AUDIT REPORT

Northeast Community Services Agency

February 2006

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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John G. Morgan
Comptroller

February 23, 2006

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Board of Directors
Northeast Community Services Agency
P. O. Box 2467
Johnson City, Tennessee 37605-2467

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Northeast Community Services Agency for the period July 1, 2003, through July 31, 2005.

The review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements resulted in no audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/ddm
05/096

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COMPTROLLER OF THE TREASURY
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August 4, 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 Northeast Community Services Agency for the period July 1, 2003, through July 31, 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 Northeast Community Services Agency's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Northeast 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 resulted in no audit findings. We have reported other less significant matters involving the agency's internal control and instances of noncompliance to the Northeast Community Services Agency's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/ddm

State of Tennessee

Audit Highlights

Comptroller of the Treasury | Division of State Audit

Financial and Compliance Audit
Northeast Community Services Agency
February 2006

AUDIT SCOPE

We have audited the Northeast Community Services Agency for the period July 1, 2003, through July 31, 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; revenue 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 audit report contains no findings.

Financial and Compliance Audit
Northeast Community Services Agency

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Financial and Compliance Audit
Northeast Community Services Agency

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Northeast 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 established a mechanism to facilitate the provision of services for children and other citizens in need of services in Tennessee through centralized agencies located throughout the state.

The Northeast Community Services Agency serves the following counties: Carter, Greene, Hancock, Hawkins, Johnson, Sullivan, Unicoi, and Washington. The agency's administrative office is located in Johnson City, Tennessee.

The governing body of the Northeast Community Services Agency is the board of directors. As of July 31, 2005, the board was composed of six 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 Northeast Community Services Agency for the period July 1, 2003, through July 31, 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;

revenue 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 FINDINGS

There were no findings in the prior audit report.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

CASH

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

- the agency's controls over cash were adequate and banking functions were segregated; and
- the bank statements were appropriately reconciled and the activity reported on the bank statements appeared proper.

To accomplish our objectives, we interviewed management to gain an understanding of the agency's procedures and controls over cash and to determine that adequate segregation of duties exists. We obtained the bank statements for July 2003 through May 2005, reviewed all deposits and withdrawals for the operating and payroll account statements for reasonableness, and noted whether the reconciliations on all the accounts had been performed and approved. We questioned old, outstanding checks and withdrawals that did not appear to be completed in the ordinary course of business. We verified the accuracy of the statements and reconciliations for the October 2003 payroll account and April 2004 operating account. We also compared the agency's records of the Local Government Investment Pool account to the statement provided by the Department of the Treasury.

As a result of our inquiries, observations, and testwork, we concluded that the agency had adequate controls over cash including segregation of duties; bank statements appeared proper; and bank reconciliations had been appropriately performed on all accounts. The June 2004

Local Government Investment Pool account agreed to the statement provided by the Department of the Treasury.

REVENUE AND CASH RECEIPTS

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

- the agency's controls over the revenue and cash receipting functions were adequate;
- reconciliations between the cash receipts, mail log records, and the deposits were performed;
- the agency's policy for timely deposit of funds was followed; and
- receipts were posted to the correct account for the correct amount.

To accomplish our objectives, we interviewed key agency personnel to gain an understanding of procedures and controls over revenue and cash receipts. We obtained the cash receipts for July 2003 through May 2005, and tested a nonstatistical sample of cash receipts for compliance with depositing, reconciliation, and posting procedures.

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

- the agency had no material weaknesses regarding controls over the revenue and cash receipting functions;
- reconciliations between the cash receipts, mail log records, and the deposits were performed;
- the agency's policy for timely deposit of funds was followed; and
- receipts were posted to the correct account for the correct amount.

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;
- 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;
- equipment acquisitions were located and had been properly recorded in the accounting records;
- monitoring procedures were in place to ensure that funds awarded to subrecipients were expended in accordance with contract provisions;
- 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 period's payroll register; and
- the agency's procedures for credit cards and gas cards were adequate and purchases involving credit cards and gas 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. In addition, we reviewed the check register and selected all single payments greater than $5,000 and all combined payments to a single vendor totaling $25,000 or more to determine whether a vendor contract was in place when required and the agency made a public announcement of funds if necessary. We tested all travel claim reimbursements for the Executive Director from July 1, 2003, through June 30, 2005, and a nonstatistical sample of other 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 June 15, 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, adequately 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 required contacts with the children and their families. We located newly purchased equipment to determine that it was properly recorded. Subrecipient monitoring procedures were reviewed to ensure that funds were expended according to contract provisions. 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. For employees leaving the agency's employment, we determined if the final pay was correct and whether the employees appeared on the following period's payroll register. We reviewed procedures for credit and gas card purchases and tested a nonstatistical sample of the credit card and gas card transactions for appropriateness.

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

- controls over expenditures and program compliance were adequate;
- the plan of operation and related amendments were properly approved;
- 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;
- case managers were maintaining the required case file documentation and making required contacts with children and their families for the Family Support Services and Family Crisis Intervention Programs;
- equipment purchased during the audit period was located and recorded in the accounting records;
- monitoring procedures were in place for subrecipients to ensure that funds were expended in accordance with contract provisions;
- recently hired employees were qualified for their positions, their initial wages were properly calculated, and the appropriate background checks were performed;
- final pay for employees terminating employment was properly calculated and the employees did not appear on the following period's payroll register; and
- the agency's procedures for credit cards and gas cards were adequate, and purchases involving credit cards and gas cards were appropriate.

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 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 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 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 auditors may include testing of controls as a 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 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 controls after the auditors have left the field.

The assessment and the controls should be reviewed and approved by the commissioner or agency head. 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.

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 Northeast Community Services Agency establish an audit committee. The board chair of the CSA appointed a three-member committee in September 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

Northeast Community Services Agency
as of July 31, 2005

Mr. Ray Lyons, Executive Director

BOARD OF DIRECTORS

<u>Executive Committee Members</u>

Ms. Carolynn Kinser, Chair
Mr. Bobby Larkins, Vice-Chair
Mr. George Lowe, Treasurer
Ms. Cleo Reed, Secretary
Ms. Carol Kiener, At-Large

<u>Other Member of the Board of Directors</u>

Ms. Linda Buck

<u>Audit Committee</u>

Ms. Cleo Reed
Mr. Bobby Larkins
Mr. George Lowe