AUDIT REPORT

South Central Community Services Agency

September 2006

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

September 7, 2006

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

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the South Central Community Services Agency for the period May 1, 2005, through May 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/ddm
06/085

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COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
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June 14, 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 South Central Community Services Agency for the period May 1, 2005, through May 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 the South Central Community Services Agency's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the South Central Community Services Agency is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

Our audit disclosed 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 South Central Community Services Agency's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/ddm

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit

South Central Community Services Agency

September 2006

AUDIT SCOPE

We have audited the South Central Community Services Agency for the period May 1, 2005, through May 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, 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 FINDING

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

The South Central Community Services Agency did not ensure that bank reconciliations were properly completed and approved as required by policy.

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INTRODUCTION

POST-AUDIT AUTHORITY

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

BACKGROUND

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

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

The governing body of the South Central Community Services Agency is the board of directors. As of May 31, 2006, the board was comprised of seven members. (See Appendix.) An executive committee, consisting of five board members, has the authority to act on behalf of the board of directors in the management of the agency's property, affairs, and funds in the 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 and approved by the board.

The agency's primary mission is to effectively develop, coordinate, and utilize every available community resource to provide timely, cost-effective, and appropriate services that are beneficial to the health, well-being, stability, and safety of the families within the South Central Region.

In September 2005, the agency contracted with the Department of Finance and Administration to provide emergency housing assistance through the Interim Shelter Program. The primary goal was to ensure that all eligible persons who had been evacuated from the coastal areas of Louisiana, Mississippi, and Alabama as a result of Hurricane Katrina and Hurricane Rita were contacted, registered, and offered interim housing and case management services. The agency provided evacuee services through May 31, 2006.

In an agreement between the Bureau of TennCare in the Department of Finance and Administration and the Division of Mental Retardation Services in the Department of Finance and Administration, the agency is providing individual support coordination services for Medicaid-eligible individuals enrolled in the Home and Community Based Services Waiver for the Mentally Retarded and Developmentally Disabled. The services assist the enrollee in identifying, selecting, obtaining, coordinating, and using both paid services and natural supports to enhance the enrollee's independence, integration in the community, and productivity. The agency served its first client in November 2005, and at the end of fieldwork the agency was serving 21 clients.

AUDIT SCOPE

We have audited the South Central Community Services Agency for the period May 1, 2005, through May 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, 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).

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 South Central Community Services Agency filed its report with the Department of Audit on June 14, 2006. A follow-up of all prior audit findings was conducted as part of the current audit. The current audit disclosed that the South Central Community Services Agency has resolved previous audit findings concerning noncompliance with case management policies and procedures, background checks not being performed timely for case managers, and failing to report an incident of fraud to the Comptroller of the Treasury.

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;
- revenues recorded for the TennCare Transportation Program were reasonable in relation to the number of clients served; and
- bank reconciliations were properly completed on all accounts in a timely manner.

To accomplish our objectives, we interviewed management and observed internal controls to gain an understanding of the agency's procedures and controls for bank reconciliations and cash receipts. 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 agency. We also requested all of the bank reconciliations for the period May 2005 through April 2006, for the agency's operating account and Local Government Investment Pool (LGIP) account.

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

- in all material respects, the agency's controls over cash and cash receipting were adequately designed;
- amounts received for TennCare Transportation were reasonable; and
- bank reconciliations were not properly performed and documented for the operating account and LGIP account (see finding).

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

Finding

The Fiscal Director at South Central Community Services Agency did not properly complete bank reconciliations as required by policy. For the months of July 2005 through April 2006, he did not reconcile the operating account balance per the agency's accounting records with the balance per the bank statement. Instead, the Fiscal Director only ensured that checks clearing the bank were checks written by the agency. These incomplete reconciliations were documented and approved by the Executive Director each month. In addition, from October 2005 through April 2006, no documented reconciliations were present for the Local Government

Investment Pool (LGIP) account with the required Executive Director's approval. The Fiscal Director stated that the LGIP statements were compared to the agency's records, but they were not documented with the required approvals.

The agency's internal operations policy entitled "Custodian of Accounts and Account Reconciliations" requires monthly reconciliations of the operating account and the LGIP account. The policy also states that "upon completion of the reconciliation of the accounts, the Executive Director and the person performing the reconciliation will both sign and date the reconciliation."

The agency also had eight outstanding checks that had not been adequately investigated when these operating account reconciliations were reviewed in May 2006. The eight outstanding checks were from four to ten months old and totaled $35,724.58. One outstanding check for $29,193.18 had actually cleared the bank on July 28, 2005, and should not have been reported as outstanding in the accounting records. We examined this canceled check and found it to agree with the accounting records.

A previous Fiscal Director accepted another job and resigned from the agency in August 2005. That Fiscal Director had been completing the required reconciliations. After the new Fiscal Director joined the agency in November 2005, the September 2005 LGIP reconciliation was completed, but no future reconciliations were performed or documented for either bank account. The new Fiscal Director indicated he did not understand his responsibility to perform and document both of these monthly reconciliations including the comparison of the balance per the agency's records to the balance per the bank statement for the operating account. The job description for the Fiscal Director does not mention the responsibility to perform bank reconciliations.

Bank reconciliations need to be properly completed and outstanding checks investigated in a timely manner to ensure any bank errors can be corrected and that the agency's accounting records are accurate. In addition, not preparing bank reconciliations in a timely manner increases the risk that fraud may occur and not be detected in a timely manner.

These problems were brought to the Executive Director's and Fiscal Director's attention in May 2006. The Fiscal Director then prepared the May bank reconciliations. We examined these reconciliations and found them to be properly completed, approved, and in agreement with supporting documentation. In addition, the Fiscal Director took steps to investigate the old outstanding checks. Furthermore, the job description for the Fiscal Director was updated to include the responsibility for performing bank reconciliations.

Recommendation

The Fiscal Director should properly complete the monthly operating account and LGIP bank reconciliations in a timely manner as required by agency policy. The reconciliation should agree the balance per the accounting records with the bank balance and list all reconciling items including outstanding checks. The Fiscal Director should ensure outstanding checks are actually outstanding and investigated timely. The Fiscal Director should also ensure the completed bank reconciliations are submitted to the Executive Director for approval.

The Executive Director should ensure that bank reconciliations are completed in a timely manner and should follow up with the Fiscal Director if the required reconciliations are not submitted. Before approving the bank reconciliations, the Executive Director should ensure that reconciliations are properly completed.

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. Bank reconciliations for both the operating account (Bank of America) and Local Government Investment Pool (LGIP) were either incomplete or not properly documented for the period October 2005 to April 2006. While the accounts were reviewed and informally reconciled as a part of the monthly closing process, the internal controls were not in place to ensure proper documentation of the reconciliation process. The transition in the entire fiscal staff and the vacancy in the Fiscal Director position from August 2005 to November 2005, which allowed for basically no transition of expertise or knowledge, was a contributing factor to this situation.

Beginning with the month of May 2006, both accounts will be reconciled with all appropriate documentation and approvals. In addition, outstanding checks and other reconciling items will be investigated and resolved in a timely manner. Management will incorporate the reconciliation process into the Agency risk assessment grid and ensure that adequate internal controls are in place to mitigate and prevent the associated risks involved in this process. An agency employee, the Director of Quality Assurance/Middle Tennessee Teen Institute, will serve as the ongoing compliance monitor for Agency internal controls.

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 plan of operation and amendments were properly approved;

- case files adequately document 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;
- goods or services were received prior to payment;
- expenditures for the Executive Director's 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 obtained the plan of operation and related amendments to determine the appropriateness of approvals. We examined a nonstatistical sample of the 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 Program expenditures to determine that expenditures were approved, supported, and allowable under the applicable guidelines for the Interim Shelter Program. In addition, we tested the Interim Shelter Program expenditures sample for evidence that the goods or services were received prior to payment. We tested all Executive Director travel claim expenditures for compliance with the Comprehensive Travel Regulations. We discussed policies and procedures for credit card purchases with staff and tested all credit card purchases by the Executive Director for appropriateness. We also tested credit card purchases related to the Interim Shelter Program sample discussed above for appropriateness.

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

- the design of the agency's controls over expenditures and program compliance was adequate;
- the plans of operation and amendments were properly approved;
- case files adequately document individual families' eligibility for the Interim Shelter Program;
- in all material respects, expenditures for goods or services were properly approved, supported, and allowable under applicable Interim Shelter Program guidelines;
- goods or services were received prior to payment;
- in all material respects, expenditures for travel were paid to the Executive Director in accordance with the Comprehensive Travel Regulations; and
- in all material respects, 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, 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 of directors of the agency appointed a three-member audit committee in March 2005. The audit committee charter was approved by the Comptroller of the Treasury on July 13, 2006. However, the audit committee has not had a meeting to begin performing the responsibilities required by the audit committee charter including a review of management's risk assessments, the internal control structure, the code of conduct, the conflict-of-interest policy, and the agency's process for monitoring compliance with laws and regulations. Also, the audit committee needs to establish procedures for employees to notify the audit committee directly about accounting, internal controls, and auditing matters. These procedures should include the methods for the receipt, retention, and treatment of complaints.

APPENDIX

South Central Community Services Agency
as of May 31, 2006

Mr. Larry Post, Executive Director

BOARD OF DIRECTORS

Executive Committee Members

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

Other Members of the Board of Directors

Mr. Timothy Armstrong
Ms. Marcia Vanattia

Audit Committee

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