AUDIT REPORT

Memphis and Shelby County Community Services Agency

July 2007

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
(615) 741-2501

John G. Morgan
Comptroller

July 26, 2007

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Board of Directors

Memphis and Shelby County Community Services Agency
1407 Union Avenue, Suite 1300
Memphis, Tennessee 38104

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of Memphis and Shelby County Community Services Agency for the period July 1, 2003, through March 31, 2006.

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

Sincerely,

John G. Morgan

John G. Morgan
Comptroller of the Treasury

JGM/cj
06/073

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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May 4, 2006

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 Memphis and Shelby County Community Services Agency for the period July 1, 2003, through March 31, 2006.

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 Memphis and Shelby County Community Services Agency's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Memphis and Shelby County 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 a finding which is detailed in the Objectives, Methodologies, and Conclusions section of this report. The agency's management has responded to the audit finding; we have included the response following the finding. We will follow up the audit to examine the application of the procedures instituted because of the audit finding.

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

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/cj

State of Tennessee

Audit Highlights

Comptroller of the Treasury Division of State Audit

Financial and Compliance Audit
Memphis and Shelby County Community Services Agency
July 2007

AUDIT SCOPE

We have audited the Memphis and Shelby County Community Services Agency for the period July 1, 2003, through March 31, 2006. 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 bank reconciliations; and expenditures and compliance with the Family Support Services, Family Crisis Intervention, Independent Living Programs, and the Interim Shelter Program. 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; participating in the negotiation and procurement of services for the state; and approving the Community Services Agencies' Plans of Operation (budgets).

AUDIT COMMITTEE APPOINTED
CHARTER APPROVED

On May 19, 2005, the Tennessee General Assembly 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. Entities, pursuant to the act, are required to appoint the audit committee and develop an audit committee charter in accordance with the legislation. The ongoing responsibilities of an audit committee include, but are not limited to:

1. overseeing the financial reporting and related disclosures, especially when financial statements are issued;

2. evaluating management's assessment of risk and the agency's system of internal controls;

3. formally reiterating, on a regular basis, to the board, agency management, and staff their responsibility for preventing, detecting, and reporting fraud, waste, and abuse;

4. serving as a facilitator of any audits or investigations of the agency, including advising auditors and investigators of any information it may receive pertinent to audit or investigative matters;

5. informing the Comptroller of the Treasury of the results of assessment and controls to reduce the risk of fraud; and

6. promptly notifying the Comptroller of the Treasury of any indications of fraud.

In a previous audit report, we recommended that the Memphis and Shelby County Community Services Agency establish an audit committee. The board of the CSA appointed a four-member committee on December 21, 2005. The audit committee charter was approved by the Comptroller of the Treasury on May 8, 2006. Additionally, the audit committee approved a written code of conduct on May 17, 2006.

DOCUMENTED RISK ASSESSMENT NOT PREPARED

As of the end of fieldwork on May 4, 2006, the audit committee had not yet approved, nor had management prepared, a documented risk assessment.

AUDIT FINDING

Bank Reconciliations Were Not Properly Prepared, Increasing the Risk of Misstatements in the Accounting Records Due to Error or Fraud

Account balances per the operating account bank statements and the payroll account bank statements were not properly reconciled with the cash balance per the general ledger by the current and former Fiscal Director of the Memphis Shelby County Community Services Agency. Also, reconciliations of the operating account and the payroll account were not always performed within 30 days of the bank statement closing date.

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Memphis and Shelby County Community Services Agency

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INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Memphis and Shelby County 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 Memphis and Shelby County Community Services Agency's administrative office is in Memphis, Tennessee.

The governing body of the Memphis and Shelby County Community Services Agency is the board of directors. As of March 31, 2006, the board was composed of seven members. (See Appendix.) An executive committee, consisting of four 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 was appointed by the Commissioner of the Department of Children's Services, subject to the approval of the board.

AUDIT SCOPE

We have audited the Memphis and Shelby County Community Services Agency for the period July 1, 2003, through March 31, 2006. 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 bank reconciliations; and expenditures and compliance with the Family

Support Services, Family Crisis Intervention, Independent Living Programs, and the Interim Shelter Program. 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; participating in the negotiation and procurement of services for the state; and approving the Community Services Agencies' Plans of Operation (budgets).

PRIOR AUDIT FINDINGS

Section 8-4-10, *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 Memphis and Shelby County Community Services Agency filed its report with the Department of Audit on July 19, 2005. A follow-up of all prior audit findings was conducted as part of the current audit. The current audit disclosed that the Memphis and Shelby County Community Services Agency has corrected previous audit findings concerning compliance with state rules and regulations regarding contract terms and timely payment of vendors, as well as membership of the CSA board of directors violating state law.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

CASH AND BANK RECONCILIATIONS

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

- the design of the agency's controls over cash and bank reconciliations was adequate;
- cash receipts were deposited timely and posted correctly to the accounting records;
- the agency's petty cash fund could be accounted for and disbursements from the fund were proper and properly recorded;
- revenues recorded for the TennCare Transportation program were reasonable in relation to the number of clients served; and
- bank reconciliations were accurate, performed promptly, and approved in accordance with agency policy.

To accomplish our objectives, we interviewed management to gain an understanding of the agency's procedures and controls over cash and bank reconciliations. We obtained the cash receipts for July 1, 2003, through March 27, 2006, and tested a nonstatistical sample of cash receipts for timeliness of deposit and proper posting to the accounting records. Also, we performed a surprise petty cash count and tested a nonstatistical sample of petty cash disbursements for the period July 1, 2003, through April 27, 2005. We obtained enrollment statistics from the Bureau of TennCare in the Department of Finance and Administration and compared the indicated revenue with the revenue recorded to determine whether the recorded revenue was reasonable. We also obtained and reviewed the bank statements and the Local Government Investment Pool statements for June 2005 through March 2006. In addition, we reviewed the bank statements and the Local Government Investment Pool statement for June 2004.

As a result of our inquiries, observations, and testwork, we concluded that

- the design of the agency's controls over cash receipts and bank reconciliations was adequate;
- cash receipts were deposited timely and properly posted to the accounting records, with only minor exceptions;
- the agency's petty cash fund could be accounted for and disbursements from the fund were proper and properly recorded, with minor exceptions; and
- revenues recorded for the TennCare Transportation program appeared reasonable.

We determined that bank reconciliations were approved in accordance with policy; however, the bank reconciliations were not performed in a timely manner and were not accurate as noted in the finding below.

Bank reconciliations were not properly prepared, increasing the risk of misstatements in the accounting records due to error or fraud

Finding

The current and former Fiscal Director at Memphis Shelby County Community Services Agency (MSCCSA) failed to properly reconcile balances per the operating account bank statements and the payroll account bank statements with the cash balance per the general ledger. While monthly bank reconciliations were prepared by the current and former Fiscal Director, though not always in a timely manner, and approved by the Executive Director, that on the surface appeared to reconcile, they were in reality erroneous. The actual cash balance per the general ledger was not used in the reconciliations. Both the Fiscal Director and the Executive Director were aware that the reconciliations were in error; however, they were unable to discover the exact cause.

Our review of both the operating and payroll bank statements, general ledgers, and outstanding checklists for the period June 1, 2004, through March 31, 2006, confirmed that the amounts on the general ledger, after considering all known reconciling items, still did not agree with those on the bank statements. The monthly discrepancy between the book and the bank balances for the operating account was as high as $50,922 and as high as $88,991 for the payroll account. These discrepancies could not be explained by management. Based on our review of accounting records and our discussions with management and staff, it appears the variance between book balance and bank balances started when a change was made to new accounting software prior to July 2003. These errors appeared to be a result of entries being posted incorrectly to the general ledger or entries not being posted at all. Since no correction was made, the discrepancy continued throughout the audit period and fluctuated in magnitude due to additional errors made in the audit period.

Due to timing differences between when transactions are entered into the bank statements and when transactions are entered into the accounting records, account balances on the bank statements are usually different from those on the accounting records. The goal of reconciling bank statements is to determine if the discrepancy is due to error rather than timing. Although the current and former Fiscal Director for MCCSA attempted to perform a monthly reconciliation of the book balance and the bank balance for the operating account and the payroll account, the two balances were never actually reconciled. If accurate and timely bank reconciliations are not prepared, misstatements in the accounting records due to error or fraud may occur and go undetected.

As a result of the increased risk of fraud, we performed additional audit procedures. The results of those procedures did not uncover any fraudulent activities.

In addition, our review of monthly bank statements, general ledgers, deposits in transit, and outstanding checklists from June 2005 through March 2006 indicated that six of ten operating account reconciliations were not performed within 30 days of the bank statement closing date and five of ten payroll account reconciliations were not performed within 30 days of the bank statement closing date. It is important that reconciliations be performed within 30 days of the bank's closing date because the bank's policy is that errors must be reported within that time frame.

Recommendation

The Executive Director should ensure that bank statements are accurately and promptly reconciled with accounting records. Furthermore, the Executive Director should ensure that known errors are thoroughly investigated and corrected.

Management should ensure that risks such as these noted in this finding are adequately identified and assessed in their documented risk assessment activities. Management should identify specific staff to be responsible for the design and implementation of internal controls to prevent and detect exceptions timely. Management should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt action should exceptions occur.

Management's Comment

We concur. As noted in your finding, the monthly discrepancy between our book and bank balances seems to have occurred during the transition from one accounting software program to another. Efforts to reconcile were more difficult because the balances were not reconciled in a timely manner.

Currently all accounts are reconciled within 30 days of receipt of bank statements and book balances are checked against bank balances. All known errors are thoroughly investigated and corrected.

EXPENDITURES AND PROGRAM COMPLIANCE

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

- the design of the agency's controls over expenditures and program compliance was adequate;
- the plans of operation and amendments were properly approved;
- expenditures for goods or services were properly approved, supported, and allowable (including payments for goods or services under the Family Support Services, Family Crisis Intervention, Independent Living Programs, and the Interim Shelter Program);
- a vendor contract was in place when required and contract guidelines were followed;
- the agency maintained appropriate documentation for children in the Independent Living Programs and followed established guidelines;
- case files contained adequate documentation regarding families served by the Interim Shelter Program and program guidelines were followed;
- expenditures for travel were paid in accordance with the travel regulations;
- the agency's policies and procedures for credit cards were adequate and purchases involving credit cards were appropriate;
- the agency maintained the required documentation 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; and

- final pay for terminated employees was properly calculated and the employees did not appear on the following period’s payroll register.

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 plans of operation and related amendments and determined the appropriateness of approvals. A nonstatistical sample of expenditure transactions, excluding payroll and travel, was selected to determine that expenditures were approved, supported, and allowable. In addition, we obtained the vendor payment listing for the period July 1, 2003, through May 20, 2005, and compared it to vendor contracts to determine whether a vendor contract was in place when required and contract guidelines were followed. A nonstatistical sample of service payments was tested for the period July 1, 2003, through May 24, 2005, to determine if the agency maintained appropriate documentation for children in the Independent Living Programs and followed established guidelines. We examined a nonstatistical sample of Interim Shelter Program enrollee case files to determine if adequate documentation was included and the program guidelines were followed. We tested a nonstatistical sample of the Executive Director’s travel claims for the period July 1, 2003, through May 20, 2005, and all of the Executive Director’s travel claims for the period June 1, 2005, through March 8, 2006. In addition, we tested a nonstatistical sample of other travel claims for the period July 1, 2003, through March 23, 2006. We discussed policies and procedures governing credit cards and credit card purchases. In addition, we tested a nonstatistical sample of credit card transactions for the period July 1, 2003, through May 20, 2005, and we also tested the three largest transactions for the period June 1, 2005, through March 31, 2006, for appropriateness.

We obtained a list of all children in the Family Support Services and Family Crisis Intervention programs who received services from July 1, 2003, through May 24, 2005, and tested a nonstatistical sample of children’s case files to determine whether the case managers maintained the required documentation and made required contacts with the children and their families. We obtained personnel files and other supporting documentation of all employees hired from July 1, 2003, through May 28, 2005, 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 during the period July 1, 2003, through May 31, 2005, we determined if the final pay was correct and whether the employees appeared on the following period’s payroll register.

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

- the design of controls over expenditures and program compliance was adequate;
- the plans of operation and related amendments were properly approved;
- expenditures for goods or services were properly approved, supported, and allowable;
- a vendor contract was in place when required and contract guidelines were followed, with minor exceptions;

- the agency maintained appropriate documentation for children in the Independent Living Programs and followed established guidelines, with minor exceptions;
- adequate documentation was maintained in Interim Shelter Program case files and program guidelines were followed;
- expenditures for travel were paid in accordance with the travel regulations, with minor exceptions;
- the agency's unwritten policies and procedures for credit cards were adequate and purchases involving credit cards were appropriate;
- recently hired employees appeared qualified for their positions, their initial wages were properly calculated, and the appropriate background checks were performed; and
- final pay for employees terminating employment was properly calculated and the employees did not appear on the following period's payroll register.

However, the agency did not comply with the Family Support Services and Family Crisis Intervention programs' policies related to case file documentation and contacts with children and families as noted in the Observations and Comments section of this report.

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 the 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 established at any time by management or older 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 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 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 entity.

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit,* 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, 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 also 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

On May 19, 2005, the Tennessee General Assembly 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. Entities, pursuant to the act, are required to appoint the audit committee and develop an audit committee charter in accordance with the legislation. The ongoing responsibilities of an audit committee include, but are not limited to:

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3. formally reiterating, on a regular basis, to the board, agency management, and staff their responsibility for preventing, detecting, and reporting fraud, waste, and abuse;

4. serving as a facilitator of any audits or investigations of the agency, including advising auditors and investigators of any information it may receive pertinent to audit or investigative matters;

5. informing the Comptroller of the Treasury of the results of assessment and controls to reduce the risk of fraud; and

6. promptly notifying the Comptroller of the Treasury of any indications of fraud.

In a previous audit report, we recommended that the Memphis and Shelby County Community Services Agency establish an audit committee. The board of the CSA appointed a four-member committee on December 21, 2005. The audit committee charter was approved by the Comptroller of the Treasury on May 8, 2006. Additionally, the audit committee approved a written code of conduct on May 17, 2006.

As of the end of fieldwork on May 4, 2006, the audit committee had not yet approved, nor had management prepared, a documented risk assessment.

CASE MANAGEMENT SERVICES UNDER THE FAMILY SUPPORT SERVICES PROGRAM AND THE FAMILY CRISIS INTERVENTION PROGRAM

The Department of Children's Services (DCS) contracted with the Memphis and Shelby County Community Services Agency (CSA) to provide case management services to noncustodial children, and their families, who were at imminent risk of entering state custody or who had been in the state's custody and had returned to their families. The CSA provided case management services under the Family Support Services Program (FSS), the Family Crisis Intervention Program (FCIP), and the Order of Reference from the courts including case manager visits with children and their families and maintenance of case files.

Testwork was performed on a random sample of 60 case files—52 FSS case files and 8 FCIP cases files—of children who received services from July 1, 2003, through May 24, 2005. Our testwork revealed that the Memphis and Shelby County Community Services Agency did not comply with case management policies and procedures related to case file documentation and contact documentation with children and families in the Family Support Services Program and the Family Crisis Intervention Program. For example, case files tested were not always assigned to a case manager within 24 hours, or one working day; the initial contact with the family was not always made within one working day of when the referral was received; a Service Plan was not always developed within 15 working days of receipt of the case and/or the Service Plan was not signed by the adult family members and by the child at risk, as appropriate; and the case manager did not always make a minimum of one face-to-face contact per week for the first four weeks.

Effective August 31, 2005, the Memphis and Shelby County Community Services Agency no longer provided case management services for the Department of Children's Services. As of September 1, 2005, case files were transferred to DCS and CSA staff was hired by DCS to continue to perform these services.

APPENDIX

MEMPHIS AND SHELBY COUNTY COMMUNITY SERVICES AGENCY

Susan Adams, Executive Director

BOARD OF DIRECTORS

As of March 31, 2006

Board Officers

Gwendolyn Wright, Chair
Rieta Selberg, Vice-Chair
Betsy Black, Secretary

Executive Committee Members

Gwendolyn Wright, Chair
Rieta Selberg
Betsy Black
J.W. Gibson

Audit Committee

J.W. Gibson, Chair
Betsy Black
Rieta Selberg
Gwendolyn Wright

Other Members of the Board of Directors

Sara Lewis
Pat Morgan
William Terrell, Jr., M.D.