AUDIT REPORT

Northeast Community Services Agency

October 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

October 17, 2006

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

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Northeast Community Services Agency for the period August l, 2005, through June 30, 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
06/087

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COMPTROLLER OF THE TREASURY
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July 27, 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 Northeast Community Services Agency for the period August l, 2005, through June 30, 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 Northeast Community Services Agency's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Northeast Community Services Agency is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

Our audit 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 agency's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/th

State of Tennessee

A u d i t H i g h l i g h t s

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit
Northeast Community Services Agency
October 2006

AUDIT SCOPE

We have audited the Northeast Community Services Agency for the period August 1, 2005, through June 30, 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 CSA appointed a three-member audit committee in September 2005. The board obtained approval from the Comptroller of the Treasury for their audit committee charter on August 25 , 2006. The audit committee has prepared a draft code of conduct and a new conflict-of-interest statement for the agency. At the end of audit fieldwork on July 27, 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 Performed Promptly, and as a Result, Management Has Not Mitigated the Risk That Errors or Fraud Could Occur and Not Be Detected Timely
The Northeast Community Services Agency did not ensure that bank reconciliations were prepared in a timely manner (page 3).

Financial and Compliance Audit
Northeast Community Services Agency

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Financial and Compliance Audit
Northeast Community Services Agency

INTRODUCTION

POST-AUDIT AUTHORITY

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

BACKGROUND

The Community Services Agency Act of 1996 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 Northeast Community Services Agency serves the following counties: Carter, Greene, Hancock, Hawkins, Johnson, Sullivan, Unicoi, and Washington. The agency's administrative offices are in Johnson City, Tennessee.

The governing body of the Northeast Community Services Agency is the board of directors. As of June 30, 2006, the board was composed of eight members. (See Appendix.) An executive committee, consisting of five board members, has the authority to act on behalf of the board of directors in the management of the agency's property, affairs, and funds in extraordinary circumstances when the governing board cannot convene. The agency's programs are carried out by staff under the supervision of the Executive Director, who is appointed by the Commissioner of the Department of Finance and Administration, 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 Northeast Community Services Agency for the period August 1, 2005, through June 30, 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' Plan of Operation (budgets).

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

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 promptly in accordance with policy;
- revenues recorded for the TennCare Transportation Program were reasonable in relation to the number of clients served; and
- bank reconciliations were accurate and were 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 July 1, 2005, through June 2, 2006, and tested a nonstatistical sample of cash receipts for proper posting to the accounting records and for timeliness of deposit in accordance with policy. We obtained TennCare enrollment data from the Bureau of TennCare in the Department of Finance and Administration for December 2005, calculated estimated TennCare Transportation revenue, and compared the estimated revenue with the revenue recorded by Northeast Community Services Agency. We also obtained and reviewed all of the bank statements and bank reconciliations for August 2005 through May 2006.

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 deposited funds promptly in accordance with policy;
- revenues recorded for the TennCare Transportation Program appeared reasonable; and
- the bank reconciliations were accurate.

However, bank reconciliations were not performed in a timely manner, as noted in the finding below.

Bank reconciliations were not performed promptly, and as a result, management has not mitigated the risk that errors or fraud could occur and not be detected timely

Finding

Management of the Northeast Tennessee Community Services Agency (CSA) did not ensure that fiscal staff prepared bank reconciliations in a timely manner as required by the Northeast Tennessee Community Services Agency Internal Operations Policies and Procedures 3.13. The policy states, "The Departmental Bank Account(s) and the Local Government Investment Pool account will be reconciled in a timely manner by a qualified person as approved by the Executive Director."

Neither management nor staff prepared the bank reconciliations timely for the five months of August 2005 through December 2005. Reconciliations during this time frame were performed from 34 to 92 days after being received. Beginning in January 2006, the CSA began preparing the reconciliations in a more timely manner (within 30 days).

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 closely monitor the internal control processes. 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. NECSA management will take measures to ensure that the bank reconciliations are done within 30 days of receipt to give adequate time to detect errors or fraud.

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 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 design of the agency's policies and procedures for credit cards was 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 Interim Shelter Program enrollee case files from August 1, 2005, through May 31, 2006, to determine if individual families' eligibility for the Interim Shelter

Program was adequately documented. We obtained the agency's check register for August 1, 2005, through May 26, 2006, and tested a nonstatistical sample of expenditures to determine that expenditures were approved, supported, and allowable under the applicable guidelines, including Interim Shelter Program guidelines when applicable. We tested a nonstatistical sample of travel expenditures from August 1, 2005, through May 26, 2006, for compliance with Comprehensive Travel Regulations. We also tested all Executive Director travel claim expenditures for compliance with Comprehensive Travel Regulations for the same time period. We reviewed policies and procedures for credit card purchases, and tested a nonstatistical sample of credit card purchases from the period August 1, 2005, through May 26, 2006, 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 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 design of the agency's policies and procedures for credit cards was 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

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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 assessments 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 CSA appointed a three-member audit committee in September 2005. The board obtained approval from the Comptroller of the Treasury for their audit committee charter on August 25, 2006. The audit committee has prepared a draft code of conduct and a new conflict-of-interest statement for the agency. At the end of audit fieldwork on July 27, 2006, the audit committee had not received management's assessment of risk and had not evaluated the agency's system of internal controls.

APPENDIX

NORTHEAST COMMUNITY SERVICES AGENCY

Mr. Ray Lyons, Executive Director

BOARD OF DIRECTORS

Executive Committee Members

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

Audit Committee

Ms. Carolynn Kinser
Ms. Carol Kiener
Mr. George Lowe

Other Members of the Board of Directors

Ms. Linda Buck
Ms. Brenda Kegley
Mr. Michael Harrison