AUDIT REPORT

Northeast Community Services Agency

September 2007

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
(615) 741-2501

John G. Morgan
Comptroller

September 13, 2007

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 July 1, 2006, through January 31, 2007.

The review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements resulted in no audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/tlk
07/047

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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February 8, 2007

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 July 1, 2006, through January 31, 2007.

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 resulted in no audit findings. We have reported other less significant matters involving the agency's internal control and instances of noncompliance to the Northeast Community Services Agency's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/tlk

State of Tennessee

Audit Highlights

Comptroller of the Treasury Division of State Audit

Financial and Compliance Audit
Northeast Community Services Agency
September 2007

AUDIT SCOPE

We have audited the Northeast Community Services Agency for the period July 1, 2006, through January 31, 2007. 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 and revenue, and expenditures. 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; participating in the negotiation and procurement of services for the state; and approving the Community Services Agencies' Plans of Operation (budgets).

AUDIT COMMITTEE ACT OF 2005

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.

AUDIT COMMITTEE ESTABLISHED AND CHARTER APPROVED

In a previous audit report, we recommended that the Northeast Community Services Agency establish an audit committee. The board chair of the CSA appointed a three-member committee in September 2005. The audit committee was affirmed by the entire board on November 21, 2005. The audit committee charter was approved by the Comptroller of the Treasury on August 25, 2006.

CODE OF CONDUCT IMPLEMENTED

Additionally, the audit committee has implemented a code of conduct, and a new conflict-of-interest statement has been finalized and signed by all employees.

RISK ASSESSMENT NOT RECEIVED

As of the end of our audit fieldwork, February 8, 2007, the audit committee has not yet received management's assessment of risk and they have not yet evaluated the agency's system of internal controls.

AUDIT FINDINGS

The audit report contains no findings.

Financial and Compliance Audit
Northeast Community Services Agency

TABLE OF CONTENTS

Financial and Compliance Audit
Northeast Community Services Agency

INTRODUCTION

POST-AUDIT AUTHORITY

This is a 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 January 31, 2007, 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 was 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 was to assist families who were evacuated from coastal areas of Louisiana, Mississippi, and Alabama as a result of Hurricane Katrina and Hurricane Rita. This program ended on June 30, 2006.

In April 2006, the agency also entered into an agreement with the Department of Finance and Administration's Division of Mental Retardation Services to provide support coordination services for Medicaid-eligible enrollees in the Home and Community Based Services Waiver for the Mentally Retarded and Developmentally Disabled. The agency's Independent Support Coordination Program assists enrollees by identifying, selecting, obtaining, coordinating, and using services to enhance the enrollees' independence, integration in the community, and productivity in the community. As of February 8, 2007, the agency was serving 32 recipients.

AUDIT SCOPE

We have audited the Northeast Community Services Agency for the period July 1, 2006, through January 31, 2007. 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 and revenue, and expenditures. 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; participating in the negotiation and procurement of services for the state; and approving the Community Services Agencies' Plans of Operation (budgets).

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 recommendations in the prior audit report. The Northeast Community Services Agency filed its report with the Department of Audit on January 17, 2007. A follow-up of the prior audit finding was conducted as part of the current audit. The current audit disclosed that the Northeast Community Services Agency has corrected the previous audit finding concerning bank reconciliations not being performed promptly.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

CASH AND REVENUE

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

- the design of the agency's controls over revenue was adequate;
- expenditure reimbursements requested under the Edward Byrne Memorial Grant were received, deposited, and posted correctly to the accounting records;
- monthly capitation payments related to the contract with the Division of Mental Retardation Services (DMRS) were based on the number of recipients served, deposited, and posted correctly to the accounting records; and
- bank reconciliations were accurate and performed promptly.

To accomplish our objectives, we interviewed management to gain an understanding of the agency's procedures and controls over revenue. We obtained the expenditure reimbursement requests for the Edward Byrne Memorial Grant for the period July 2006 through October 2006 to ensure amounts requested were received, deposited, and posted correctly to the accounting records. We also obtained the monthly per client billings for the DMRS contract for the period July 2006 through October 2006 to ensure amounts billed were based on the number of recipients served, deposited, and posted correctly to the accounting records. In addition, we obtained all bank reconciliations for July 2006 through November 2006 to ensure they were performed promptly, and we performed detailed testwork to ensure their accuracy.

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

- the agency's controls over revenue were adequately designed;
- expenditure reimbursements requested under the Edward Byrne Memorial Grant were received, deposited, and posted correctly to the accounting records;
- monthly capitation payments related to the contract with the DMRS were based on the number of recipients served, deposited, and posted correctly to the accounting records; and
- bank reconciliations were accurate and performed promptly.

EXPENDITURES

Our primary objectives were to determine whether

- the design of the agency's controls over expenditures was adequate;
- the close-out procedures for the Interim Shelter program were adequate;
- expenditures related to the Edward Byrne Memorial Grant were adequately supported, properly approved, and in compliance with guidelines;
- expenditures for travel were paid in accordance with the Comprehensive Travel Regulations;
- the agency's policies and procedures for credit cards were adequate and credit card purchases were adequately supported and reasonable; and
- the agency's plan of operation and amendment were properly approved.

To accomplish our objectives, we interviewed key agency personnel to gain an understanding of procedures and controls over expenditures, and we reviewed written policies and procedures, contracts, and grants. We also interviewed key agency personnel to gain an understanding of procedures performed to close out the Interim Shelter program, and we reviewed related supporting documentation. We obtained the monthly invoices submitted by the contractor for the Edward Byrne Memorial Grant for the period July 2006 through December 2006 to ensure the expenditures were adequately supported, properly approved, and in compliance with guidelines. We tested a nonstatistical sample of travel expenditures from July 1, 2006, through December 31, 2006, for compliance with the Comprehensive Travel Regulations. We also tested all of the Executive Director's travel claim expenditures for the same time period. We discussed policies and procedures for credit card purchases with staff. In addition, we tested a nonstatistical sample of credit card purchases made from July 1, 2006, through December 31, 2006, to determine if the purchases were adequately supported and reasonable. Finally, we obtained the plan of operation and related amendment to determine the appropriateness of approvals.

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

- the agency's controls over expenditures were adequately designed;
- the close-out procedures for the Interim Shelter program were adequate;
- expenditures related to the Edward Byrne Memorial Grant were adequately supported, properly approved, and in compliance with guidelines, with a minor exception noted;

- expenditures for travel were paid in accordance with the Comprehensive Travel Regulations;

- the agency's policies and procedures for credit cards were adequate and credit card purchases were adequately supported and reasonable; and

- the plan of operation and amendment were properly approved.

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, *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

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APPENDIX

NORTHEAST COMMUNITY SERVICES AGENCY

Mr. Ray Lyons, Executive Director

BOARD OF DIRECTORS
As of January 31, 2007

Executive Committee

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

Audit Committee

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

Other Members of the Board of Directors

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