

PERFORMANCE AUDIT

Department of State

February 2011



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit
Division of State Audit



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STATE OF TENNESSEE
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February 8, 2011

Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable Tre Hargett
Secretary of State
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have conducted a performance audit of selected programs and activities of the Department of State for the period August 1, 2008, through December 30, 2010.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Management of the Department of State 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 resulted in no audit findings.

We have reported other less significant matters involving the Department of State's internal control and instances of noncompliance to the Department of State's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/KBT/js
11031

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

Performance Audit
Department of State
February 2011

AUDIT SCOPE

We have audited the Department of State for the period August 1, 2008, through December 30, 2010. 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 revenues; grants and contracts; the Division of Business Services' Motor Vehicle Temporary Liens Program and Summons Section; and the Financial Integrity Act. The audit was conducted in accordance with generally accepted government auditing standards.

AUDIT FINDINGS

The audit report contains no findings.

Performance Audit Department of State

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Performance Audit Department of State

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the audit of the Department of State. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which requires the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The Secretary of State is one of the three constitutional officers provided by Tennessee’s constitution. The Secretary of State, according to the constitution, is to maintain a register of the official acts and proceedings of the Governor and is to be prepared to present them before the General Assembly. Additional functions of the Secretary of State are outlined in the state statutes and regulations.

The Secretary of State is the chief officer of the Department of State. The Department of State keeps the original copies of all acts and resolutions adopted by the General Assembly and signed by the Governor. Certified copies of public and private acts are available for a nominal fee. The department is also required by statute to keep other records: the receipt and recording of corporate charters, the receipt of trademarks, the execution of notary commissions, and the receipt of state administrative rules and regulations.

The Department of State is organized into nine major divisions: Fiscal and Administrative Services, Human Resources and Organizational Development, Information Systems, Administrative Procedures, Business Services, Charitable Solicitations and Gaming, Elections, Library and Archives, and Publications.

The Fiscal and Administrative Services Division provides the general administrative services necessary to support the department. These include budgeting, accounting, procurement, and special administrative services.

The Human Resources and Organizational Development Division is responsible for the department's human resources activities. These activities include the management of employment practices, administration of employee programs, and compliance with human rights legislation.

The Information Systems Division is responsible for all information technology services necessary to support the Department of State. These responsibilities include information systems and technology planning, project development and implementation, technical support, network planning and administration, and procurement assistance.

The Administrative Procedures Division provides administrative judges to conduct contested case hearings for state administrative agencies and develops uniform rules of procedure for the conduct of those hearings. This division is also required to assist state agencies in complying with the Uniform Administrative Procedures Act.

The Business Services Division executes the processing and recordkeeping duties of the Secretary of State relating to the following areas: apostilles and authentications, corporations, general partnerships, limited liability companies, limited liability partnerships, limited partnerships, mine foreman certificates, motor vehicle temporary liens, municipal clerk certifications, nonresident fiduciary appointments, notary commissions, summons, state deeds and leases, trademarks, and Uniform Commercial Code.

The Charitable Solicitations and Gaming Division is responsible for the registration and regulation of charitable organizations, charitable gaming events, professional solicitors, professional fundraising counsels, and vendors that solicit contributions for the benefit of charitable organizations. The division also investigates fund-raising irregularities and takes appropriate action to assure public confidence in charitable activities.

The Elections Division is responsible for coordinating the activities of county election commissions and the uniformity of election procedures throughout the state. The coordinator interprets questions of the law for the benefit of all election officials, reviews election law legislation, and prepares the election manual and election handbooks for use by election officials.

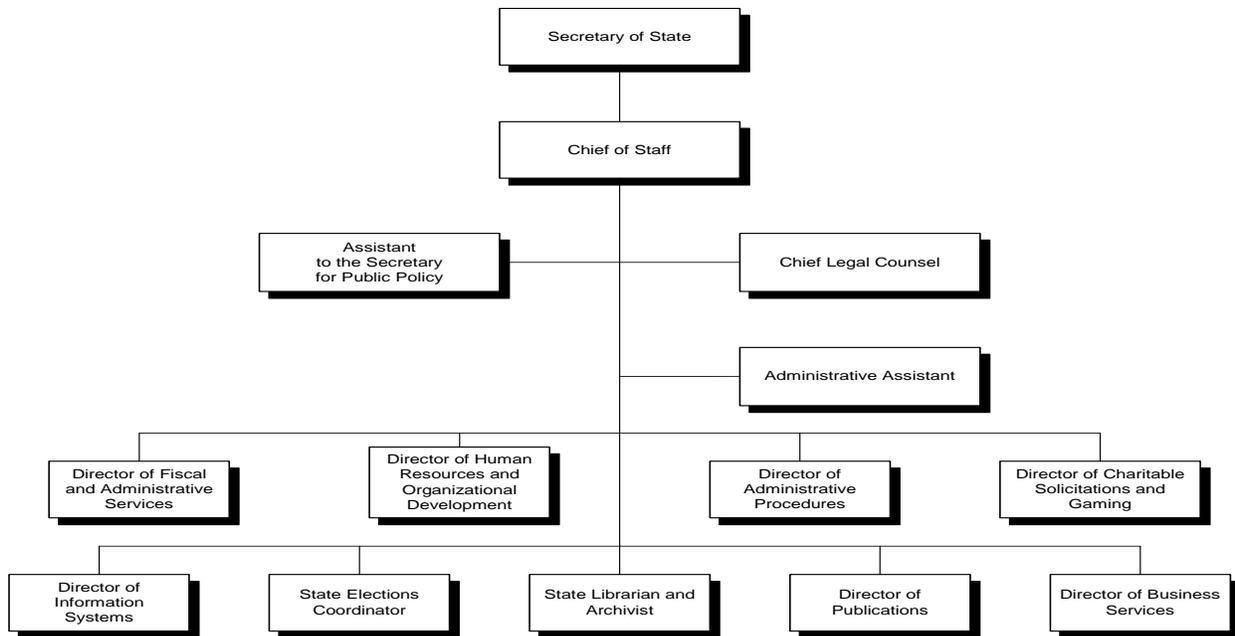
The Library and Archives Division collects and preserves books and records of historical, documentary, and reference value and encourages and promotes library development throughout the state.

The Publications Division publishes the *Tennessee Blue Book*, *Public and Private Acts of the General Assembly*, *Tennessee Administrative Register*, *Tennessee Open Appointments Vacancy Report*, *Rules and Regulations of the State of Tennessee*, and other documents for which the Secretary of State is responsible. This division is also responsible for the creation and maintenance of the department's website.

For administrative purposes, the State Election Commission, the Tennessee Registry of Election Finance, the Tennessee Economic Council on Women, and the Tennessee Ethics Commission are attached to the Department of State for all matters relating to receipts, disbursements, budgets, audits, and other related items. In June 2009, the Tennessee Registry of Election Finance merged with the Tennessee Ethics Commission to form the Bureau of Ethics and Campaign Finance.

An organization chart of the Department of State is below.

**Department of State
Organization Chart
December 2010**



AUDIT SCOPE

We have audited the Department of State for the period August 1, 2008, through December 30, 2010. 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 revenues; grants and contracts; the Division of Business Services' Motor Vehicle Temporary Liens Program and Summons Section; and the Financial Integrity Act. The audit was conducted in accordance with generally accepted government auditing standards.

PRIOR AUDIT FINDING

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 recommendation(s) in the prior audit report. The Department of State filed its report with the Department of Audit on April 14, 2009. A follow-up of the prior audit finding was conducted as part of the current audit.

RESOLVED AUDIT FINDING

The current audit disclosed that the Department of State has corrected the previous audit finding concerning inadequate cash-receipting procedures for the Corporate Management System.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

REVENUES

The primary objectives of our review of revenues were to determine whether

- revenue transactions were properly recorded;
- cash collected was deposited timely in compliance with Department of Finance and Administration Policy 25;

- revenue functions were adequately segregated and physical controls over cash were adequate;
- fees were billed or charged and recorded at the correct amount;
- department-specific risks related to revenues were documented in management's risk assessment;
- the prior audit finding on the Corporate Management System had been corrected; and
- revenue collections from the regional libraries for unusual or unexpected transactions were proper.

To accomplish our objectives, we interviewed key department personnel to gain an understanding of the department's procedures, systems, and controls over revenues, and we reviewed supporting documentation for those controls. For the Universal Commercial Code, Corporations, and Non-corporation sections of the Business Services Division and the Charitable Solicitations and Gaming Division, we tested transactions during the period August 1, 2008, through November 30, 2010, to determine whether they were properly recorded. During the audit period, the department replaced its automated system for processing revenue transactions in the Corporations Section of the Business Services Division. To determine whether revenue transactions in this division were properly recorded, we tested the former Corporate Management System for the period August 1, 2008, through September 25, 2009, and the current Business Entities and Accounting Reports system for the period September 28, 2009, through November 30, 2010.

To determine whether revenue transactions were properly recorded by the Bureau of Ethics and Campaign Finance, we tested their manual processing system for the period August 31, 2009, (date of merger of Registry of Election Finance with the Ethics Commission) through November 30, 2010. We interviewed management and observed accounting reports to determine if the department confirmed that revenue was properly recorded by reconciling its revenue records with the revenue reports issued by the Department of Finance and Administration (F&A). We evaluated the length of time between deposit and cash collection during the audit period to determine whether cash was deposited timely in compliance with F&A Policy 25.

We evaluated whether revenue functions were adequately segregated and if physical controls over cash were adequate. We reviewed revenue to the Ethics Commission from registration fees paid by employers of lobbyists and by lobbyists to determine if the fees were properly billed or charged and recorded at the correct amount. We reviewed management's risk assessment to determine if department-specific risks related to revenues were documented. We discussed with management whether the prior audit finding had been corrected and reviewed supporting documentation to verify corrective action, including implementation procedures. We performed analytical procedures on revenue collections from the regional libraries to determine if unusual or unexpected transactions were proper.

Based on our interviews, reviews, and testwork, we determined that

- revenue transactions were properly recorded;
- cash receipts were deposited timely in compliance with F&A Policy 25 with minor exceptions;
- revenue functions were adequately segregated and physical controls over cash were adequate;
- fees were billed or charged and recorded at the correct amount for the divisions selected for review;
- department-specific risks related to revenues were documented in management's risk assessment;
- the prior audit finding had been corrected; and
- there were no unusual or unexpected transactions in the revenue collections from regional libraries.

GRANTS AND CONTRACTS

The primary objectives of our review of grants and contracts were to determine whether

- an annual monitoring plan was submitted by the department in compliance with the Department of Finance and Administration (F&A) Policy 22;
- the appropriate number of grantees was monitored in accordance with F&A Policy 22;
- the department distinguished subrecipients from vendors in accordance with the criteria listed in F&A Policy 22, Part 9;
- Community Enhancement Grant (CEG) recipients submitted accounting reports in compliance with statutory requirements; and
- the status report for the CEG program provided by management was accurate.

To accomplish our objectives, we interviewed key department personnel to gain an understanding of the department's procedures and controls over grants and contracts, and we reviewed supporting documentation. We obtained and reviewed the annual monitoring plans for the period August 1, 2008, through December 30, 2010. We reviewed the list of grantees

included in each monitoring plan and discussed with department personnel the process for identifying the number of grantees to be monitored each year. We tested grants awarded during fiscal years 2009 and 2010 to ensure that the appropriate number of grantees was monitored. We obtained a listing of vendors with departmental contracts for the period August 1, 2008, through November 8, 2010. We compared the listing of vendors to the listing of subrecipients in the annual monitoring plan to ensure that the department distinguished vendors from subrecipients. We reviewed the department's database for the CEG program and tested a nonstatistical sample of accounting reports to determine whether recipients submitted accounting reports in compliance with statutory requirements and to verify that the status or number of accounting reports received was accurately reported by the department.

Based on our interviews, reviews, and testwork, we determined that

- annual monitoring plans were submitted by the department in compliance with F&A Policy 22;
- the appropriate number of grantees was monitored in accordance with Policy 22 with minor exceptions;
- the department adequately distinguished subrecipients from vendors;
- CEG recipients submitted accounting reports in compliance with statutory requirements with minor exceptions; and
- the status report for the CEG program provided by management was accurate.

DIVISION OF BUSINESS SERVICES

Motor Vehicle Temporary Liens Program

The Motor Vehicle Temporary Liens Program establishes a procedure in the Office of the Secretary of State for recording a lien on a vehicle prior to Department of Safety's issuance of a certificate of title evidencing that lien. When a manufacturer's statement of origin or an existing certificate of title is unavailable, a first lien holder may file with the Division of Business Services a notarized copy of an instrument creating and evidencing a lien on the vehicle. The filing of such a document with the Division of Business Services constitutes constructive notice of the lien against the vehicle to creditors of the owner and subsequent purchasers, except liens that are by law dependent on possession.

The primary objectives of our review of the Motor Vehicle Temporary Liens Program in the Division of Business Services were to determine whether

- a notarized copy of the lien was on file; and

- payment of the filing fee was received by the department.

To accomplish our objectives, we interviewed key department personnel to gain an understanding of the department's procedures and controls over the Motor Vehicle Temporary Liens Program and reviewed supporting documentation. We tested a nonstatistical sample of Motor Vehicle Temporary Liens transactions for the period March 1 through December 2, 2010, to determine that a notarized copy of the lien was on file and that payment of the filing fee was received by the department.

As a result of the testwork performed, we concluded that Motor Vehicle Temporary Liens transactions had the notarized copy of the lien on file and payment of the filing fee was received by the department.

Summons Section

The Summons Section is responsible for issuing summons to certain individuals or businesses in legal proceedings. The summons announces that a legal proceeding has been started against that individual or business and that a file has been started in the court records. The summons will also announce a date the defendant must either appear in court, or respond in writing to the court or to the opposing party or parties.

The primary objectives of our review of the Summons Section in the Division of Business Services was to determine whether

- all relevant information was recorded into the Services of Process Database; and
- the servicing fee was received and recorded.

To accomplish our objectives, we interviewed key department personnel to gain an understanding of the department's procedures and controls over summons and reviewed supporting documentation. We tested a nonstatistical sample of summons transactions for the period August 1 through December 2, 2010, to determine if all relevant information was recorded into the Service of Process Database and the servicing fee was received and recorded.

As a result of the testwork performed, we concluded that all relevant information was recorded into the Service of Process Database and that the servicing fee was received and recorded.

FINANCIAL INTEGRITY ACT

Section 9-18-104, *Tennessee Code Annotated*, stipulates that by December 31, 2008, initially, and then by December 31 of every year thereafter, the head of each state agency shall, on the basis of the evaluations conducted in accordance with the guidelines prescribed under Section 9-18-103, prepare and transmit to the Commissioner of Finance and Administration and

the Comptroller of the Treasury a report that states that the agency acknowledges its management's responsibility for establishing, implementing, and maintaining an adequate system of internal control; and that a management assessment of risk performed by the agency provides or does not provide reasonable assurance of compliance with the objectives of the assessment as specified by the statute.

The primary objectives of our review of the Financial Integrity Act were to determine whether

- the department head submitted the Financial Integrity Act report in accordance with state statute;
- documentation to support the department's evaluation was properly maintained;
- procedures used in compiling information for the report were in accordance with the guidelines prescribed under Section 9-18-103, *Tennessee Code Annotated*; and
- corrective actions have been implemented for weaknesses identified in the report.

To accomplish our objectives, we interviewed key employees responsible for compiling information for the report. We reviewed the reports for December 2009 and 2010 to determine if the reports were submitted in accordance with state statute, to the Department of Finance and Administration and the Comptroller of the Treasury. We also reviewed the supporting documentation to verify that the documentation was properly maintained. We reviewed the procedures used in compiling information for the report to determine that they were in accordance with statutory guidelines. We also interviewed management to determine whether corrective actions have been implemented for weaknesses identified in the report.

As a result of the audit procedures performed, we ascertained that the department submitted the reports for December 2009 and 2010 in accordance with state statute. We concluded that supporting documentation for each evaluation was properly maintained. The department's procedures for compiling information for the report were in compliance with the guidelines prescribed under Section 9-18-103, *Tennessee Code Annotated*. We also determined that weaknesses were identified in the 2009 report for the Business Services Division and that corrective actions were implemented for the weaknesses identified in the report. No material weaknesses were identified in the December 2010 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. Management's responsibility is 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 entity 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 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.

APPENDIX

ALLOTMENT CODES

305.01	Secretary of State
305.02	State Election Commission
305.03	Public Documents
305.04	State Library and Archives
305.05	Regional Libraries
305.06	Library Construction
305.07	Registry of Election Finance
305.08	Economic Council on Women
305.09	Charitable Solicitations and Gaming
305.10	Help America Vote Act
305.11	Ethics Commission
305.12	Community Enhancement Grants