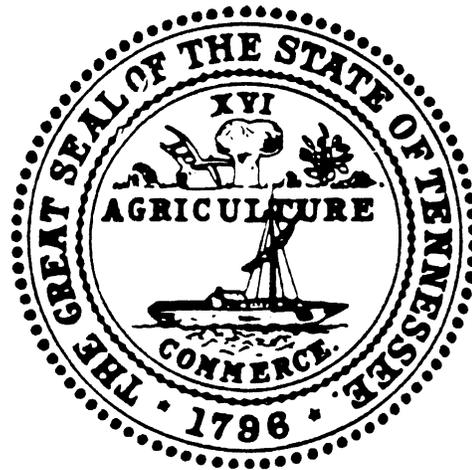


AUDIT REPORT

East Tennessee Community Services Agency

August 2006



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit
Division of State Audit



Arthur A. Hayes, Jr., CPA, JD, CFE
Director

Edward Burr, CPA
Assistant Director

Kandi Thomas, CPA, CFE
Audit Manager

Donald Vanatta
In-Charge Auditor

Justin Daniel
Staff Auditor

Amy Brack
Editor

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 401-7897

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

August 17, 2006

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Board of Directors
East Tennessee Community Services Agency
201 Center Park Drive
Suite 1100
Knoxville, Tennessee 37922

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the East Tennessee Community Services Agency for the period February 1, 2005, through March 21, 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
Comptroller of the Treasury

JGM/th
06/074



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

SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

March 29, 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 East Tennessee Community Services Agency for the period February 1, 2005, through March 21, 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 the East Tennessee Community Services Agency's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the East Tennessee 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 the East Tennessee Community Services Agency's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/th

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
East Tennessee Community Services Agency
August 2006

AUDIT SCOPE

We have audited the East Tennessee Community Services Agency for the period February 1, 2005, through March 21, 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, cash receipts, expenditures, and compliance with 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, participation in the negotiation and procurement of services, and approving the Community Services Agencies' Plans of Operation (budgets).

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:

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 the previous audit report, we reported that the board chair of the Community Services Agency appointed a three-member audit committee on January 13, 2005. The audit committee charter was approved by the Comptroller of the Treasury on June 12, 2006. Additionally, the audit committee approved a written code of conduct and a new conflict-of-interest statement for the agency and provided copies of each to agency management staff.

At the end of audit fieldwork on March 29, 2006, the audit committee had not received management's assessment of risk and had not evaluated the agency's system of internal controls.

AUDIT FINDING

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

The East Tennessee Community Services Agency did not ensure that bank reconciliations were prepared in a timely manner (page 3).

Financial and Compliance Audit East Tennessee Community Services Agency

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
Post-Audit Authority	1
Background	1
AUDIT SCOPE	2
PRIOR AUDIT FINDINGS	2
OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS	2
Cash and Cash Receipts	2
Finding - Bank reconciliations were not prepared, increasing the risk of misstatements in the accounting records due to error or fraud	3
Expenditures and Program Compliance	4
OBSERVATIONS AND COMMENTS	6
Management's Responsibility for Risk Assessment	6
Fraud Considerations	6
Audit Committee	7
APPENDIX	8
Board of Directors	8

Financial and Compliance Audit East Tennessee Community Services Agency

INTRODUCTION

POST-AUDIT AUTHORITY

This is the 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 East Tennessee Community Services Agency serves the following counties: Anderson, Blount, Campbell, Claiborne, Cocke, Grainger, Hamblen, Jefferson, Knox, Loudon, Monroe, Morgan, Roane, Scott, Sevier, and Union. The agency’s administrative offices are in Knoxville, Tennessee.

The governing body of the East Tennessee Community Services Agency is the board of directors. As of March 29, 2006, the board was composed of 11 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 is appointed by the Commissioner of the Department Children’s Services, subject to the approval of the board.

In September 2005 the agency contracted with the Department of Finance and Administration to conduct case management for the Interim Shelter Program. This program’s purpose is to assist with housing and personal items for families who were evacuated from coastal areas of Louisiana, Mississippi, and Alabama as a result of Hurricane Katrina and Hurricane Rita.

AUDIT SCOPE

We have audited the East Tennessee Community Services Agency for the period February 1, 2005, through March 21, 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, cash receipts, expenditures, and compliance with 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, 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 East Tennessee Community Services Agency filed its report with the Department of Audit on February 21, 2006. A follow-up of all prior audit findings was conducted as part of the current audit. The current audit disclosed that the East Tennessee Community Services Agency has corrected previous audit findings concerning inadequate monitoring of compliance with case management policies and procedures.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

CASH AND CASH RECEIPTS

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

- the design of the agency's controls over cash and cash receipting was adequate;
- cash receipts were posted correctly to the accounting records;
- the agency deposited funds in accordance with policy;
- revenues recorded for the TennCare Transportation program were reasonable in relation to the numbers of clients served; and

- bank reconciliations were accurate and performed promptly.

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 February 1, 2005, through March 21, 2006, and tested a nonstatistical sample of cash receipts for proper posting to the accounting records and depositing in accordance with policy. We obtained TennCare enrollment data from the Bureau of TennCare in the Department of Finance and Administration, calculated TennCare Transportation estimated revenue, and compared the estimated revenue with the revenue recorded by the CSA. We also obtained and reviewed all of the bank statements and bank reconciliations for the period January 2005 through January 2006, and we verified the accuracy of the October 2005 reconciliation.

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

- the agency's controls over cash and cash receipting were adequately designed;
- cash receipts were posted correctly to the accounting records;
- the agency correctly deposited funds in accordance with policy;
- revenues recorded for the TennCare Transportation program appeared reasonable; and
- the October 2005 bank reconciliation was accurate, although bank statements were not always reconciled with the accounting records monthly (see finding).

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

Finding

Management of the East Tennessee Community Services Agency (CSA) did not ensure that fiscal staff prepared bank reconciliations as required by the East Tennessee Community Services Agency Rules of Operation Policy 3.13. The policy states, "Each monthly Departmental Bank Account(s) statement and each monthly Local Government Investment Pool account statement will be reconciled in a timely manner by a qualified person as designated by the Executive Director."

Neither management nor staff prepared the bank reconciliations for the five months of October 2005 through February 2006. According to the Executive Director, the reconciliations were not prepared because the CSA accountant responsible for the reconciliations left the agency's employment in October 2005. In February 2006, the CSA hired a temporary accountant who has begun the process of preparing the reconciliations. The October and November reconciliations were completed in March 2006.

Effective internal control provides reasonable assurance regarding the prevention or detection of errors or fraud. Not preparing bank reconciliations in a timely manner increases the risk that potential errors or fraud may occur and not be detected in a timely manner.

Recommendation

The Executive Director should not permit control procedures to cease because of staff vacancies. Adjustments to control procedures should be made to ensure that the objectives of the procedures are still achieved. The Executive Director should ensure that prompt bank reconciliations are always performed in accordance with CSA policy.

Management should ensure that the risks noted in this finding are adequately identified and assessed in management's documented risk assessment activities. Management should identify specific staff to be responsible for the design and implementation of internal controls to adequately mitigate those risks and 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. All controls and control activities, including monitoring, should be adequately documented.

Management's Comment

We concur. East Tennessee Community Services Agency had not completed bank reconciliations in a timely manner, but action was taken to correct and alleviate this problem. A staff person was assigned duties related to bank reconciliations, fiscal monitoring, tracking, and preparation of financial reports. Financial reports and bank reconciliations are complete through May 2006. Fiscal staff are currently concentrating on completion of fiscal activities related to June 2006 and closure of fiscal year 2005-06.

EXPENDITURES AND PROGRAM COMPLIANCE

Our primary objectives were to determine whether

- the design of the agency's controls over expenditures and program compliance was adequate;
- the agency corrected prior-year findings;
- the plan of operation and amendments were properly approved;
- case files adequately documented individual families' eligibility for the Interim Shelter Program;
- expenditures for goods or services were properly approved, supported, and allowable under applicable Interim Shelter Program guidelines;

- expenditures for travel were paid in accordance with the Comprehensive Travel Regulations; 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. We also reviewed written policies and procedures. We reviewed the prior-year audit finding and followed up with management to determine the corrective action taken. We obtained the plan of operation and related amendments to determine the appropriateness of approvals. We examined a nonstatistical sample of Interim Shelter Program enrollee case files to determine if individual families' eligibility for the Interim Shelter Program was adequately documented. We obtained the agency's check register and tested a nonstatistical sample of Interim Shelter expenditures to determine that expenditures were approved, supported, and allowable under the applicable guidelines for the Interim Shelter Program. We tested a nonstatistical sample of travel expenditures for compliance with Comprehensive Travel Regulations. We tested all Executive Director travel claims for compliance with Comprehensive Travel Regulations. We discussed policies and procedures for credit card purchases with staff and tested a sample of credit card purchases related to the Interim Shelter Program for appropriateness.

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

- the agency's controls over expenditures and program compliance were adequately designed;
- the agency corrected prior-year findings;
- the plan of operation and amendments were properly approved;
- case files adequately documented individual families' eligibility for the Interim Shelter Program;
- expenditures for goods or services were properly approved, supported, and allowable under applicable Interim Shelter Program guidelines;
- expenditures for travel were paid in accordance with the Comprehensive Travel Regulations; and
- the agency's policies and procedures for credit cards were adequate and purchases made with the 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 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 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

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 the previous audit report, we reported that the board chair of the Community Services Agency appointed a three-member audit committee on January 13, 2005. The audit committee charter was approved by the Comptroller of the Treasury on June 12, 2006. Additionally, the audit committee approved a written code of conduct and a new conflict-of-interest statement for the agency and provided copies of each to agency management and staff.

At the end of fieldwork on March 29, 2006, the audit committee had not received management's assessment of risk and had not evaluated the agency's system of internal controls.

APPENDIX

EAST TENNESSEE COMMUNITY SERVICES AGENCY

Mike Harkleroad, Executive Director

BOARD OF DIRECTORS

Executive Committee Members

Mr. Eddie Davis, Chairperson
Mr. James Gaddis, Vice Chairperson
Mr. David Lietzke, Secretary
Ms. Sherrie Claiborne, Treasurer

Audit Committee

Mr. James Gaddis, Chairperson
Ms. Sherrie Claiborne
Ms. Nancy Rader

Other Members of the Board of Directors

Ms. Flo Charles
Ms. Paula R. Gibson
Ms. Anne Phillips
Ms. Ann Richardson
Mr. Rick Thomas
Mr. Robert A. Webb