30, 2014

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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, 2014

Opinions on the Financial Statements

The opinions on the financial statements of the Baccalaureate Education System Trust – Educational Services Plan, the Tennessee Stars 529 College Savings Plan, the Chairs of Excellence Trust, the Criminal Injuries Compensation Fund, the Flexible Benefits Plan, the Risk Management Fund, the Intermediate Term Investment Fund, and the State Pooled Investment Fund are unmodified. Our independent auditor’s reports on these financial statements are included in the *State of Tennessee Treasurer’s Report* for the year ended June 30, 2014.

Audit Finding

Internal controls related to the information system for the Baccalaureate Education System Trust Funds were not adequate

The Department of the Treasury had not established adequate internal controls over participant accounts in the BEST information system (page 4).



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**Independent Auditor's 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***

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

We have audited the financial statements of the Baccalaureate Education System Trust – Educational Services Plan, the Tennessee Stars 529 College Savings Plan, the Chairs of Excellence Trust, the Criminal Injuries Compensation Fund, the Flexible Benefits Plan, the Risk Management Fund, the Intermediate Term Investment Fund and the State Pooled Investment Fund as of and for the year ended June 30, 2014, and the related notes to the financial statements, and have issued our reports thereon dated December 19, 2014. 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 *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the department's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department of the Treasury's internal control. Accordingly, we do not express an opinion on the effectiveness of the department's internal control.

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 entity's financial statements will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency* is a deficiency, or a

combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, we identified the following deficiency in internal control that we consider to be a material weakness:

Internal controls related to the information system for the Baccalaureate Education System Trust Funds were not adequate.

This deficiency is described in the Finding and Recommendation section of this report.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department of the Treasury's financial statements are free from material misstatement, we performed tests of its 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 *Government Auditing Standards*.

Department's Response to Finding

The department's response to the finding identified in our audit is included in the Finding and Recommendation section of this report. The department's response was not subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Deborah V. Loveless, CPA
Director
December 19, 2014

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 department filed its report with the Department of Audit on July 22, 2014. A follow-up of the prior audit findings was conducted as part of the current audit.

The current audit disclosed that the department has corrected the previous audit finding concerning inadequate controls over disclosure of noncompliance with investment policies for the State Pooled Investment Fund and the Chairs of Excellence Trust.

Finding and Recommendation

Internal controls related to the information system for the Baccalaureate Education System Trust Funds were not adequate

Background

The state of Tennessee sponsors two qualified tuition plans, which are authorized by Section 529 of the Internal Revenue Code. While both plans are administered by the Baccalaureate Education System Trust (BEST), only the TNStars College Savings 529 Program is open for new contributions. Accounting for both programs is the responsibility of the Tennessee Department of the Treasury. The PowerAgent information system, which is developed and maintained by a third-party contractor, Envision Financial Systems (Envision), serves as administrator of both the accounting system and web-based client portal used with the TNStars program.

Condition

Inadequate Controls Over Participant Account Changes. During our audit of the financial statements of both BEST programs for the year ended June 30, 2014, we identified internal control deficiencies that could allow Treasury staff to make various unauthorized changes to participant accounts, including changing mail and e-mail addresses, beneficiaries, or account passwords or transferring funds between accounts. Treasury staff would not necessarily have detected unauthorized changes because of inadequate internal control. Program participants would not have always been aware of changes to their account because of inadequate confirmation procedures. Address, e-mail, or password changes to TNStars accounts would not have generated any confirmation notices to participants. Changes to accounts holding pre-paid tuition units would have generated a confirmation; however, the staff member responsible for printing and mailing the confirmation was the same one entering the changes. Moreover, confirmation of an address change was sent only to the new address rather than both the new and original addresses. No instances of unauthorized payments or transfers were noted during testwork.

Criteria

Management has a responsibility to design, implement, and maintain a system of adequate internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition.

Cause

Management did not address these risks in its annual risk assessment process.

Effect

If corrective measures are not taken, the risk of misappropriation of BEST assets will continue to exist.

Recommendation

The Treasurer should ensure that internal controls over participant accounts in the BEST information system are properly designed and working effectively to ensure staff cannot effect unauthorized changes to accounts.

Management Comment

We concur. Although there are currently various controls such as 24-hour online access by participants, issuance of quarterly participant statements, confirmations of most financial transactions, segregation of duties, dual verification of several financial transactions, and generation of audit logs, we concur that certain additional controls would enhance the program. The department will require that all transactions are subject to either dual verification by staff or confirmation notices to participants.

Specifically, as it relates to the controls over participant account changes, including changes to mailing addresses, e-mail addresses, and beneficiary designations in the TNStars PowerAgent system, there will be dual verification and confirmations sent to participants for these account changes. These changes will be immediately implemented by establishing appropriate segregation of duties. Further, as a long-term solution, Treasury staff will work with Envision, the recordkeeping software provider, to ensure that the letters are automatically generated as is our current practice with financial confirmations. This automated function will require a software enhancement that is expected to be in place by the end of fiscal year 2015. If the changes relate to a mailing address or e-mail address, the confirmation will be sent to the old and new mailing or e-mail address. For all financial transactions in TNStars, including the transferring of funds between participant accounts, there is currently dual verification and appropriate automatic email/mail confirmation to participants.

Additionally, the ability of participants to manage their online passwords will be automated through a software enhancement in order to reduce the need for staff assistance with password changes. Passwords will be fully managed by participants online, and automated e-mail notifications will be sent to customers to notify them of any changes made online relative to

password and other account registration changes that occur online. This functionality should be completed by January 9, 2015, by Envision.

Relative to changes of beneficiaries for the BEST Prepaid Plan, a peer review process will be implemented immediately. Additionally, a Change of Beneficiary report will be created and reviewed to ensure that the changes made coincide with the information provided by the participant. Finally, there will be immediate segregation of duties relative to mailing of the confirmation.

The risk relative to participant account changes will be addressed as part of the annual department risk assessment process.

Observations and Comments

The operations of the Department of the Treasury are accounted for in the general fund of the State of Tennessee. The department administers the Baccalaureate Education System Trust – Educational Services Plan, a private-purpose trust fund; the Tennessee Stars 529 College Savings Plan, a private-purpose trust fund; the Chairs of Excellence Trust, a permanent fund; the Criminal Injuries Compensation Fund, a special revenue fund; the Flexible Benefits Plan, an employee benefit trust fund; the Risk Management Fund, an internal service fund; the Intermediate Term Investment Fund, an external investment pool; the State Pooled Investment Fund, an external investment pool (which includes the Local Government Investment Pool); and the Tennessee Consolidated Retirement System, pension trust funds. This audit included all of the above funds except for the Tennessee Consolidated Retirement System, which is reported on in a separate audit report. Our independent auditor's reports on these financial statements are included in the *State of Tennessee Treasurer's Report* for the year ended June 30, 2014.

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, 2014. 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, 2014, and the *State of Tennessee Single Audit Report* for the year ended June 30, 2014.