AUDIT REPORT

Tennessee Residence Foundation

For the Year Ended
December 31, 2005

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

May 23, 2006

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

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Residence Foundation for the year ended December 31, 2005. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/cj
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State of Tennessee

Audit Highlights

Comptroller of the Treasury   Division of State Audit

Financial and Compliance Audit
Tennessee Residence Foundation
For the Year Ended December 31, 2005

AUDIT OBJECTIVES

The objectives of the audit were to consider the Tennessee Residence Foundation's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, and contracts; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

The audit report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

Audit Report
Tennessee Residence Foundation
For the Year Ended December 31, 2005

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Tennessee Residence Foundation
For the Year Ended December 31, 2005

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Residence Foundation. This audit was performed at the request of the chairperson of the board of directors for the foundation.

BACKGROUND

The Tennessee Residence Foundation, as created by Tennessee Public Acts of 1999, Chapter 212, is a not-for-profit organization that was incorporated on December 5, 2000. The purpose of the foundation is to purchase, receive through loan, or otherwise acquire or dispose of furnishings, fixtures, works of art, and other articles which are of Tennessee origin or of particular historic or artistic interest to the citizens of Tennessee, or which are otherwise needed to furnish and to permanently enhance the interior decor of the public reception and formal entertainment areas within the Tennessee executive residence. Tennessee Public Acts of 2004, Chapter 548, changed the name of the foundation from the Tennessee Executive Residence Preservation Foundation to the Tennessee Residence Foundation. Tennessee Public Acts of 2005, Chapter 267, expanded the powers of the foundation to include raising and spending funds for the renovation, restoration, reconstruction, expansion, and upkeep of the executive residence.

ORGANIZATION

The Tennessee Residence Foundation is governed by a seven-member board of directors. The board of directors consists of the Governor's spouse, or designee if the Governor is not married; three members, one from each grand division of the state, appointed by the Governor; the chair of the Tennessee State Museum Foundation Board; and two additional members, selected by the Governor from the membership of the Tennessee State Museum Foundation Board.

AUDIT SCOPE

The audit was limited to the period January 1, 2005, through December 31, 2005, and was conducted in accordance with auditing standards generally accepted in the United States of America. Financial statements are presented for the year ended December 31, 2005, and for comparative purposes, the year ended December 31, 2004.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the Tennessee Residence Foundation's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, and contracts;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

OBSERVATIONS AND COMMENTS

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

Auditors and management are required to assess the risk of fraud in the operations of the entity. The risk assessment is based on a critical review of operations considering what frauds could be perpetrated in the absence of adequate controls. The auditors' risk assessment is limited to the period during which the audit is conducted and is limited to the transactions that the auditors are able to test during that period. The risk assessment by management is the primary method by which the entity is protected from fraud, waste, and abuse.

Since new programs may be established at any time by management or older programs may be discontinued, that assessment is ongoing as part of the daily operations of the entity.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. It is management's responsibility to design, implement, and monitor effective controls in the entity. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditor's 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's 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 controls 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.

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.

AUDIT COMMITTEE

As a result of the fraud-related business failures of companies such as Enron and WorldCom in recent years, Congress and the accounting profession have taken aggressive measures to try to detect and prevent future failures related to fraud. These measures have included the signing of the *Sarbanes-Oxley Act of 2002* by the President of the United States and the issuance of Statement on Auditing Standards No. 99 by the American Institute of Certified Public Accountants. This new fraud auditing standard has not only changed the way auditors perform audits but has also provided guidance to management and boards of directors on creating antifraud programs and controls. This guidance has included the need for an independent audit committee.

The board chair of the Tennessee Residence Foundation appointed a three-member audit committee in February 2006. However, as of the end of our audit, the audit committee was not fully functional and had no charter. In recognition of the benefits of audit committees for government, the Tennessee General Assembly has 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. Applicable entities are required to develop an audit committee charter and appoint the audit committee in accordance with the legislation. The specific activities of any audit committee will depend on, among other things, the mission, nature, structure, and size of each agency. In establishing the audit committee and creating its charter, each board should examine its agency's particular circumstances. Anti-fraud literature notes that there are two categories of fraud: fraudulent financial reporting and misappropriation of assets. The audit committee should consider the risks of fraud in its agency in general as well as the history of its particular agency with regard to prior audit findings, previously disclosed weaknesses in internal control, and compliance issues. The audit committee should consider both the risk of fraudulent financial reporting and the risk of fraud due to misappropriation or abuse of agency assets. Also, the board and the audit committee should keep in mind that agencies receiving public funding should have a lower threshold of materiality than private-sector entities with regard to fraud risks.

Boards should exercise professional judgment in establishing the duties, responsibilities, and authority of their audit committee. The factors noted below are not intended to be an exhaustive listing of those matters to be considered. The committee should not limit its scope to reacting to a preconceived set of issues and actions but rather should be proactive in its oversight of the agency as it concentrates on the internal control and audit-related activities of the entity. In fact, this individualized approach is one of the main benefits derived from an audit committee.

At a minimum, audit committees should:

1. Develop a written charter that addresses the audit committee's purpose and mission, which should be, at a minimum, to assist the board in its oversight of the entity.

2. Formally reiterate, on a regular basis, to the board and its agents their responsibilities for preventing, detecting, and reporting fraud, waste, and abuse.

3. Serve as a facilitator of any audits or investigations of the entity, including advising auditors and investigators of any information they may receive or otherwise note regarding risks of fraud or weaknesses in the board's internal controls; reviewing with the auditors any findings or other matters noted by the auditors during audit engagements; working with the entity's management and agents to ensure implementation of audit recommendations; and assisting in the resolution of any problems the auditors may have with cooperation from entity management or its agents.

4. Develop a formal process for assessing the risk of fraud at the entity, including documentation of the results of the assessments and assuring that internal controls are in place to adequately mitigate those risks.

5. Develop and communicate to agents of the entity their responsibilities to report allegations of fraud, waste, or abuse at the entity to the committee and the Comptroller of the Treasury's Office as well as a process for immediately reporting such information.

6. Immediately inform the Comptroller's Office when fraud is detected.

7. Develop and communicate to the entity and its agents a written code of conduct reminding those individuals of the public nature of the entity and the need for all to maintain the highest level of integrity with regard to the financial operations and any related financial reporting responsibilities of the entity; to avoid preparing or issuing fraudulent or misleading financial reports or other information; to protect entity assets from fraud, waste, and abuse; to comply with all relevant laws, rules, policies, and procedures; and to avoid engaging in activities which would otherwise bring dishonor to the entity.

The charter of the audit committee should include, at a minimum, the following provisions:

1. The audit committee should be a standing committee of the board.

2. The audit committee should be composed of at least three members. The chair of the audit committee should preferably have some accounting or financial management background. Each member of the audit committee should have an adequate background and education to allow a reasonable understanding of the information presented in the financial reports of the entity and the comments of auditors with regard to internal control and compliance findings and other issues.

3. The members of the audit committee must be independent from any appearances of other interests that are in conflict with their duties as members of the audit committee.

4. An express recognition that the board, the audit committee, and the management and agents of the entity are responsible for taking all reasonable steps to prevent, detect, and report fraud, waste, and abuse.

5. The audit committee should meet regularly throughout the year. The audit committee can meet by telephone, if that is permissible for other committees. However, the audit committee is strongly urged to meet at least once a year in person. Members of the audit committee may be members of other standing committees of the board, but the audit committee meetings should be separate from the meetings of other committees of the board.

6. The audit committee should record minutes of its meetings.

The Division of State Audit will be available to discuss with the board any questions it might have about the creation of its particular audit committee. There are also other audit committees which have already been established at other state agencies that the board may wish to contact for advice and further information.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the financial statements of the Tennessee Residence Foundation.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
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Independent Auditor's Report

February 24, 2006

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying statements of financial position of the Tennessee Residence Foundation as of December 31, 2005, and December 31, 2004, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Tennessee Residence Foundation's board of directors. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee Residence Foundation, as of December 31, 2005, and December 31, 2004, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/cj

Exhibit A

Tennessee Residence Foundation
Statements of Financial Position
December 31, 2005, and December 31, 2004

	2005	2004
Assets		
Current assets		
Cash and cash equivalents (Note 2)	$ 2,708,144.78	$ 2,282,772.65
Investments (Note 3)	1,041,629.33	-
Contributions receivable (Note 4)	1,091,334.68	1,008,835.65
Refund receivable	47.58	-
Total current assets	4,841,156.37	3,291,608.30
Noncurrent assets		
Contributions receivable, net (Note 4)	1,222,461.87	2,014,196.67
Total assets	$ 6,063,618.24	$ 5,305,804.97
Liabilities and net assets		
Liabilities		
Accounts payable	$ 673.00	$ -
Net assets		
Temporarily restricted	2,319,674.55	3,023,032.32
Unrestricted	3,743,270.69	2,282,772.65
Total net assets	6,062,945.24	5,305,804.97
Total liabilities and net assets	$ 6,063,618.24	$ 5,305,804.97

The notes to the financial statements are an integral part of this statement.

Exhibit B

Tennessee Residence Foundation
Statement of Activities
For the Year Ended December 31, 2005

	Unrestricted	Temporarily Restricted	Total
Revenues and gains			
Contributions	$ 353,249.21	$ 420,896.21	$ 774,145.42
Fundraising proceeds	7,270.10	-	7,270.10
Investment income	59,059.00	-	59,059.00
Net assets released from restrictions	1,124,253.98	(1,124,253.98)	-
Total revenues and gains	1,543,832.29	(703,357.77)	840,474.52
Expenses and losses			
Fundraising	42,671.24	-	42,671.24
Management and general	35,202.50	-	35,202.50
Restoration	5,357.20	-	5,357.20
Realized losses on cash equivalents	103.31	-	103.31
Total expenses and losses	83,334.25	-	83,230.94
Change in net assets	1,460,498.04	(703,357.77)	757,140.27
Net assets - beginning of the year	2,282,772.65	3,023,032.32	5,305,804.97
Net assets - end of the year	$ 3,743,270.69	$ 2,319,674.55	$ 6,062,945.24

The notes to the financial statements are an integral part of this statement.

Exhibit C

Tennessee Residence Foundation
Statement of Activities
For the Year Ended December 31, 2004

	Unrestricted	Temporarily Restricted	Total
Revenues and gains			
Contributions	$ 2,049,455.36	$ 3,023,032.32	$ 5,072,487.68
Total revenues and gains	2,049,455.36	3,023,032.32	5,072,487.68
Expenses and losses			
Fundraising	6,053.00	-	6,053.00
Management and general	16,700.60	-	16,700.60
Restoration	121,599.00	-	121,599.00
Unrealized losses on cash equivalents	231.80	-	231.80
Total expenses and losses	144,584.40	-	144,584.40
Change in net assets	1,904,870.96	3,023,032.32	4,927,903.28
Net assets - beginning of the year	377,901.69	-	377,901.69
Net assets - end of the year	$ 2,282,772.65	$ 3,023,032.32	$ 5,305,804.97

The notes to the financial statements are an integral part of this statement.

Exhibit D

Tennessee Residence Foundation
Statements of Cash Flows
For the Years Ended December 31, 2005, and December 31, 2004

		2005		2004
Cash flows from operating activities:				
Contributions	$	1,456,944.81	$	2,049,455.36
Fundraising proceeds		7,270.10		-
Payments to contractors		(5,357.20)		(121,599.00)
Payments to suppliers		(51,437.36)		(22,753.60)
Miscellaneous receipts		625.42		-
Interest and dividends received		59,059.00		-
Loss on cash equivalent		(103.31)		(231.80)
Net cash provided by operating activities		1,467,001.46		1,904,870.96
Cash flows from investing activities				
Purchase of certificate of deposit		(1,041,629.33)		-
Net cash provided by (used for) investing activities		(1,041,629.33)		-
Net increase in cash		425,372.13		1,904,870.96
Cash at beginning of the year		2,282,772.65		377,901.69
Cash at the end of the year	$	2,708,144.78	$	2,282,772.65
Reconciliation of change in net assets to net cash provided by operating activities:				
Change in net assets	$	757,140.27	$	4,927,903.28
(Increase) decrease in receivables		709,188.19		(3,023,032.32)
Increase in accounts payable		673.00		-
Net cash provided by operating activities	$	1,467,001.46	$	1,904,870.96
Noncash investing, capital and financing activities				
In-kind contributions	$	26,436.38	$	-

The notes to the financial statements are an integral part of this statement.

Tennessee Residence Foundation
Notes to the Financial Statements
December 31, 2005, and December 31, 2004

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Tennessee Residence Foundation, as created by Tennessee Public Act of 1999, Chapter 212, is a 501(c)3 not-for-profit organization that was incorporated on December 5, 2000. The purpose of the foundation is to purchase, receive through loan, or otherwise acquire or dispose of furnishings, fixtures, works of art, and other articles which are of Tennessee origin or of particular historic or artistic interest to the citizens of Tennessee, or which are otherwise needed to furnish and to permanently enhance the interior decor of the public reception and formal entertainment areas within the executive residence and to raise and spend funds for the renovation, restoration, reconstruction, expansion, and upkeep of the executive residence.

The Tennessee Residence Foundation is governed by a seven-member board of directors. The board of directors consists of the Governor's spouse, or designee if the Governor is not married; three members, one from each grand division of the state, appointed by the Governor; the chair of the Tennessee State Museum Foundation Board; and two additional members, selected by the Governor from the membership of the Tennessee State Museum Foundation Board.

Basis of Presentation

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. The foundation follows all applicable pronouncements of the Financial Accounting Standards Board.

Measurement Focus and Basis of Accounting

The accompanying financial statements of the Tennessee Residence Foundation have been prepared using the flow of economic resources measurement focus and the accrual basis of accounting. Under this basis, revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

NOTE 2. CASH AND CASH EQUIVALENTS

In addition to demand deposits, this classification includes instruments which are readily convertible to known amounts of cash and which have original maturities of three months or less.

NOTE 3. INVESTMENTS

Investments, which consist of a certificate of deposit, are stated at cost.

NOTE 4. CONTRIBUTIONS

The foundation reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets to a more limited use than the purpose for which the foundation as a whole was established. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Unconditional promises to give

Unconditional promises to give are recognized as a receivable. Unconditional promises to give that are expected to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discount of those amounts is computed using the interest percentage available for current investments. Conditional promises to give are not included as support until the conditions are substantially met. As of December 31, 2005, and December 31, 2004, all receivables are for unconditional promises to give.

The contributions receivable as of December 31, 2005, and December 31, 2004, are given below:

	2005	2004
Contributions due in:		
Less than one year	$ 1,091,334.68	$ 1,008,835.65
One year to five years	1,417,166.35	2,335,002.69
Contributions receivable before unamortized discount	2,508,501.03	3,343,838.34
Less: Unamortized discount	(194,704.48)	(320,806.02)
Contributions receivable, net	$ 2,313,796.55	$ 3,023,032.32

In-kind contributions

In-kind contributions represent the value of noncash contributions provided by an external organization. These contributions consisted of services provided for fundraising events. As it would have been necessary for the foundation to provide these services had they not been donated by various organizations, the receipt of these contributions resulted in current financial resources and was recognized in the financial statements. The Tennessee Residence Foundation received in-kind contributions of $26,436.38 for the year ended December 31, 2005.

NOTE 5. PRIOR-YEAR RESTATEMENT

In the prior year, all contributions receivable were recorded as current assets. The following calendar year 2004 amounts were restated to break down the receivables amount between current and noncurrent assets.

	Original amount	Restated amount
Statement of Financial Position		
Current assets - Contribution receivable	$ 3,023,032.32	$ 1,008,835.65
Noncurrent assets - contributions receivable	$ -	$ 2,014,196.67