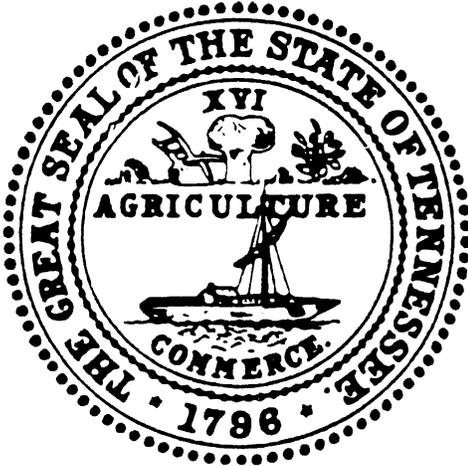


AUDIT REPORT

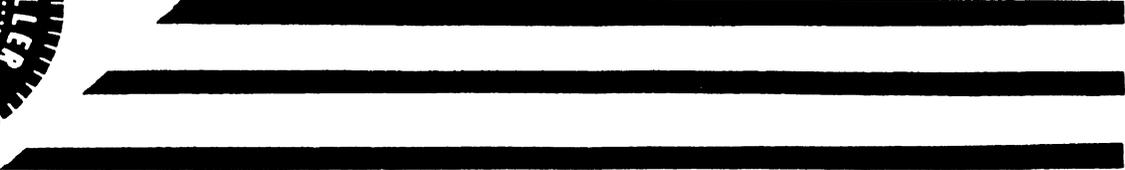
Southwest Community Services Agency

December 2005



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit
Division of State Audit



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**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

State Capitol
Nashville, Tennessee 37243-0260
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John G. Morgan
Comptroller

December 8, 2005

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Board of Directors
Southwest Community Services Agency
33 Old Hickory Blvd. E
Jackson, Tennessee 38305

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Southwest Community Services Agency for the period July 1, 2003, through June 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/kbt
05/102



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT

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July 18, 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 Southwest Community Services Agency for the period July 1, 2003, through June 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 Southwest Community Services Agency's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Southwest 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 management 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 Southwest Community Services Agency's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/kbt

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Southwest Community Services Agency
December 2005

AUDIT SCOPE

We have audited the Southwest Community Services Agency for the period July 1, 2003, through June 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, cash receipts, 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 Management Did Not Adequately Monitor Staff's Compliance With the Case Management Policies and Procedures for Children and Families and Did Not Mitigate the Risk of Inadequate Performance of Services for Some Children and Families

The Southwest Community Services Agency has not complied with case management policies and procedures related to adequate case file documentation and its contacts with children and families (page 5).

CSA Management Failed to Adequately Assess and Mitigate the Risk of Overpayments to Service Providers, Resulting in Unsupported or Improper Payments Totaling \$2,564

The agency did not have adequate internal control regarding its review and payment of invoices to service providers, which resulted in incorrect and unsupported expenditures (page 9).

Financial and Compliance Audit Southwest Community Services Agency

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Financial and Compliance Audit Southwest Community Services Agency

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the East Tennessee 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 Southwest Community Services Agency serves the following counties: Chester, Decatur, Fayette, Hardeman, Hardin, Haywood, Henderson, Lauderdale, Madison, McNairy, and Tipton. The agency’s administrative offices are in Jackson, Tennessee.

The governing body of the Southwest Community Services Agency is the board of directors. As of June 30, 2005, the board was composed of eight members. (See Appendix.) An executive committee, consisting of two 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.

Effective July 1, 2005, the Department of Children’s Services and the Department of Correction began the process of transferring approximately 97 Community Services Agency employees serving in jobs that are classified as career service to positions within those departments. The Southwest Community Services Agency will continue to administer the TennCare Transportation program and will seek programs with other agencies for the purpose of providing coordination of funds or programs for the care of the citizens of the state.

AUDIT SCOPE

We have audited the Southwest Community Services Agency for the period July 1, 2003, through June 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, cash receipts, 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

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 Southwest Community Services Agency filed its report with the Department of Audit on April 4, 2005. A follow-up of all prior audit findings was conducted as part of the current audit. The current audit disclosed that the Southwest Community Services Agency has corrected previous audit findings concerning incurring expenditures prior to contracts being approved and placing an ineligible employee on administrative leave with pay.

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 cash and cash receipting were adequate;
- receipts were posted correctly to the accounting records;
- the agency deposited funds within one day of receipt;
- reconciliations between the cash receipts and the deposit slips were performed; and

- bank statements were accurate and were reconciled to the accounting records monthly.

To accomplish our objectives, we interviewed management to gain an understanding of the agency's procedures and controls for bank reconciliations and cash receipts. We obtained the cash receipts for July 1, 2003, through June 30, 2005, and tested a nonstatistical sample of cash receipts for proper posting, depositing, and reconciliation procedures. We also obtained and reviewed all of the bank statements and bank reconciliations for the audit period and verified the accuracy of the August 31, 2003, and June 30, 2005, bank reconciliations.

As a result of inquiries and reviews, we found that the agency has adequate controls over cash and cash receipting; complied with receipt posting, depositing, and reconciliation procedures; and performed timely bank reconciliations.

EXPENDITURES AND PROGRAM COMPLIANCE

Our primary objectives were to determine whether

- the agency's controls over expenditures and program compliance were adequate;
- the agency corrected prior-year findings;
- the plan of operation and amendments were properly approved;
- expenditures for goods or services were properly approved, supported, and allowable (including payments for services under the Family Support Services, Family Crisis Intervention, and Independent Living Programs);
- goods or services were received prior to payment;
- a vendor contract was in place when required and the agency made a public announcement if necessary;
- the agency maintained case files and performed required contacts with the children and families in the Family Support Services and Family Crisis Intervention Programs;
- expenditures for travel were paid in accordance with the Comprehensive Travel Regulations;
- 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 policies and 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 services providers. We also reviewed written policies and procedures. We followed up prior audit findings to determine if corrective action was taken. We obtained the plan of operation and related amendments to determine the appropriateness of approvals. We obtained the agency's check register and tested nonstatistical samples to determine that expenditures were approved, supported, and allowable under the applicable guidelines for the Family Support Services, Family Crisis Intervention, and Independent Living Programs. We also reviewed sample transactions to determine that goods and services were received prior to payment. In addition, we reviewed the check register and selected all single payments over \$5,000 and payments in the aggregate of \$25,000 or more to a single payee during one fiscal year to determine whether payments were made under an approved contract and whether the agency made public announcements as necessary. We obtained a list of all children who received services for the audit period 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 tested a nonstatistical sample of the travel claims reimbursements to determine whether claims were paid in accordance with travel regulations. 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 policies and 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

- prior audit findings were corrected;
- the plan of operation and related amendments were properly approved;
- in all material respects, 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;
- recently hired employees were qualified for their positions, their initial wages were properly calculated, and appropriate background checks were performed;
- final pay for employees terminating employment was properly calculated and the employees did not appear on the following payroll register; and

- the agency's policies and procedures for credit cards were adequate and purchases involving credit cards were appropriate.

However, we determined that the agency did not comply with the Family Support Services and Family Crisis Intervention Programs' policies related to its case file documentation and contacts with children and families. See finding 1. Also, we noted in finding 2 that the agency did not have adequate controls regarding its review of invoices and payments to service providers, which resulted in payments to service providers that were unauthorized and unallowable.

1. The agency management did not adequately monitor staff's compliance with the case management policies and procedures for children and families and did not mitigate the risk of inadequate performance of services for some children and families

Finding

The Southwest Community Services Agency (CSA) staff did not comply with the case management policies and procedures related to case file documentation and contact with children and families. Furthermore, CSA management did not adequately monitor staff to ensure that these policies and procedures were followed, resulting in inadequate performance of services for some children and families. The Department of Children's Services (DCS) contracted with the CSA to provide case management services to noncustodial children, and their families, 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 and maintenance of case files.

The Department of Children's Services has developed policy and procedure manuals for both FSS and FCIP establishing 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, or prepared; and the requirements for documentation of evidence to support compliance with the policies and procedures. These policies and procedures provide that 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 according to these policies and procedures.

We reviewed 25 children's case files from a population of 2,171 files, to determine if the CSA complied with the *Policy and Procedure Manual For Family Support Services and Family Crisis Intervention Program Procedure Manual* contact requirements for children and their families. Our testwork determined that the CSA was required to make 130 contacts with the 25 children and families. The results of our review revealed that overall the CSA case managers failed to make 7 of the 130 required contacts (5%). Specific details are as follows:

- For 3 of the 24 non-emergency-FSS and FCIP children’s case files tested (13%), the case manager did not make the initial contact with the family within 24 hours of the receipt of the authorization or application for services. Specifically, the case managers did not make contact with the children until 5, 7, and 17 calendar days after the authorization to provide services was received.
- Based on review of 9 non-emergency FSS children’s case files, we found that in 2 of 9 files tested (22%), there were no case recordings to indicate that the case manager followed up with a face-to-face contact within 5 working days of the initial contact. The case recordings indicated that for one child the follow-up face-to-face contacts occurred 25 working days after the initial contact. For the other child, the case manager did not make any contact with the child or family, as noted above, until 13 working days (17 calendar days) after the agency received the authorization to provide services.
- For one of the 16 emergency-FSS and FCIP children’s case files tested (6%), there were no case recordings to indicate that the case manager followed up with a face-to-face contact within 48 hours after receipt of the child’s authorization or application for services. The follow-up contact was made 17 days after receipt of the application for services.
- We reviewed 10 children’s FSS case files and determined that the CSA case managers were required to make 40 monthly face-to-face contacts with these 10 children. The case recordings indicated that a case manager missed one of the required monthly contacts (3%). The Department of Children’s Services *Policy and Procedure Manual For Family Support Services, Section V, Service Delivery*, page 14, states,

The Family Support case manager must conduct . . . a minimum of one face-to-face contact per month for the remainder of the service delivery phase.

The Department of Children’s Services *Policy and Procedure Manual For Family Support Services, Section V, Service Delivery*, page 11, states,

In cases that are not indicated as an emergency, the Family Support staff person will make initial contact (either face to face or by phone) with the family within 24 hours or 1 working day . . . After the initial contact the FSS case manager must follow up with a face-to-face contact within 5 working days . . . If the referring case manager has recommended that the family receive emergency services, the Family Support case manager must make initial contact on the same day and will have a follow-up face-to-face contact with the family within 48 hours. . . .

The Department of Children's Services *Family Crisis Intervention Program Procedure Manual, Initial Crisis Intervention section*, page 11, states,

An initial contact will be made with the juvenile and family as soon as possible and no later than 24 hours after receipt of the application. . . .
In person contacts should be made as soon as possible and no later than 48 hours after receipt of the application. . . .

We also reviewed children's files for the 83 forms required to be on file for the 25 children to determine if CSA staff maintained this child-specific documentation in the files and that the forms were completed timely. Our review revealed weaknesses in 8 of the 83 forms (10%):

- For 2 of the 10 children's FSS case files tested (20%), we noted one file did not contain a service plan and another file contained a service plan that was completed 30 days late.

The Department of Children's Services *Policy and Procedure Manual For Family Support Services, Section V, Service Delivery*, page 13, states,

Family Support Services case manager will develop an assessment and a written Service Plan that addresses the unique needs of the child and family within 15 working days of receipt of the authorization.

- In one of the 15 children's FCIP case files tested (7%), we noted that the CSA did not prepare a crisis intervention / resolution plan within 10 working days of the receipt of the child's application. The resolution plan in the child's file was completed 19 working days after the application was received.

The Department of Children's Services *Family Crisis Intervention Program Procedure Manual, Short-Term Intervention section*, page 15, states,

. . . the crisis intervention case manager will complete the following procedures as soon possible but no later than ten (10) working days after receipt of the application . . . F. Assist the juvenile and family to complete a written plan seeking their agreement as to tasks and activities that will be pursued to alleviate the presenting problems . . . Use the Crisis Intervention/Resolution Plan Form for this purpose. . . .

- We reviewed 9 children's FSS case files and determined that CSA case managers were required to prepare 12 quarterly progress reports. One case manager failed to prepare or maintain 3 of the required quarterly progress reports (25%) for one child.

The Department of Children's Services *Policy and Procedure Manual For Family Support Services, Section V, Service Delivery*, page 13, states,

Family Support staff will put written progress reports in the record on a quarterly basis.

- For 2 of the 15 children’s FCIP case files tested (13%), we noted that the case manager did not maintain a closing summary signed by the team leader. Both of these files contained the first page of the closing summary in the case notes but did not have the remainder of the document including the signatures.

The Department of Children’s Services *Family Crisis Intervention Program Procedure Manual, Closing a Case section*, page 20, states,

The case file must be closed in writing with a summary. The summary must be signed by the team leader.

In performing our testwork, we also noted that the CSA did not close children’s FCIP cases within the time frame required by policy. Our review revealed that the CSA did not close 13 of 15 cases (87%) within 45 days, or within 75 days if an extension was obtained, of the initial receipt of the child’s application for service. The 13 cases were open from 16 to 202 days beyond the required closure date and the CSA continued to provide services. None of the files contained documentation of an extension.

The Department of Children’s Services *Family Crisis Intervention Program Procedure Manual, Closing a Case section*, page 19, states,

When closure is determined to be appropriate, the crisis intervention case manager will proceed to close the case as soon as possible and no later than 45 days (or 75 days if extension is obtained) after the initial receipt of the application.

The Southwest CSA’s failure to comply with the DCS required case management policies and procedures for FSS and FCIP related to case file documentation and contacts with children and families violates its contractual agreement with the Department of Children’s Services. 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 monitoring of required documentation and contacts, 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

As long as the CSA continues to administer these programs on behalf of DCS, the Executive Director in coordination with the Director of Children and Family Services and team leaders should monitor case managers to ensure that staff properly maintain case files for all children and make face-to-face contact with the children as required by DCS policies and procedures. The Department of Children's Services plans to assume these duties in the near future by hiring the CSA employees. 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. Southwest CSA's contract with DCS ended on September 30, 2005, so the likelihood of these deficiencies being repeated is minimal. It should be noted that many of the deficiencies indicate that SWCSA did not follow approved DCS policy. However, authority to waiver from the approved policy was granted by DCS, in writing, on numerous occasions. In certain situations, these waivers were required by DCS. Several draft policies were issued by DCS, and SWCSA was instructed to adhere to these draft policies.

2. CSA management failed to adequately assess and mitigate the risk of overpayments to service providers, resulting in unsupported or improper payments totaling \$2,564

Finding

The Southwest Community Services Agency (CSA) did not have adequate controls regarding its review and payment of invoices to service providers. This resulted in overpayments to service providers or payments that were unsupported.

The State of Tennessee, Department of Children's Services, contracted with the CSA to provide child and family case management services and other services to children who had been in the state's custody or who were at imminent risk of entering state custody. The CSA's employees provided the case management services, and other services were provided by service providers on contract with the CSA.

Our testwork consisted of a review of expenditures paid to service providers on behalf of children and families. We selected 71 expenditure transactions totaling \$25,229 from a population of 6,457 transactions totaling \$1,876,853. Our review revealed that 16 of the 71 expenditures (23%) were either inaccurate or unsupported expenditures as detailed below:

- For 2 of the 16 transactions, the agency over paid \$412.50 to service providers because CSA staff failed to verify the accuracy of the service providers' invoice. These two errors occurred on the same invoice for two different children. For one child, the service provider incorrectly calculated 6 hours of service @ \$50/hour as \$600 rather than \$300. The CSA staff failed to verify the accuracy of the invoice and paid the service provider \$600, rather than the actual \$300 that was due. For the other child, the service provider incorrectly calculated the 17.25 hours of service @ \$50/hour as \$975, rather than \$862.50. The CSA failed to verify the accuracy of the invoice for this child and paid the provider \$975, resulting in an overpayment of \$112.50.
- For 14 of the 16 transactions, the CSA staff did not maintain adequate progress notes related to the services provided to children. Based on discussion with management, the agency's procedure is to maintain the service providers' progress notes in the children's case files after CSA staff reconcile the progress notes to the service providers' invoices. However, the CSA could not provide the progress notes supporting these transactions. As a result, the CSA paid \$2,151.50 to the service providers without adequate supporting documentation that services were provided.

Because there was not an adequate review of the invoices and because all progress notes were not maintained, the CSA overpaid for services and was not able to substantiate that some children received the services for which the CSA paid.

Recommendation

As long as the CSA continues to administer these programs on behalf of the Department of Children's Services, the Executive Director in coordination with the Director of Children and Family Services, team leaders, and fiscal staff should ensure that controls are appropriately designed and followed related to the review of service providers' invoices and billing documentation prior to reimbursement to prevent incorrect or unsupported payments. The Executive Director should monitor staff to ensure controls are followed before reimbursement is made to services providers.

The Department of Children's Services plans to assume these duties in the near future by hiring CSA employees. Employees transferring to DCS should ensure that appropriate review is made of provider invoices and billing documentation. Appropriate leadership in DCS 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. We conducted an analysis of our system and determined that this deficiency was the result of a filing error. SWCSA standard procedures dictate that progress notes be presented by vendors when invoicing SWCSA. These progress notes are reviewed by the fiscal department, and passed on to the program department, where they are placed in client files. For a period of time, the progress notes were reviewed by fiscal and passed on to program, where they were filed in bulk rather than individual case files. These bulk filings were mistakenly sent to storage and we were unable to locate them during the course of the audit. This problem has been corrected and the progress notes can now be found in the individual client's file.

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 the 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 department. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditor testing is limited and is usually targeted to test the effectiveness of particular controls. Even if controls appear to be operating effectively during the time of the auditor testing, they may be rendered ineffective the next day by management override or by other circumventions that, if left up to the auditor to detect, will not be noted until the next audit engagement and then only if the auditor tests the same transactions and controls. Furthermore, since staff may be seeking to avoid auditor criticisms, they may comply with the controls during the period that the auditors are on site and revert to ignoring or disregarding the controls 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.

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 World Com 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 Southwest Community Services Agency establish an audit committee. The board chair of the CSA appointed the chair of the committee in March 2005, and two other board members agreed to serve on the committee. However, as of the end of our audit, the audit committee was not fully functional and was in the process of developing its 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.

APPENDIX

SOUTHWEST COMMUNITY SERVICES AGENCY

Don Patterson, Executive Director

BOARD OF DIRECTORS

Executive Committee Members

Robin Powers, Acting Chair
Spurgeon Smith, Secretary/Treasurer

Audit Committee

Robin Powers – Acting Chairman
Deborah Jenkins
Vijayashree Reddy

Other Members of the Board of Directors

Reverend John E. Meeks
Vanissa Brown Holmberg
Charlotte Gammill
Mildred Lawhorn, DCS Commissioner Designee