AUDIT REPORT

South Central Community Services Agency

April 2006

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

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COMPTROLLER OF THE TREASURY
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John G. Morgan
Comptroller

April 27, 2006

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Board of Directors
South Central Community Services Agency
P. O. Box 459
Columbia, Tennessee 38402

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the South Central Community Services Agency for the period July 1, 2003, through April 30, 2005.

The review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements resulted in certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/eb
05/069

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COMPTROLLER OF THE TREASURY
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May 12, 2005

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 South Central Community Services Agency for the period July 1, 2003, through April 30, 2005.

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 South Central Community Services Agency's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the South Central Community Services Agency 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 disclosed certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. The agency's administration has responded to the audit findings; we have included the responses following each finding. We will follow up the audit to examine the application of the procedures instituted because of the audit findings.

We have reported other less significant matters involving the agency's internal control and instances of noncompliance to the South Central Community Services Agency's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/eb

State of Tennessee

Audit Highlights

Comptroller of the Treasury | Division of State Audit

Financial and Compliance Audit
South Central Community Services Agency
April 2006

AUDIT SCOPE

We have audited the South Central Community Services Agency for the period July 1, 2003, through April 30, 2005. 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 cash and cash receipts, and expenditures and compliance with the Family Support Services, Family Crisis Intervention, and Independent Living Programs. 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; and approving the Community Services Agencies' Plans of Operation (budgets).

AUDIT FINDINGS

The Agency Did Not Comply With Case Management Policies and Procedures, Increasing the Risk of Inadequate Performance of Services for Some Children and Families

South Central Community Services Agency (the CSA) did not comply with case management policies and procedures related to case file documentation and agency contact with children and families. The failure to comply with the Department of Children's Services' required case management policies and procedures for the Family Support Services Program and the Family Crisis Intervention Program violates its contractual agreement with the department. Because the children served by the CSA are considered "at imminent risk," the prompt and appropriate delivery of services provided by the CSA is necessary for the protection of the children (page 5).

The Agency Did Not Have the Background Check Results for Two of Its Case Managers Prior to Their Contact With Children, Increasing the Risk of Inappropriate Contact With Children

In a review of agency personnel hired from July 1, 2003, through March 24, 2005, we found that two of nine case managers (22%) did not have a criminal background check documented in their personnel file before the case managers were allowed to have unsupervised contact with children. When employees are allowed to work alone with children before the results of background checks have been received, there is a chance a person convicted of a child-related abuse offense could have unsupervised contact with children (page 7).

Neither the Agency nor the Department of Children's Services Reported an Incident of Fraud to the Comptroller of the Treasury, Increasing the Risk of the Case Not Being Handled in the Best Interests of the State

Neither the CSA nor the Department of Children's Services notified the Comptroller of the Treasury, as required by state law, about the discovery of fraud and subsequent investigation of a South Central Community Services Agency employee for fraud. The purpose of the statutory requirement is to ensure a thorough investigation and appropriate resolution in the best interest of the state (page 8).

Financial and Compliance Audit
South Central Community Services Agency

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Financial and Compliance Audit
South Central Community Services Agency

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the South Central Community Services Agency. The audit was conducted pursuant to Section 37-5-313, *Tennessee Code Annotated*, which authorizes the Comptroller of the Treasury to "make an annual audit of the program established by this part as part of the comptroller's annual audit pursuant to Section 9-3-211."

BACKGROUND

The Community Services Agency Act of 1996 created the community services agencies. The purpose of these agencies is to coordinate funds and programs designated for care of children and other citizens in the state.

The South Central Community Services Agency serves the following counties: Bedford, Coffee, Giles, Hickman, Lawrence, Lewis, Lincoln, Marshall, Maury, Moore, Perry, and Wayne. The agency's administrative offices are in Columbia, Tennessee.

The governing body of the South Central Community Services Agency is the board of directors. As of April 30, 2005, the board was composed of eight members. (See Appendix.) An executive committee, consisting of five board members, has the authority to act on behalf of the board of directors in the management of the agency's property, affairs, and funds in extraordinary circumstances when the governing board cannot convene.

The agency's programs are carried out by staff under the supervision of the executive director, who is appointed by the Commissioner of the Department of Children's Services, subject to the approval of the board.

AUDIT SCOPE

We have audited the South Central Community Services Agency for the period July 1, 2003, through April 30, 2005. 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

cash and cash receipts, and expenditures and compliance with the Family Support Services, Family Crisis Intervention, and Independent Living Programs. 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; and approving the Community Services Agencies' Plans of Operation (budgets).

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 South Central Community Services Agency filed its report with the Department of Audit on April 15, 2005. A follow-up of the prior audit finding was conducted as part of the current audit. The current audit disclosed that the South Central Community Services Agency has corrected the previous audit finding concerning the inadequacy of controls over payroll and personnel transactions.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

CASH AND CASH RECEIPTS

The primary objectives of our review of cash and cash receipts were to determine whether

- the agency's controls over the cash receipting and revenue functions were adequate;
- receipts were posted correctly;
- the agency deposited funds in accordance with its policy;
- reconciliations between the mail log, cash receipts, and the deposit documents were performed; and
- the June 30, 2004, bank statement was appropriately reconciled to the accounting records.

To accomplish our objectives, we interviewed management to gain an understanding of the agency's procedures and controls over cash and cash receipts. We obtained the cash receipts for July 1, 2003, through March 24, 2005, and tested a nonstatistical sample of cash receipts for

proper posting, depositing, and reconciliation procedures. We also obtained, reviewed, and verified the accuracy of the June 30, 2004, bank reconciliation.

As a result of our inquiries, observations, and testwork, we found that the agency has adequate controls over cash and cash receipting functions; complied with receipt posting, depositing, and reconciliation procedures; and appropriately performed the June 30, 2004, bank reconciliation.

EXPENDITURES AND PROGRAM COMPLIANCE

The primary objectives of our review of expenditures and program compliance were to determine whether

- the agency's controls over expenditures and program compliance were adequate;
- the plan of operation and amendments were properly approved;
- expenditures for goods or services were properly approved, supported, and allowable;
- goods or services for which payments were made were received prior to payment;
- a vendor contract was in place when required and the agency made a public announcement of funds if necessary;
- expenditures for travel were paid in accordance with the Comprehensive Travel Regulations;
- payments for services were properly approved, adequately supported, and allowable under the guidelines of the Family Support Services, Family Crisis Intervention, and Independent Living Programs;
- the agency maintained complete case files and performed required contacts with the children and families in the Family Support Services and Family Crisis Intervention Programs;
- recently hired employees were qualified for their positions, their initial wages were properly calculated, and appropriate background checks were performed;
- final pay for terminated employees was properly calculated and the employees did not appear on the following payroll register; and
- the agency's procedures for credit cards were adequate and purchases involving credit cards were appropriate.

To accomplish our objectives, we interviewed key agency personnel to gain an understanding of procedures and controls over expenditures and program compliance requirements, including payments to service providers. We also reviewed written policies and procedures. We obtained the plan of operation and related amendments and determined the appropriateness of approvals. We obtained and reviewed the agency's check register and tested a

nonstatistical sample of transactions from July 1, 2003, through March 24, 2005, to determine that expenditures were approved, supported, and allowable under the applicable guidelines, and that the goods and services were received prior to payment. In addition, we reviewed the agency's check register and selected all single payments $5,000 or above, and all combined payments to a single vendor totaling $25,000 or above, to determine whether a vendor contract was in place when required and the agency made a public announcement of funds if necessary. We tested a nonstatistical sample of travel claim reimbursements to determine whether claims were paid in accordance with travel regulations.

We obtained a list of all children who received services from July 1, 2003, through April 27, 2005, and tested a nonstatistical sample of children's case files to determine whether the expenditures made on behalf of these children were properly approved, supported, and allowable under program guidelines. In addition, we reviewed children's case files to determine whether case managers maintained the required case file documentation and made face-to-face contacts with the children and their families as required. We obtained personnel files of all recently hired employees to determine if employees were qualified for the positions held, that initial wages were properly calculated, and that appropriate background checks were performed prior to employment. For employees leaving CSA employment, we determined if the final pay was correct and that employees were removed from the payroll system. We reviewed procedures for credit card purchases and tested a nonstatistical sample of the credit card transactions for appropriateness.

As a result of interviews and testwork performed, we determined that

- controls over expenditures were adequate;
- the plan of operation and related amendments were properly approved;
- expenditures for goods or services were properly approved, supported, and allowable;
- goods or services were received prior to payment;
- in all material respects, the agency entered into contracts or made public announcements when appropriate;
- expenditures for travel were paid in accordance with the Comprehensive Travel Regulations;
- payments for services were properly approved, adequately supported, and allowable under the guidelines of the Family Support Services, Family Crisis Intervention, and Independent Living Programs;
- recently hired employees were qualified for their positions and their initial wages were properly calculated;
- final pay for employees terminating employment was properly calculated and the employees did not appear on the following payroll register; and
- in all material respects, the agency's procedures for credit cards were adequate, and purchases involving credit cards were appropriate.

However, we determined that the agency did not maintain complete case files or perform all of the required contacts with the children and families in the Family Support Services and Family Crisis Intervention Programs, as noted in finding 1 below. In addition, appropriate background checks were not on file before the case managers were allowed to have unsupervised contact with children, as noted in finding 2. Furthermore, an incident of fraud was identified that was not reported to the Comptroller of the Treasury by either the South Central Community Services Agency or the Department of Children's Services, as noted in finding 3.

1. The agency did not comply with case management policies and procedures, increasing the risk of inadequate performance of services for some children and families

Finding

The South Central Community Services Agency (CSA) did not comply with case management policies and procedures related to case file documentation and agency contact with children and families. The Department of Children's Services (DCS) contracted with the CSA to provide case management services to non-custodial children who are at imminent risk of entering state custody or who have been in the state's custody and have returned to their families. The CSA provided case management services under the Family Support Services Program (FSS) and the Family Crisis Intervention Program (FCIP) including case manager visits with children and their families, development of permanency plans, and maintenance of case files.

The Department of Children's Services has developed policies and procedures manuals for both FSS and FCIP. These manuals establish the requirements for case management services and case file documentation. The program manuals stipulate the timing, frequency, and nature of required contacts; the forms or documents that must be obtained, completed, or prepared; and the method of documenting or maintaining evidence to support compliance with the policies and procedures. Details regarding the case management services should be recorded in TNKIDS, a computerized tracking system. The child's case file maintained by the CSA should contain all important documents discussed with the family as well as copies of the case recordings detailed in TNKIDS.

Our testwork consisted of a review of children's case files for compliance with programmatic requirements. We requested 25 children's case files to specifically determine that CSA staff maintained complete case files including the TNKIDS case recordings, and that CSA staff made the required face-to-face contacts with the children, families, or other individuals. The results were as follows:

- The case manager did not make the initial face-to-face or telephone contact with the family within one working day for 12 of the 23 applicable case files tested (52%). The initial face-to-face or telephone contacts were one to 26 days late. There was no documentation in one of the case files indicating when the initial contact was made.

- The case manager did not follow up with a face-to-face contact within five working days for 5 of the 19 applicable case files tested (26%). The follow-up face-to-face contacts were 2 to 96 days late. There was no documentation in one of the case files when the follow-up face-to-face contact was made.
- The child's file did not contain a written Service Delivery Plan or Crisis Intervention/Resolution Plan that was developed within 15 working days of the receipt of the case and signed by the adult family members and by the child, if appropriate, for 4 of the 24 applicable case files tested (17%). One case file did not contain a service plan or when one was completed. The service plan for another child was completed 30 days late. One child had a service plan for both services, but the plan for FSS services was completed one day late. One case file included a service plan that was not signed by the parents.
- The case manager did not conduct a minimum of one face-to-face contact per week with the family for the first four weeks or document the justification for a reduced number of visits and the approval of the supervisor for 11 of the 21 applicable case files tested (52%). Twenty-seven of 84 required weekly face-to-face visits (32%) were not made.
- After developing the Service Delivery Plan, the case manager did not have at least one face-to-face contact with the family each month or document the approval of the supervisor for telephone contacts for 8 of the 23 applicable case files tested (35%). Twenty-four of 119 monthly face-to-face visits (20%) were not made. For three of the case files, there was no indication of attempted monthly phone calls or home visits, when necessary.
- The written progress reports were not prepared on a quarterly basis and included in the case record for 3 of the 18 applicable case files tested (17%).
- The case manager did not document the efforts to locate the child and family, if necessary, for one of the four applicable case files tested (25%).
- TNKIDS, the computerized tracking system, was not properly updated regarding the case closure for 4 of the 24 applicable case files tested (17%).

The South Central Community Services Agency's failure to comply with the Department of Children's Services' required case management policies and procedures for FSS and FCIP related to case file documentation and agency contact with children and families violates its contractual agreement with the DCS. Because the children served by the CSA are considered "at imminent risk," the prompt and appropriate delivery of services provided by the CSA is necessary for the protection of the children. Furthermore, without adequate documentation, the CSA may not be able to substantiate that the children receiving services were eligible for the services, or that the services were actually provided to the children.

Recommendation

The CSA no longer administered these case management services on behalf of DCS as of September 1, 2005. The Department of Children's Services hired many of the CSA employees to assume the duties of administering these programs. Employees transferring to DCS should ensure that appropriate contacts are made with the children and families and that all required documentation is maintained in the case files. DCS management should ensure that risks such as these noted in this finding are adequately identified and assessed and that effective mitigating controls are designed and implemented. These controls should include ongoing monitoring for compliance with all pertinent requirements.

Management's Comment

We concur. Just prior to the audit, the South Central Community Services Agency (SCCSA) had implemented a new supervision/management plan that allowed supervisors to monitor our compliance to the Department of Children's Services (DCS) policies for case management and case file documentation. Improvements on meeting policies were not evident at the time of the audit but we did meet outcomes by the time our contract with DCS ended. SCCSA no longer administers this contract on behalf of DCS.

2. <u>The agency did not have the background check results for two of its case managers prior to their contact with children, increasing the risk of inappropriate contact with children</u>

Finding

In a review of agency personnel hired from July 1, 2003, through March 24, 2005, we found that two of nine case managers (22%) did not have a criminal background check documented in their personnel file before the case managers were allowed to have unsupervised contact with children. These two case managers worked with children for 18 to 32 days before the results of the background checks were received. Although the agency had documentation of attempting the check before the employee was hired, the results were not available before the case manager began working directly with children.

The possibility of a criminal, child sex offender, or child abuse offender being employed in a position with access to children is a public concern. Section 37-5-511, *Tennessee Code Annotated*, requires the Department of Children's Services (DCS) to obtain criminal violation information for employees or volunteers having access to children. Furthermore, the Brian A. Settlement Agreement also requires that all persons applying for department or contract agency positions that involve contact with children submit to a criminal records check and child abuse registry screening process before beginning training or employment. The Community Services Agencies are subject to these requirements according to Chapter 0250-7-6(3)(b) of the *Department of Children's Services Rules and Regulations*, which states, "CSA employees are

required to comply with established DCS policies, procedures, standards and legal advice in providing services to families and children pursuant to contracts with DCS."

Most case managers hired by the agency are involved in a five-week training session at the start of their employment and do not have unsupervised contact with children during this time. This would typically be a sufficient length of time to complete the background checks. However, both of the employees noted were exempt from the training and immediately began working directly with children before the completed background checks were received.

The possibility that children could be endangered contradicts the agency's mission to protect them. In addition, child safety is a sensitive area where even one incident could subject children to abuse and adversely affect the agency's credibility with the public.

Recommendation

The CSA no longer administered these case management services on behalf of DCS as of September 1, 2005. The Department of Children's Services hired many of the CSA employees to assume the duties of administering these programs. DCS management should ensure that the appropriate background checks have been performed on transferring case managers to mitigate the risk of case managers having inappropriate contact with children. New personnel hired by DCS to administer these programs should not be assigned to duties in which they have contact with children until management has received and evaluated the fingerprint results.

Management's Comment

We concur. The agency did not complete background checks for two case managers. All background checks are completed and findings documented prior to a case manager being allowed to work with clients alone. South Central Community Services Agency no longer administers this contract on behalf of DCS.

3. Neither the South Central Community Services Agency nor the Department of Children's Services reported an incident of fraud to the Comptroller of the Treasury, increasing the risk of the case not being handled in the best interests of the state

Finding

Neither the South Central Community Services Agency nor the Department of Children's Services notified the Comptroller of the Treasury, as required by state law, about the discovery of fraud and the subsequent investigation of a South Central Community Services Agency employee for fraud. In November 2004, the department discovered that a referral form for Broker Day Care Services appeared to have been altered. Although this program is a function of

the Department of Children's Services, a South Central Community Services Agency employee performs the final review and approval of the referral forms in the South Central Region. The Department of Children's Services Internal Affairs Division investigated the allegation and determined that the South Central Community Services employee had altered the referral form and that the misappropriated services cost the state a total of $3,499 from May 2004 through November 2004. At the conclusion of the Internal Affairs investigation, the South Central Community Services Agency took disciplinary action against the employee. The employee was not terminated but was placed on administrative leave for two days without pay. In addition, the employee was placed on probation for six months and was not eligible to receive raises during this period.

Section 8-19-501, *Tennessee Code Annotated*, states,

> It shall be the duty of any official of any agency of the state having knowledge of shortages of moneys of the state, or unauthorized removal of state property, occasioned either by malfeasance or misfeasance in office of any state employee, to report the same immediately to the comptroller of the treasury.

The purpose of the statutory requirement to notify the Comptroller is to ensure a thorough investigation and appropriate resolution in the best interest of the state. Failure to report fraud could cause unnecessary delays in prosecution and could result in the state not being able to recover the misappropriated funds.

Recommendation

The Executive Director of the South Central Community Services Agency (the CSA) and the Commissioner of the Department of Children's Services should ensure that all instances or suspected instances of fraud are immediately reported to the Comptroller of the Treasury. Since the CSA did not terminate the employee, the Executive Director should closely monitor the employee's job performance.

Management's Comments

South Central Community Services Agency

We concur. South Central Community Services Agency's (SCCSA) executive director did notify DCS' Internal Affairs Division of the possible incident of fraud. DCS' Internal Affairs Director stated she would notify the Comptroller of the Treasury about the incident instead of SCCSA. The SCCSA has since developed a policy addressing possible fraud found within the agency or by a subcontractor. SCCSA will report all possible incidents of fraud to the Comptroller of the Treasury and to the State Department which holds the contract. In order to monitor this employee, all staff evaluations must now be signed off by the executive director.

Department of Children's Services

We concur that DCS did not report this situation to the Comptroller's office at the conclusion of the investigation. Prior to July 1, 2005, the Community Services Agencies (CSAs) were a separate unit from DCS. DCS investigated the incident and reported the findings to the appropriate CSA office. Because the CSAs were a separate unit, all referrals made by DCS were required to be reviewed and approved by CSA staff. Fiscal responsibility and reporting fraud were responsibilities of the South Central CSA office. DCS will, however, take steps to ensure that any instances of fraud are properly reported to all required parties at the conclusion of an investigation.

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 agency. 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 transactions that the auditors are able to test during that period. The risk assessment by management is the primary method by which the agency 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 agency.

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 agency. Although 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 agency.

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99 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, and 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.

AUDIT COMMITTEE

As a result of the fraud-related business failures of companies such as Enron and WorldCom in recent years, Congress and the accounting profession have taken aggressive measures to try to detect and prevent future failures related to fraud. These measures have included the signing of the *Sarbanes-Oxley Act of 2002* by the President of the United States and the issuance of Statement on Auditing Standards No. 99 by the American Institute of Certified Public Accountants. This new fraud auditing standard has not only changed the way auditors perform audits but has also provided guidance to management and boards of directors on creating antifraud programs and controls. This guidance has included the need for an independent audit committee.

In the previous audit report we recommended that the South Central Community Services Agency establish an audit committee. The board of directors of the CSA appointed a three-member committee in March 2005. However, as of the end of our audit, the audit committee was not fully functional and had no charter. In recognition of the benefits of audit committees for government, the Tennessee General Assembly has enacted legislation known as the "State of Tennessee Audit Committee Act of 2005." This legislation requires the creation of audit committees for those entities that have governing boards, councils, commissions, or equivalent bodies that can hire and terminate employees and/or are responsible for the preparation of financial statements. Applicable entities are required to develop an audit committee charter and appoint the audit committee in accordance with the legislation. The specific activities of any audit committee will depend on, among other things, the mission, nature, structure, and size of

each agency. In establishing the audit committee and creating its charter, each board should examine its agency's particular circumstances. Anti-fraud literature notes that there are two categories of fraud: fraudulent financial reporting and misappropriation of assets. The audit committee should consider the risks of fraud in its agency in general as well as the history of its particular agency with regard to prior audit findings, previously disclosed weaknesses in internal control, and compliance issues. The audit committee should consider both the risk of fraudulent financial reporting and the risk of fraud due to misappropriation or abuse of agency assets. Also, the board and the audit committee should keep in mind that agencies receiving public funding should have a lower threshold of materiality than private-sector entities with regard to fraud risks.

Boards should exercise professional judgment in establishing the duties, responsibilities, and authority of their audit committee. The factors noted below are not intended to be an exhaustive listing of those matters to be considered. The committee should not limit its scope to reacting to a preconceived set of issues and actions but rather should be proactive in its oversight of the agency as it concentrates on the internal control and audit-related activities of the entity. In fact, this individualized approach is one of the main benefits derived from an audit committee.

At a minimum, audit committees should:

1. Develop a written charter that addresses the audit committee's purpose and mission, which should be, at a minimum, to assist the board in its oversight of the agency.

2. Formally reiterate, on a regular basis, to the board, agency management, and staff their responsibilities for preventing, detecting, and reporting fraud, waste, and abuse.

3. Serve as a facilitator of any audits or investigations of the agency, including advising auditors and investigators of any information they may receive or otherwise note regarding risks of fraud or weaknesses in the agency's internal controls; reviewing with the auditors any findings or other matters noted by the auditors during audit engagements; working with the agency management and staff to ensure implementation of audit recommendations; and assisting in the resolution of any problems the auditors may have with cooperation from agency management or staff.

4. Develop a formal process for assessing the risk of fraud at the agency, including documentation of the results of the assessments and assuring that internal controls are in place to adequately mitigate those risks.

5. Develop and communicate to staff of the agency their responsibilities to report allegations of fraud, waste, or abuse at the agency to the committee and the Comptroller of the Treasury's office as well as a process for immediately reporting such information.

6. Immediately inform the Comptroller's office when fraud is detected.

7. Develop and communicate to the board, agency management, and staff a written code of conduct reminding those individuals of the public nature of the agency and the need for all to maintain the highest level of integrity with regard to the financial operations and any related financial reporting responsibilities of the agency; to avoid preparing or issuing fraudulent or misleading financial reports or other information; to protect agency assets from fraud, waste, and abuse; to comply with all relevant laws, rules, policies, and procedures; and to avoid engaging in activities which would otherwise bring dishonor to the agency.

The charter of the audit committee should include, at a minimum, the following provisions:

1. The audit committee should be a standing committee of the board.

2. The audit committee should be composed of at least three members. The chair of the audit committee should preferably have some accounting or financial management background. Each member of the audit committee should have an adequate background and education to allow a reasonable understanding of the information presented in the financial reports of the agency and the comments of auditors with regard to internal control and compliance findings and other issues.

3. The members of the audit committee must be independent from any appearances of other interests that are in conflict with their duties as members of the audit committee.

4. An express recognition that the board, the audit committee, and the management and staff of the agency are responsible for taking all reasonable steps to prevent, detect, and report fraud, waste, and abuse.

5. The audit committee should meet regularly throughout the year. The audit committee can meet by telephone, if that is permissible for other committees. However, the audit committee is strongly urged to meet at least once a year in person. Members of the audit committee may be members of other standing committees of the board, but the audit committee meetings should be separate from the meetings of other committees of the board.

6. The audit committee should record minutes of its meetings.

The Division of State Audit will be available to discuss with the board any questions it might have about the creation of its particular audit committee. There are also other audit committees at other state agencies that the board may wish to contact for advice and further information.

APPENDIX

South Central Community Services Agency
as of April 30, 2005

Mr. Larry Post, Executive Director

BOARD OF DIRECTORS

Executive Committee Members

Ms. Molly P. Shepard, Chair
Ms. Linda Crouch, Vice-Chair
Ms. Sumika Looney, Treasurer
Ms. Sarah Black, Secretary
Mr. Jack Keny, At-large

Other Members of the Board of Directors

Ms. Brenda Helentjaris
Ms. Marcia Vanattia
Ms. Vivian Lovvron

Audit Committee

Mr. Jack Keny, Chair
Ms. Sarah Black
Ms. Molly Shepard