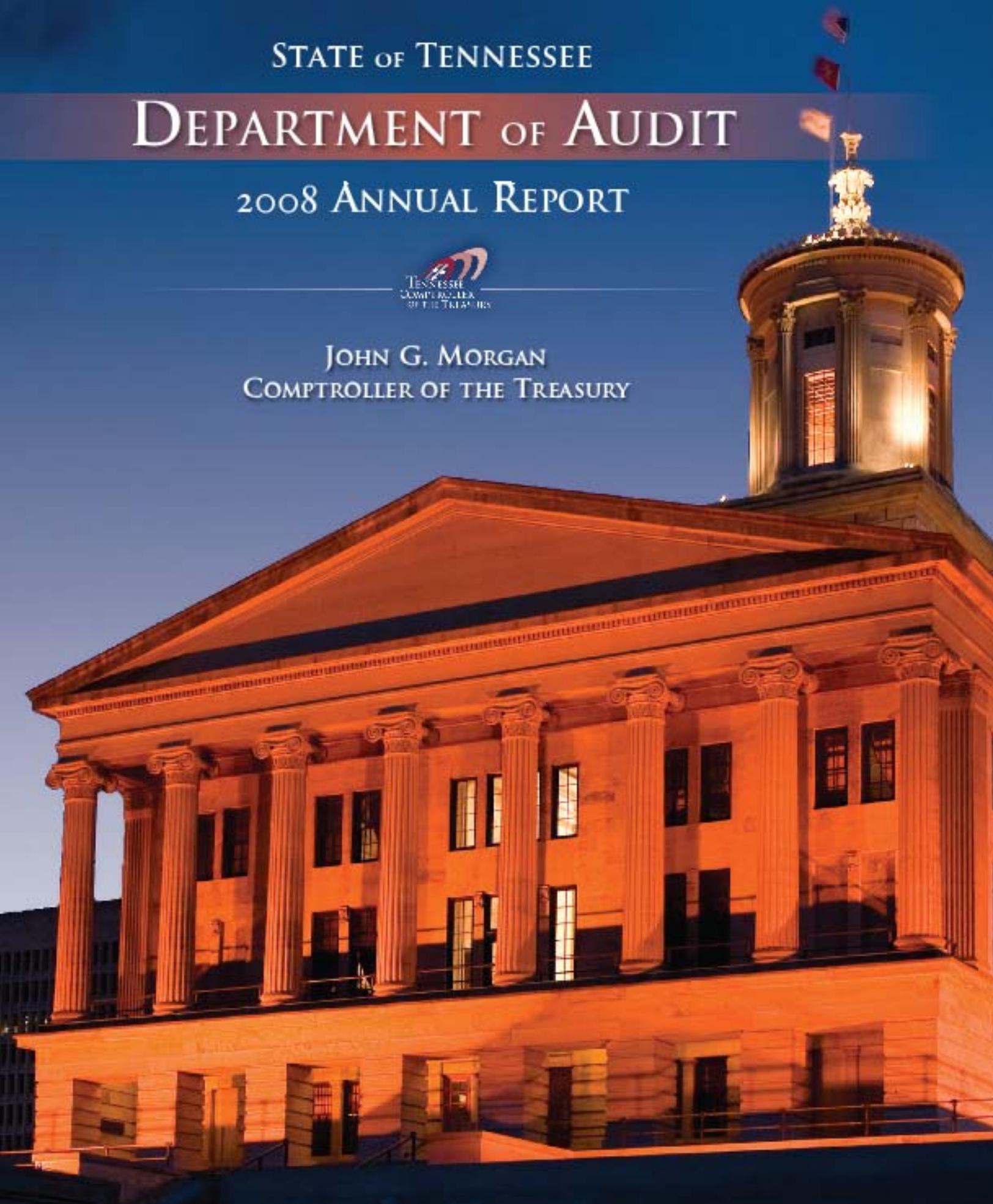


STATE OF TENNESSEE  
DEPARTMENT OF AUDIT  
2008 ANNUAL REPORT



JOHN G. MORGAN  
COMPTROLLER OF THE TREASURY





## Department of Audit 2008 Annual Report

### Comptroller of the Treasury

**John G. Morgan**

### State Audit

**Arthur A. Hayes, Jr.**, CPA, JD, MBA, CFE, CGFM  
*Director*

### County Audit

**Richard Norment**, CIA, CGFM  
*Assistant to the Comptroller for County Audit*

**Jim Arnette**, CISA, CGFM, CCP  
*Director*

### Municipal Audit

**Dennis F. Dycus**, CPA, CFE, CGFM  
*Director*



STATE OF TENNESSEE  
**COMPTROLLER OF THE TREASURY**  
State Capitol  
Nashville, Tennessee 37243-0260  
(615) 741-2501

**John G. Morgan**  
Comptroller

December 15, 2008

The Honorable Phil Bredesen, Governor  
The Honorable Ron Ramsey, Speaker of the Senate  
The Honorable Jimmy Naifeh, Speaker of the House of Representatives  
and  
Members of the General Assembly  
State Capitol  
Nashville, Tennessee 37243

Ladies and Gentlemen:

The 2008 annual report of the Department of Audit is submitted herewith in accordance with Section 4-3-304 of *Tennessee Code Annotated*.

The Department of Audit conducts audits or ensures that audits are conducted of state, county, and municipal governments; utility districts; internal school funds; and other local government authorities and agencies. Audits are also performed of state grants to nongovernmental organizations and of numerous federal programs for state and local governments.

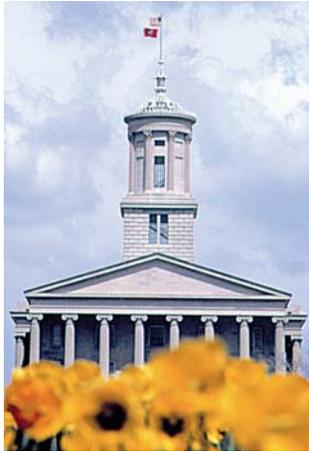
In submitting this report, I would like to express my appreciation to all those who made possible the results reported, particularly the members of the General Assembly and the staff of this office.

Respectfully submitted,

John G. Morgan  
Comptroller of the Treasury

JGM/ab





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The General Assembly created the Department of Audit in 1937. Authority to audit state and county governmental entities is contained primarily in Section 4-3-304, *Tennessee Code Annotated*. The department is required to:

- perform currently a post-audit of all accounts and financial records of the state government . . . in accordance with generally accepted auditing standards and . . . such procedures as may be established by the comptroller . . .
- make annually, and at such other times as the general assembly shall require, a complete report on the post audit . . .
- certify to the fund balance sheets, operating and other statements, covering the condition of the state's finances, as prepared by the department of finance and administration, or by the state treasurer, before publication of such statements . . .
- serve as a staff agency to the general assembly, or to any of its committees, in making investigations of any phase of the state's finances . . .
- make annually an audit of all the records of the several counties of the state . . .
- perform economy and efficiency audits, program results audits and program evaluations . . .
- require that audits to be performed by the internal audit staffs of grantees or the internal audit staffs of state departments, boards, commissions, institutions, agencies, authorities or other entities of the state shall be coordinated with the office of the comptroller of the treasury and . . . be prepared in accordance with standards established by the comptroller . . .
- require that all persons, corporations or other entities who receive grants from or through this state shall cause a timely audit to be performed, in accordance with auditing standards prescribed by the comptroller . . .

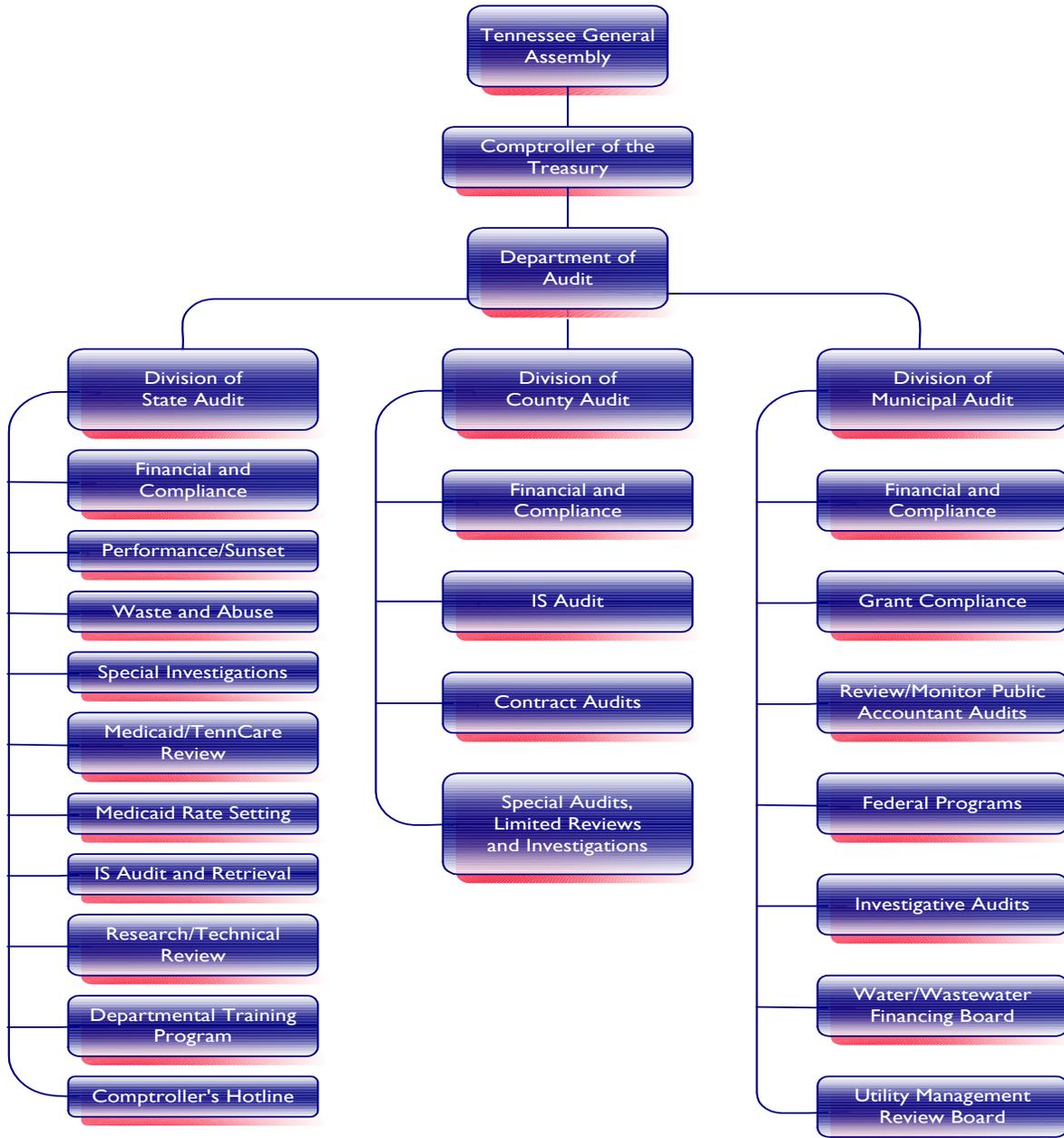
The Department of Audit comprises three divisions—State Audit, County Audit, and Municipal Audit—and employs approximately 300 people. Each division is administered by a director. The three directors are responsible for coordinating the audit function within the department and for addressing concerns and issues in auditing.

The Department of Audit is a post-audit agency. As such, it audits an entity's financial statements; an entity's compliance with applicable statutes, rules, and regulations; and/or its past record of efficiency and effectiveness at the end of a fiscal period.

Because independence is so important in a post-audit agency, the Department of Audit is in the legislative branch of state government. The department is accountable to the General Assembly and provides information to assist the legislature in overseeing the use of public funds and the efficient operation of government.

For additional information on the Department of Audit and Comptroller, go to [www.comptroller.state.tn.us](http://www.comptroller.state.tn.us).

# Department of Audit



## Department of Audit

The basic purpose of post-audits is to identify and report past errors and recommend future improvements. Pre-audits, in contrast to post-audits, are performed within an entity by its own employees to prevent errors, detect problems, and suggest improvements. The most important distinction between pre-audits and post-audits is that post-audits are organizationally independent of the audited entity. In this respect, a post-audit agency in government is comparable to an independent public accounting firm in the private or business sector.

### Auditing Standards

The Department of Audit performs its audits in accordance with government auditing standards generally accepted in the United States of America and generally accepted government auditing standards as set forth by the Comptroller General of the United States in *Government Auditing Standards* (Yellow Book).

These standards apply to financial and performance audits and attestation engagements. The Yellow Book incorporates auditing standards generally accepted in the United States of America for field work and reporting and attestation standards set forth by the American Institute of Certified Public Accountants.

The Department of Audit conducts its Single Audit in accordance with the Single Audit Act as amended by the 1996 Single Audit Act amendments and Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

### Peer Review

To comply with Section 8-4-102, *Tennessee Code Annotated*, the Speakers direct the Department of Audit to undergo a quality assessment review under the auspices of the National State Auditors Association. The most recent review was performed in August 2008 by certified public accountants and other professionals holding executive-level posts in federal and state governments. The purpose of the review was to ensure that the department is meeting its responsibility to perform audit work in accordance with government auditing standards generally accepted in the United States of America.

The report of the peer review for the year ended June 30, 2008, rendered an unqualified opinion on the department's system of quality control. In the opinion of the quality assessment team, "the system of quality control of the State of Tennessee Comptroller of the Treasury, Department of Audit in effect for the period of July 1, 2007, through June 30, 2008, has been suitably designed and was complied with during the period to provide reasonable assurance of conforming with applicable auditing standards." The next peer review is scheduled for August 2010.

For additional information on the State Auditor's Association, go to [www.nasact.gov](http://www.nasact.gov).



# Comptroller of the Treasury Strategic Plan Framework



## *Mission*

**To improve the quality of life for all Tennesseans  
by making government work better**

## *Purpose*

**To serve the people of Tennessee by:**

- Contributing to the protection of the public trust and promoting the public interest
- Enhancing effective public policy decisions at all levels of government
- Fulfilling operational and oversight responsibilities as may be assigned with the highest possible degree of excellence, efficiency, and effectiveness

## *Goals and Objectives*

**Assure public resources are used effectively, efficiently,  
and in compliance with applicable law**

- Exercise an oversight role of governmental entities and agencies
- Continue to evaluate the effectiveness and efficiency of resources used by each division through a performance-based operation
- Ensure the secure, efficient, and effective use of technology solutions

**Accomplish and provide continuous improvement for the statutory  
and other assigned responsibilities of the Comptroller's Office**

- Use cross-divisional teams to address office-wide themes and appropriate strategic objectives
- Continue to advance the Comptroller's Office to a performance-based operation

**Provide timely, adequate, and accurate information to decision makers at all government levels**

- Maintain a process to develop appropriate information for decision makers
- Maintain a process to provide decision makers with appropriate information concerning policy, resource use, and management
- Encourage cooperation and joint efforts among divisions

**Provide a diverse, competent, ethical and professional staff  
and maintain continual development of such staff**

- Adhere to a uniform Code of Ethics Program
- Maintain a succession plan for management
- Maintain a training program for the continual development of all staff
- Seek a healthy and safe work environment
- Review compensation issues within the Comptroller's Office on an annual basis
- Maintain a recruiting and hiring process that promotes diversity

**Provide and maintain effective communication with internal and external audiences**

- Maintain and improve a program which coordinates timely communications using the best available technology for internal and external communications
- Maintain appropriate historical information
- Inform and educate the citizens of the state, the general assembly, and other government entities about the role of the Comptroller
- Maintain a pro-active presence in professional organizations and associations

## *Core Values*

<i>Honesty and Integrity</i>	<i>Accuracy and Reliability</i>	<i>Accountability</i>
------------------------------	---------------------------------	-----------------------

The Division of State Audit conducts financial and compliance audits, performance audits, and investigations. It also performs special studies to provide the General Assembly, the Governor, and the citizens of Tennessee with objective information about the state's financial condition and the performance of the state's many agencies and programs. This division thus aids the legislature in ensuring that state government is accountable to the citizens of Tennessee. In fulfilling this audit function, the division issued 85 reports during the year ended June 30, 2008; an additional 114 audits and special investigations were in progress at June 30, 2008.

This division includes six sections: Financial and Compliance, TennCare, Performance, Waste and Abuse, Special Investigations, and Information Systems. Highlights of the work each section performed from July 1, 2007, through June 30, 2008, are presented in this chapter. Complete reports are available upon request or on the Internet at [www.comptroller.state.tn.us/sa/reports/index.html](http://www.comptroller.state.tn.us/sa/reports/index.html).

In addition to auditing, the division reviews and comments on exposure drafts from professional organizations and conducts technical research and training. The division also assists the Comptroller in the formulation of state policy and regulations, either directly by consulting with representatives of state agencies or indirectly by submitting comments about proposed policies and procedures.

### Financial and Compliance

The Financial and Compliance section conducts financial and compliance audits of all state departments, agencies, and institutions.

A major endeavor of the Financial and Compliance section was the Single Audit of the State of Tennessee for the year ended June 30, 2007, conducted in accordance with Office of Management and Budget (OMB) Circular A-133. The *Single Audit Report* reflected federal awards of over \$10 billion. The results of the audit of compliance indicated that the State of Tennessee complied, in all material respects, with the compliance requirements applicable to each of the state's major federal programs.

However, the results of auditing procedures disclosed instances of noncompliance with compliance requirements applicable to major federal programs that were required to be reported in accordance with OMB Circular A-133.

As a result of testing the state's compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs, costs of \$255,509 were questioned for the year ended June 30, 2007.

The consideration of internal control for the State of Tennessee disclosed two significant deficiencies; however, neither was considered to be a material weakness in relation to the state's general-purpose financial statements. The consideration of internal controls for the state's major federal programs disclosed numerous significant deficiencies, one of which was considered a material weakness.

The Single Audit included an audit of the state's general-purpose financial statements. This audit resulted in an unqualified opinion on the general-purpose financial statements of the State of Tennessee for the year ended June 30, 2007.

# State Audit

The audit also determined that the Schedule of Expenditures of Federal Awards was fairly stated, in all material respects, in relation to the general-purpose financial statements taken as a whole.

In addition to the *Single Audit Report*, separate audit reports were issued on many departments, agencies, and institutions of state government including the Department of the Treasury, the Office of the Comptroller of the Treasury, departments administering major federal programs, and units of the government not subject to the control of the centralized accounting system: state universities, community services agencies, the Tennessee State School Bond Authority, the Tennessee Local Development Authority, the Tennessee State Veterans' Homes Board, and the Tennessee Housing Development Agency. The smaller departments and agencies of the government and the community colleges are audited on a two- or three-year cycle.

The separate audits of the departments, agencies, and institutions are not meant to serve as organization-wide audits as described in the Single Audit Act as amended in 1996 and Office of Management and Budget Circular A-133. Some, however, serve as segments of the organization-wide audit of the State of Tennessee; therefore, they include the necessary tests for compliance with applicable laws, regulations, contracts, and grant agreements and the required consideration of the internal control.

## The Audit Process

Financial and compliance audits are conducted in accordance with Government Auditing Standards Generally Accepted in the United States of

America issued by the United States Comptroller General. The section performs the following general procedures as part of the financial and compliance audit process:

- Reviews the working papers from previous audits and applicable regulations, rules, policies, procedures, laws, and legal opinions.
- Considers the internal control at the entity, including a review of information systems, and determines the nature, timing, and extent of tests to be performed.
- Reviews the original budget and subsequent budget revisions and compares them to actual revenues and expenditures.
- Obtains and analyzes explanations for significant variances.
- Reviews the internal control in the computerized accounting and management information systems.
- Tests to determine the appropriateness of expenditures and the entity's accountability for revenues and cash receipts.
- Tests to substantiate assets, liabilities, and fund balances.
- Reviews federal and state grants to determine the entity's accountability for grant funds and compliance with applicable laws, rules, and regulations.
- Reviews management's representations regarding financial transactions, supporting accounting data, and other disclosure items.
- Evaluates all evidence obtained during the audit process in order to formulate an opinion on the financial transactions and to prepare findings on significant problems.

# State Audit

## Results of Audits

During the year ended June 30, 2008, the division published 57 financial and compliance audit reports containing 108 audit findings and issued opinions on 28 sets of financial statements. On June 30, 2008, another 72 audits were in progress. The section released financial and compliance audit reports for the following entities:

Department of Agriculture	Memphis and Shelby County Community Services Agency 2007
Alcoholic Beverage Commission	Memphis and Shelby County Community Services Agency 2008
Austin Peay State University	Middle Tennessee State University
Comprehensive Annual Financial Report 2007	Northeast Community Services Agency
Chattanooga State Technical Community College	Northwest Community Services Agency
Chattanooga State Technical Community College Foundation	Office of Legislative Administration
Department of Children's Services	Department of Personnel
Clean Water State Revolving Fund	Board of Probation and Parole
Cleveland State Community College	Department of Revenue
Columbia State Community College	Single Audit 2007
Comptroller of the Treasury	Southeast Community Services Agency
District Attorneys General Conference	South Central Community Services Agency
East Tennessee State University	Southwest Community Services Agency
Department of Economic and Community Development	Tennessee Education Lottery Corporation
Department of Education	Tennessee Higher Education Commission
East Tennessee Community Services Agency	Tennessee Sports Hall of Fame
Endowment for Educational Excellence	Tennessee Student Assistance Corporation
Executive Department	Tennessee Technological University
Department of Finance and Administration	Tennessee Advisory Commission on Intergovernmental Relations
Fiscal Review Committee	Tennessee Bureau of Investigation
Department of General Services	Tennessee Consolidated Retirement System
Department of Human Services Audit Results	Tennessee Housing Development Agency
Jackson State Community College	Tennessee Local Development Authority
Department of Labor and Workforce Development Audit Results	Tennessee Rehabilitative Initiative in Corrections
Memphis and Shelby County Community Services Agency 2006	Tennessee State School Bond Authority
	Tennessee Wildlife Resources Agency
	Department of Transportation
	Department of the Treasury
	University of Memphis
	University of Tennessee
	Upper Cumberland Community Services Agency
	U.T. Radio Station (WUOT)

# State Audit

<b>Common Themes of Financial and Compliance Findings</b>	<b>No.</b>
Noncompliance with state or federal laws, regulations, or policies	13
Loss or potential loss of revenues	11
Improper or unnecessary payments or the potential for such payments	8
Noncompliance with established controls over payment cards	5
Lack of proper risk assessments	5
Inadequate controls over access to management information systems	5
Inadequate controls over equipment	4
Inadequate controls over inventories	2
Bank reconciliations not properly prepared	2
Inadequate controls over residents trust funds	2

## Performance

A performance audit is an independent examination of the extent to which agencies and departments of state government are faithfully carrying out their programs. The audit reports assist the General Assembly and agency management by

- assessing the extent to which state agencies have fulfilled their statutory mandate and the efficiency and effectiveness of management’s organization and use of resources,
- developing recommendations for management or legislative action that might improve the efficiency and effectiveness of the agency’s operations, and
- providing pertinent program and financial data about the agencies.

Most of the Performance Audit section’s workload is performance auditing directed by the Tennessee Governmental Entity Review Law, commonly known as the Sunset Law (Section 4-29-101 et seq., *Tennessee Code Annotated*). This law requires that each agency, board, commission, or other entity be reviewed at least once every eight years by the legislative Joint Government Operations Committee to determine whether that entity should be continued, restructured, or terminated.

Audit staff focus their efforts on the audits of major entities. In the year ended June 30, 2008, the Performance Audit section released the following 15 reports—11 Sunset audit reports covering 23 entities, 2 performance audits, and 2 special reports:

# State Audit

Board for Licensing Health Care Facilities  
Corrections Corporation of America  
Human Resource Agencies  
Department of Revenue  
Department of Safety  
Select Oversight Committee on Corrections  
Sportsmen's Wildlife Foundation  
State Government Energy Conservation Efforts  
Tennessee Board of Regents  
Tennessee Consolidated Retirement System  
Board of Trustees and Medical Board  
Tennessee Emergency Management Agency and  
Related Compacts  
Tennessee Higher Education Commission  
Tennessee Regulatory Authority  
Tennessee State Board of Accountancy  
Tennessee Student Assistance Corporation

Eleven Sunset projects were in process at year-end. The Government Operations Committees held 22 public hearings on 93 entities in the year ended June 30, 2008. At these hearings, Performance Audit staff presented audit reports covering 27 entities. Another 65 entities submitted written responses to staff-prepared questions based on the entities' statutory authority and responsibility. One entity updated committee members on their activities, including actions taken in response to an audit presented in a prior year.

## Audit Process

Performance audits are conducted in accordance with *Government Auditing Standards* issued by the United States Comptroller General. Audits progress through six phases: planning, detailed audit field work, report writing, comments from

agency management, publication of the final report, and presentation of the final report at a legislative hearing. Performance auditing includes the following activities:

- Review of relevant state and federal laws, court cases, Attorney General's opinions, executive orders, rules, and regulations.
- Review of the agency's procedures, plans, and policies.
- Examination of the agency's records, files, and correspondence.
- Interviews with staff of the audited agency and related agencies.
- Observation of the agency's operations and activities.
- Analysis of the agency's revenue and expenditure data.
- Analysis of the agency's program data, performance measures, and reported results.
- Review of comparative data from other states.
- Surveys of individuals, agencies, and organizations served or affected by the agency.
- Tests for compliance with significant legal and administrative requirements.
- Evaluation of the extent to which the agency achieved desired results at the lowest reasonable cost.
- Recommendations of possible alternatives for legislative or administrative action that may result in more efficient and effective accomplishment of the agency's legislative mandate.

## State Audit

<b>Common Themes of Performance Findings</b>	<b>No.</b>
Inadequate policies, procedures, and processes	17
Inadequate monitoring systems	10
Review and/or revision needed for policies, statute, or processes	10
Inadequate documentation	6
Statute noncompliance	5
Information system related deficiencies	4
Complaint processing timeliness/effectiveness	3
Conflict of interest policy and disclosure weaknesses	3
Inconsistent performance	2

### **Waste and Abuse**

The Waste and Abuse section is focused on looking at waste and abuse or the potential for waste and abuse. According to *Government Auditing Standards* (the Yellow Book), "Abuse is distinct from illegal acts and other noncompliance. When abuse occurs, no law, regulation, contract provision or grant agreement is violated. Rather the conduct of a government program falls far short of societal expectations for prudent behavior." The section produces special reports highlighting areas where state agencies have not acted in the best interest of the state. The special reports are generally briefer than our audit reports. Members of this section look at issues with only one or two objectives instead of the more comprehensive scope addressed in traditional performance audits, but often cover the

same issue in numerous state agencies. Topics for the Waste and Abuse section projects may be originated by any source, including the Comptroller of the Treasury, the Director of State Audit, management and staff of any division of the Comptroller's Office, a legislator, someone in another part of state government, or someone outside of state government. Two reports were released during the fiscal year ended June 30, 2008:

Status of Submission of Title VI Implementation Plans

Status of Submission of Title IX Implementation Plans

Five audits were in progress on June 30, 2008.

# State Audit

## TennCare

The TennCare section of the Division of State Audit, under an agreement with the Department of Finance and Administration, performs certain audit and rate-setting functions for the state's TennCare program.

A staff of 20 professional auditors performs the following functions:

Reimbursable rate computation and examinations for nursing homes and Intermediate Care Mental Retardation facilities that participate in the Medicaid Program.

- Examinations of TennCare Managed Care Contractors (MCCs) that contract with the state to provide medical services under the program. The examinations are performed jointly with, and released under, the Department of Commerce and Insurance.
- Agreed-upon procedures engagement performed to compute the Certified Public Expenditures (CPE) for public hospitals. CPE is defined as unreimbursed TennCare costs. The TennCare waiver provides for additional federal funding depending on the level of CPE in public hospitals.
- Computing of reimbursement settlements and prospective rates for Federally Qualified Health Centers and Rural Health Clinics as required by the Benefits Improvement and Protection Act of 2000.
- Provide financial and budgeting support to the Bureau from nursing home paid claims extracts.
- Cost settlements for state-operated Development Centers that provide services to mentally retarded recipients.
- Clinical monitoring of the state's Mental Retardation Waiver project.

## Examinations of Nursing Facilities

In fiscal year ended June 30, 2008, the TennCare section completed nine examinations of the following Nursing Facilities:

Hartsville Convalescent Center  
Wayne Care Nursing Home  
Wayne County Nursing Home  
McMinn Memorial Nursing Home  
Life Care Center of Copper Basin  
Life Care Center of Cleveland  
The Palace  
The Wexford House  
Chester County Nursing Home

The examinations reported findings such as

- Nonallowable expenses
- Inaccurate accumulation of resident days
- Improper billing of resident hospital leave days
- Residents inappropriately charged for covered services
- Need to properly manage unrefunded credit balances

## Examinations of TennCare MCCs

In fiscal year ended June 30, 2008, the TennCare section assisted the Department of Commerce and Insurance in performing three examinations of MCCs. Examples of significant findings reported included

- Deficiencies in claims processing system

# State Audit

- Deficiencies in provider contract language
- Failure to comply with prompt pay requirements
- Noncompliance with statutory accounting principles

## Special Projects – Grier Consent Decree

The state, legislature, or federal government often requests that the Division of State Audit work on special TennCare projects. One such project is currently in progress.

The state, under a consent decree with the federal court, has agreed to comply with certain requirements with respect to TennCare enrollee grievances and appeals. The TennCare managed care contractors and their providers are also subject to the consent decree, so it has widespread implications. The agreement, commonly referred to as the “Grier Consent Decree,” became fully effective on November 1, 2000.

The Grier Consent Decree requires the state to enter into an agreement with the Comptroller’s Office to monitor all aspects of compliance with the order and to report quarterly. Quarterly reports through March 31, 2008, have been completed, and the report for the quarter ended June 30, 2008, is in progress.

## Special Investigations

Authority to conduct special investigations is provided in part by Sections 8-4-201 through 8-4-208, *Tennessee Code Annotated*. The Special Investigations section gathers information and evidence resulting in prosecutions and recovery of funds and coordinates the efforts of other agencies involved in the investigation. The investigators assist local district attorneys general, Tennessee’s Office of the Attorney General, the Office of the United States Attorney General, and the Tennessee Bureau of Investigation.

Investigative reviews are initiated as a result of information discovered during audits by the Department of Audit and through information from individuals or other departments and agencies. The matters investigated during the fiscal year ended June 30, 2008, ranged from embezzlement of public funds to abuse of public resources. Two reports were released:

15<sup>th</sup> Judicial District Community Corrections Program: Improper Use of State Time and Resources by Former Executive Director Ron Swindle to Buy Antique Glassware and Other Items on eBay

Tennessee Education Lottery Corporation: Review of Issues Related to the Computer Programming Error That Affected the Cash 3 and Cash 4 Games During the Period July 28, 2007, Through August 20, 2007

Sixteen investigations were in progress at June 30, 2008. Investigations were completed on matters at the state level as well as matters at the local level. Investigators often found that losses were incurred as a result of weak internal control or ineffective management.

Ongoing investigative reviews resulted in the receipt of a settlement for \$425,725, and one resignation in lieu of termination for gross misconduct.

# State Audit

## Information Systems

The Information Systems (IS) section provides three basic services: data retrieval, IS systems review, and computer forensic analysis.

The data retrieval staff provide information for audit field work. They write computer programs to provide information from the state's centralized accounting system, individual agency service delivery systems, and college and university transaction files.

The IS review staff are responsible for obtaining and documenting an understanding of the internal control structure in the computerized accounting

and management information systems of entities undergoing financial and compliance audits.

The IS section provides services in the area of computer forensic analysis. Evidence of fraud and abuse may be found on subjects' computers, and the IS section works in support of the special investigations section to acquire, identify, and analyze this evidence. The section utilizes specialized software and hardware to recover evidence of official misconduct by state employees and in support of civil or criminal action against persons or entities engaging in illegal activities resulting in damages to the state.

The Department of Audit, through the Division of County Audit, is responsible for the annual audits of all 95 counties in the state. The division may conduct the audit of a county or accept an audit prepared by a certified public accountant provided the audit meets minimum standards for county audits established by the Comptroller of the Treasury. However, the Division of County Audit is required to prepare an audit in each county at least once every five years or to participate with, or monitor the audit with, the certified public accountant.

### Financial and Compliance

The division presently conducts audits in 89 counties. These audits are assigned to teams that audit the various offices and/or departments and entities of county government. The audit staff is divided into four geographical areas: East, Mideast, Middle, and West. Each area is under the supervision of an audit manager who is responsible for audit planning and supervision.

### The Audit Process

The Division of County Audit performs the following general procedures as part of the financial and compliance audit process:

- Evaluates the entity's existing internal controls in the appropriate areas of operation.
- Confirms the accountability for receipts by examining, for example, tax rolls, state and federal revenue data, and letters of inquiry.
- Determines the appropriateness of disbursements by examining budget authorization, paid invoice files, purchasing files, payroll records, and other financial records.
- Determines the authorization for transactions by reviewing the minutes of meetings of county commissions, school boards, highway commissions, and various committees such as budget and finance, and purchasing.
- Determines compliance with federal regulations and state and local laws.
- Obtains management's representations with respect to the financial statements, as well as the supporting accounting data, and other items of disclosure.

- Evaluates financial statement presentation to determine conformity with generally accepted accounting principles.
- Evaluates the validity of all evidence obtained throughout the audit process to formulate an opinion on the financial statements.

### Scope of Activity Post-Audit of County Governments

The Division of County Audit conducted audits in 89 of the state's 95 counties for the 2006-07 audit year. A minimum of ten offices or departments in each county was audited:

1. County Trustee
2. County Mayor
3. Department of Education
4. Department of Highways
5. County Clerk
6. Circuit Court Clerk
7. General Sessions Court Clerk
8. Chancery Court Clerk and Master
9. Register
10. Sheriff

The audits of all offices were for the year ended June 30, 2007. The audit field work in each county is conducted by an audit team. The size of the team is determined by the complexity of the assignment. Approximately ten weeks of field work are required, including audit review and supervision by an auditor 4 and/or audit manager. The draft audit reports are reviewed in the Nashville office, printed and released. The division also prepares audits of two special school districts and performs special audits and reviews as requested or as deemed necessary.

# County Audit

## Results of Audits

### Financial and Compliance Audits

Audits of financial transactions for the year ended June 30, 2007, conducted by the Division of County Audit disclosed cash shortages in the following offices or funds:

1. Jackson County Sheriff's Department.....	\$ 1,866
2. Maury County School Department.....	501
3. McNairy County Sheriff's Department.....	1,035
4. Pickett County Executives Office .....	2,077
5. Scott County General Sessions Court Clerk's Office.....	17,234
6. Sequatchie County Sheriff's Department.....	8,669
7. Sevier County Executives Office .....	741
8. Sumner County School Department.....	2,023
9. Unicoi County General Sessions Court Clerk's Office.....	791
10. Van Buren County Mayor's Office .....	1,072
11. Williamson County District Attorney General's Office.....	3,928
12. Williamson County Library Department .....	266
13. Williamson County Clerk's Office.....	50
<b>Total Cash Shortages .....</b>	<b><u>\$40,253</u></b>

The audits conducted by this division disclosed fund deficits of \$313,048,374 in 66 governmental fund accounts in 42 counties. Audits also reflected net asset deficits totaling \$33,506,012 in 14 enterprise funds and 7 internal service fund accounts in 14 counties.

The division's examination of offices and departments in 89 counties resulted in several recurring audit findings summarized on the next page.

## County Audit

<b>Recurring Findings</b>	<b>No.</b>
Government-wide financial statements were not prepared.	29
A system of central accounting, budgeting, and/or purchasing was not in use, frequently resulting in inefficient and uneconomical operations of various county offices and departments.	50
Fund expenditures exceeded appropriations approved by the local governing body.	22
Purchasing procedures were not in accordance with controlling statutes.	32
Clerks of court failed to prepare and/or reconcile a trial balance of execution docket balances with cash journal accounts.	15
Drug control funds were not administered in compliance with statutory provisions.	4
Funds were not deposited within three days of receipt, as required by state law.	31
Depositories for county funds were not required to place securities in escrow in sufficient amounts to adequately protect funds on deposit, as required by state law.	12
Loans, notes, or lease-purchase agreements were not approved by the County Commission and/or director of Local Finance.	24
Fees and commissions earned by the county clerk, clerks of court, and register were not remitted to the county in compliance with controlling statutes.	13
Inventory records of assets owned by the county were not maintained, as required by generally accepted accounting principles.	17
Deficiencies occurred in accounting/recordkeeping.	82
An internal control weakness resulted due to the inadequate segregation of duties for accounting personnel.	69
Purchase orders were not used or were not issued properly in the purchasing process.	41

# County Audit

## Contract Audits

In six counties, certified public accountants perform financial and compliance audits. The division monitors these audits in accordance with a four-year monitoring plan which includes a review of working papers prepared by certified public accountants.

The division also approves the contracts of certified public accountants and reviews their audit reports and working papers. The objective of this review is to ensure that in addition to the standards prescribed by the American Institute of Certified Public Accountants and Government Auditing Standards issued by the United States Comptroller General, certain standards prescribed by the Comptroller of the Treasury have been followed.

### Scope of Activity Monitoring and Review of Contract Audits

The division will monitor audits of six county governments during the next four years. The audits of Washington and McMinn Counties were monitored for the year ended June 30, 2007, and the audit of Shelby County will be monitored for the year ended June 30, 2008.

The division reviewed 293 audit reports for the year ended June 30, 2007, submitted by certified public accountants for audits of county governments, authorities, boards, commissions, agencies, and special school districts. The division anticipates it will review 293 such reports for the year ended June 30, 2008.

## Information System Reviews

Most county government offices and departments in Tennessee have automated all or a portion of their daily operations. The information system (IS) review section is responsible for evaluating those computer-based accounting and information systems to determine whether an entity's existing procedures and controls provide adequate assurance of data accuracy and financial and operating statement reliability. An assistant director supervises this section's IS audit manager and seven IS auditors, who are assigned to different areas of the state.

General and application controls of a county's computer hardware and computerized accounting and information systems are evaluated. Findings resulting from this evaluation are discussed with the appropriate officials and included in the county's annual financial report.

### Scope of Activity Information System Reviews

As required by the division's annual audit plan, information system related controls were evaluated in 89 counties and two special school districts during the year ending June 30, 2008.

## Other Services

### Technical Assistance

In addition to the basic audit function and the monitoring and review of audits by certified public accountants, the division provides other services. These services include providing information and assistance to facilitate implementation of new auditing and accounting standards; submission of federal program data to the federal clearing house on behalf of county governments;

## County Audit

requesting technical data for pension and other postemployment benefits note disclosures from the State of Tennessee; maintenance of the uniform chart of accounts that is used by county governments; and participation in the review of the telephone calls made to the Comptroller's Fraud Hotline. The division also provides, upon request, assistance to counties in resolving current problems with financial administration, as well as answering questions on various local governmental matters. The division provides fiscal reviews of new legislation related to county governments and works closely with the state legislature with regard to the passage of new statutes for county governments.

### **Reviews of Funds Administered by District Attorneys General**

During 2008, the division conducted reviews of District Attorney General Funds, Judicial District Drug Task Force Funds, and other funds the district attorneys general administer in the state's 31 judicial districts. Each review covered the period July 1, 2006, through June 30, 2007. The scope of each review was limited to the transactions of the individual funds and did not include the overall operation of the district attorneys' offices.

### **Reviews of County Correctional Incentive Program (CCIP)**

*Tennessee Code Annotated*, Title 41, Chapter 8, referred to as the County Correctional Incentive Act, provides counties financial incentives to house nondangerous felony offenders at local correctional facilities. The purpose of the program is to mutually benefit state and county governments by helping to alleviate overcrowding in state correctional facilities and reduce high operating costs, and to assist counties in

upgrading local correctional facilities and programs. Counties participating in the program may be reimbursed at either a minimum statutory daily rate or a rate based on a county's "reasonable allowable cost" to house convicted felons.

The Division of County Audit conducts reviews of counties participating in the County Correctional Incentive Program. In performing the reviews, the division tests the county's financial records and other supporting records pertaining to the Final Cost Settlement Reports. Test work is also performed on the Correction Facility Summary Reports and State Prisoner Reports. Reviews were conducted in 25 detention facilities during the 2007-08 audit year. As a result of the reviews, it was determined that the state had overpaid \$115,059 for eight facilities and underpaid \$2,473 for three facilities.

The reviews of ten facilities resulted in no over or underpayments. The record-keeping system for two facilities with noted overpayments did not allow us to make a reasonable determination of over or underpayments, and a final cost settlement for these facilities was at the discretion of the Department of Correction. Subsequent monthly claims filed by the affected counties have been or are being adjusted to reflect the underpayments or overpayments.

The Division of Municipal Audit ensures that annual audits, required by state statute, are performed for all Tennessee municipalities, public school activity and noncentralized cafeteria funds, utility districts, housing authorities, charter schools, and certain nonprofit agencies receiving grants from the State of Tennessee. Also, as required by state statute, the division ensures that an agreed-upon procedures audit is performed for certain daycare providers receiving subsidy payments through the State of Tennessee. In addition, the division investigates allegations of misconduct, fraud, and waste in these entities.

### Audit Review Process

Local governmental units (other than counties) and nonprofit agencies contract with independent certified public accountants to perform annual audits of Tennessee's 344 municipalities, 104 city-related entities, 77 quasi governmental entities, 48 quasi nonprofit entities, 182 utility districts, 161 public school activity and noncentralized cafeteria funds, 11 charter schools, 85 housing authorities, 3 housing authority related entities, 51 day care centers, and 186 nonprofit agencies. The entities use standard contracts, prepared by the Comptroller of the Treasury, that must be approved by the Comptroller's designee in the Division of Municipal Audit before audit work begins. These audits must be performed in accordance with generally accepted government auditing standards or agreed-upon procedures and certain other minimum requirements prescribed by the Comptroller of the Treasury. In addition, the auditor must comply with certain other federal and state provisions.

The Division of Municipal Audit reviews each audit report to verify that it adheres to applicable reporting requirements. If a local governmental unit or nonprofit agency fails or refuses to have an audit, the Comptroller may direct the Division of Municipal Audit, or may appoint a certified public accountant, to perform the audit. The division evaluates the audit working papers of certified public accounting firms that audit local governmental and nonprofit entities. If the firm's

audit working papers are deemed substandard, the Comptroller of the Treasury takes appropriate action, which might include referral to the State Board of Accountancy. The division is responsible for tracking 2,051 nonprofit organizations that have received grants from the State of Tennessee; some of these organizations are required to have an audit of their entire organization. These audits are conducted by certified public accounting firms which contract with the division.

Sections 68-221-1010 and 7-82-401g(1), *Tennessee Code Annotated*, require the Comptroller to refer financially distressed municipal wastewater and public utility districts to the state's Water/Wastewater Financing Board or the Utility Management Review Board. After reviewing the audit reports, the Division of Municipal Audit refers financially distressed facilities to the appropriate board. The board then reviews the current financial condition of the facility and its proposed plan for eliminating its financially distressed condition. If the board finds the facility's plan unacceptable, the board will recommend an alternate course of action.

During the year ended June 30, 2008, 28 municipal wastewater facilities were referred to the Water/Wastewater Financing Board, and 18 utility districts were referred to the Utility Management Review Board. As a result, several utility districts and municipal water and/or sewer systems are now operating or are on their way to operating on a financially sound basis.

# Municipal Audit

## Investigative Audits

The division investigates allegations of misconduct, fraud, and waste in specified local governments and other publicly funded entities. Investigative audits are performed as a result of allegations received through the Department of Audit's toll-free hotline, routine audit reviews, information received from certified public accountants, other state agencies, concerned citizens and/or officials, and requests received from local district attorney generals, the State Attorney General's Office, the FBI, and other prosecutorial and law enforcement agencies. Upon completion of each examination, the Comptroller issues a report or letter presenting documented occurrences of improper activity and recommending corrective action. The report is forwarded to the State Attorney General and the local district attorney general for any legal action deemed necessary.

The division also conducts investigative audits that include a thorough review of the internal control structures and compliance with applicable laws. Municipalities are required by statute to maintain their records, at a minimum level, in accordance with the *Internal Control and Compliance Manual for Tennessee Municipalities*, prescribed by the Comptroller of the Treasury. Utility districts are required by state statute to follow the *Uniform Accounting Manual for Tennessee Utility Districts*, compiled by the Division of Municipal Audit. State statute requires schools to follow the *Internal School Uniform Accounting Policy Manual*, compiled by the Tennessee Department of Education, the Department of Finance and Administration, and the Division of Municipal Audit. At the conclusion of an investigative audit, the division publishes a report which identifies internal control structure and compliance weaknesses and recommends corrective action. The audits

point out to officials the importance of sound internal controls and compliance with applicable laws and regulations.

The division routinely provides technical assistance to local government officials and certified public accountants. This assistance often requires detailed research of financial accounting concepts and state and federal statutes.

## Audits and Investigative Audits

For the year ended June 30, 2008, the Division of Municipal Audit performed 1,547 reviews of audit reports for specified local governments and other publicly funded entities. The division released 22 investigative audits during the year. The entities examined in the 22 investigative audits included 13 municipalities, 7 public schools, one nonprofit entity, and one utility district. The majority of the investigative audits involved allegations of fraud, waste, and abuse. Most investigative audits revealed weaknesses in internal controls, absence of internal controls, or potential problem areas that created an environment conducive to fraud. During the 2008 fiscal year, investigative audits revealed losses of at least \$552,030 due to fraud. In total, approximately nine defendants' cases were disposed of in fiscal year 2008. Approximately 26 criminal indictment counts were dealt with altogether. In all, seven entity-victims throughout the state recovered \$447,126 (including stolen amounts and audit costs) as a result of the investigation and subsequent prosecution of the criminal cases.

## Municipal Audit

The Division of Municipal Audit released the following investigative audit reports during the year ended June 30, 2008:

Lexington Electric System  
Adamsville Police Department  
City of Covington  
Town of Petersburg  
City of Three Way  
City of Maynardville  
Town of Oakland  
Cordell Hull Utility District  
Town of Coopertown  
Town of Monteagle  
Athens Police Department  
Maryville High School

Cloudland Elementary School  
Memphis City Schools Facility Maintenance  
Southwest Human Resource Agency  
Town of Westmoreland  
Memphis Academy of Health Sciences (Charter School)  
Town of Somerville  
Kittrell Elementary School–Nutrition Department  
City of Martin–Parks and Recreation Department  
Etowah City School  
Copper Basin High School

Since its inception, the hotline has received over 12,000 calls, including 184 calls concerning fraud, waste, or abuse between July 1, 2007, and June 30, 2008. These substantive calls—those relating to fraud, waste, or abuse—concerned a wide range of entities, including municipalities, counties, state agencies, and departments. A more detailed analysis is below. Substantive calls are investigated by the Department of Audit or referred to the appropriate state agency or program.

Of the 184 calls referred for action, responses have been received on 158, and these are considered closed. The remaining 26 continue to be considered open.

There were numerous calls to the hotline that have not been acted on because they were not relevant to the purpose of the hotline. Calls in the latter group include wrong numbers, hang-ups, general inquiries about the hotline, and requests for services provided by other agencies, such as tax assistance. Where applicable, the callers are referred to the appropriate agency or department that can provide assistance.

### Results of Hotline Calls

The following summaries are the results of hotline calls upon which corrective action was taken by the subject agency for the year ending June 30, 2008:

#### Children's Services – Improper Leave

The caller alleged that a supervisor allowed an employee to work on the supervisor's home during work hours. The allegation was found to be true. The department issued the supervisor a written warning and subjected the supervisor to an Employee Performance Plan.

#### County Audit – Misuse of County Vehicle

The caller alleged a county employee was using a county assigned vehicle for personal purposes. The allegation was found to be true. The mayor addressed the matter with the employee and instructed the employee to use the vehicle for work related matters only.

#### County Audit – Time and Attendance Irregularities

The caller alleged that a county employee was not properly claiming leave for absences, he was abusing a county issued fuel card, and the county was paying for his cell phone. Although the allegations could not be substantiated, findings

were developed due to the county not having adequate procedures to address these issues.

#### County Audit – Inventory Shortage

The caller alleged that several computers, desks, chairs, and printers bought with grant funds were missing. The allegation was partially substantiated. All desks, chairs, and printers were accounted for. One laptop computer could not be accounted for.

#### Environment and Conservation – Misuse of State Vehicle

The caller alleged that department employees were using state vehicles for personal use and were doing personal errands on state time. The allegations were found to be true. The employees were issued a written warning and time used for personal errands was deducted from their annual leave balances.

#### General Services – Misstatement of Charges by Contractor

The caller alleged that a contractor was submitting inflated invoices for contract work. The allegation was found to be true and is now under review for civil, criminal, and administrative actions.

## Comptroller's Hotline

### Health – Excessive Wait

The caller alleged that the service provider made the caller wait over six hours for a routine flu shot. The allegation was found to be true. The service provider implemented a corrective action plan to address patient flow and develop solutions to improve wait times.

### Health – Inappropriate Conduct by Employee

The caller alleged that a health department employee acted in a rude and threatening manner to a service recipient. The allegation was found to be true. The employee was issued an oral warning and was told that similar actions would not be tolerated. The department enrolled the employee in Respectful Workplace Training.

### Human Services – Inappropriate Conduct by Employee

The caller alleged that a Community Action Agency employee acted in a rude and threatening manner with a client. The allegation was found to be true. Because there had been similar complaints of poor customer service, the agency was required to develop a corrective action plan.

### Human Services – Child Support Payment Arrearage Error

The caller alleged that his stimulus check was withheld due to an error showing him being in arrears. The allegation was found to be true. The intercepted money was returned to the caller.

### Mental Health – Employee Time and Attendance

The caller alleged that a department employee slept on the job and abused the department's time and attendance policy. The department could not substantiate that the employee slept on the job, but did determine that the employee was unresponsive

to staff. The employee was suspended for three days. The employee was issued a written warning relating to her absences from work.

### Revenue – Employee Doing Homework During Work Hours

The caller alleged that a department employee was doing homework during assigned work hours. The allegation was found to be true and the employee was instructed to stop and was disciplined.

### Probation and Parole – Probation Violation

The caller alleged that a probation officer would not acknowledge evidence that she presented showing a probationer had violated the terms of his probation. One allegation was not substantiated; however, the second allegation was found to be true. A warrant was prepared based on the violation.

### Safety – Trooper Left Car Idling

The caller alleged that a Tennessee State Trooper left his car idling outside a Sheriff's Office for more than forty-five (45) minutes. The allegations were found to be true. The department determined the Trooper did not take appropriate action. The Trooper and other enforcement units were instructed to be mindful of this issue.

### Transportation – Improper E-mail Usage

The caller alleged a state employee was using his state e-mail address as a point of contact for private purposes. The allegation was found to be true. The department verbally warned the employee for his actions, instructed the employee to remove all instances of his state e-mail address as a point of contact, and instructed him to cease and desist from using his state e-mail address as a point of contact.

**Comptroller's Fraud, Waste and Abuse Hotline (800) 232-5454**

## Comptroller's Hotline

### Analysis of Substantive Hotline Calls Fiscal Year Ended June 30, 2008

<u>Agency Involved</u>	<u>Calls</u>	<u>Responded</u>	<u>Outstanding</u>
<u>Local Government</u>			
Municipal Audit	10	10	0
City of Cleveland	1	0	1
<u>County Government</u>			
County Audit	17	13	4
Carter County	1	1	0
Knox County	1	1	0
Williamson County	1	1	0
<u>State Government</u>			
Alcoholic Beverage Commission	1	0	1
Board of Probation and Parole	6	6	0
Board of Regents	3	0	3
Department of Children's Services	16	15	1
Comptroller-Property Assessments	1	1	0
Department of Correction	1	1	0
Court of the Judiciary	1	1	0
Division of Mental Retardation	3	0	3
Department of Environment and Conservation	7	6	1
Department of Finance and Administration	1	0	1
Department of General Services	3	3	0
Department of Health	21	21	0
Department of Human Services	25	25	0
Department of Labor and Workforce Develop.	4	1	3
Department of Mental Health and Dev. Dis.	9	9	0
Military Department	2	2	0
Department of Revenue	4	4	0
Department of Safety	34	30	4
Bureau of TennCare	1	1	0
Tennessee Housing Development Agency	1	1	0
Department of Transportation	6	5	1
University of Tennessee	2	0	2
<u>Miscellaneous</u>			
Salvation Army	1	0	1
<b>Total</b>	<b>184</b>	<b>158</b>	<b>26</b>

The department's professional staff perform a wide variety of audit work requiring different types of training and experience. Therefore, members of the staff have degrees in fields such as accounting, public administration, information systems, law, political science, criminal justice, education, and nursing. More than 60 of the professional staff have advanced degrees. The department encourages its employees to pursue professional certifications such as Certified Public Accountant, Certified Information Systems Auditor, Certified Fraud Examiner, and Certified Government Financial Manager.

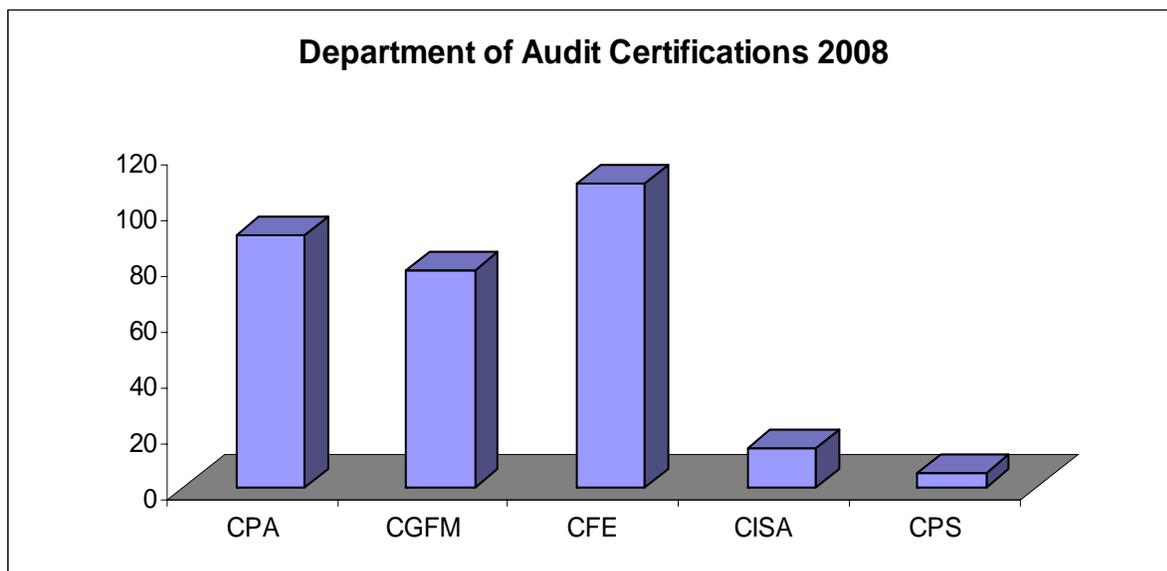
### Professional Development

As of June 30, 2008, 193 employees of the department had received one or more professional certifications. This range of experience gives a broad perspective to the department's audit work.

The Department of Audit ensures its auditors receive the required continuing professional education to meet certification standards and *Government Auditing Standards*. Auditors participate in the department's in-house training

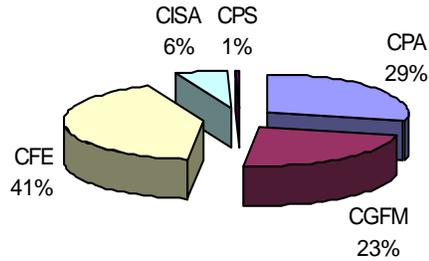
program as course developers, presenters, and participants. Over 19,000 hours of training were completed during the fiscal year ended June 30, 2008.

The Department of Audit fully supports its staff's active participation in local professional organizations, recognizing that these organizations contribute to the staff's continued growth.

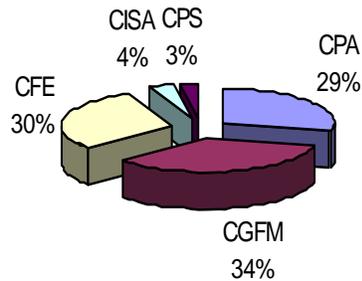


# Department Staff

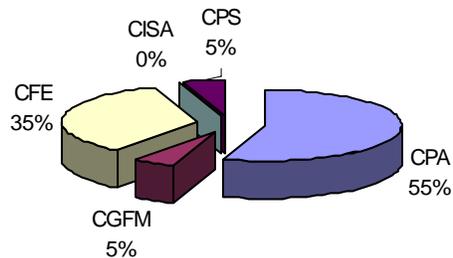
## State Audit Certifications 2008



## County Audit Certifications 2008



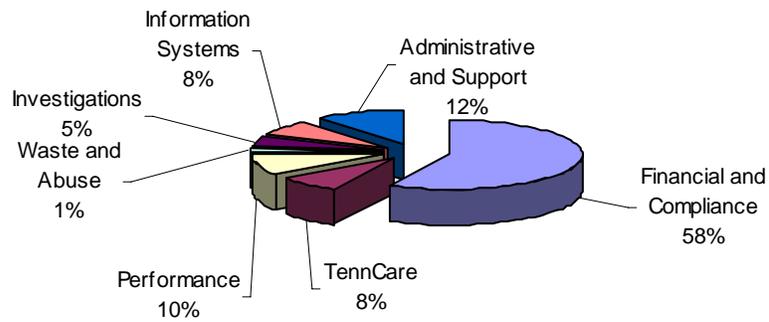
## Municipal Audit Certifications 2008



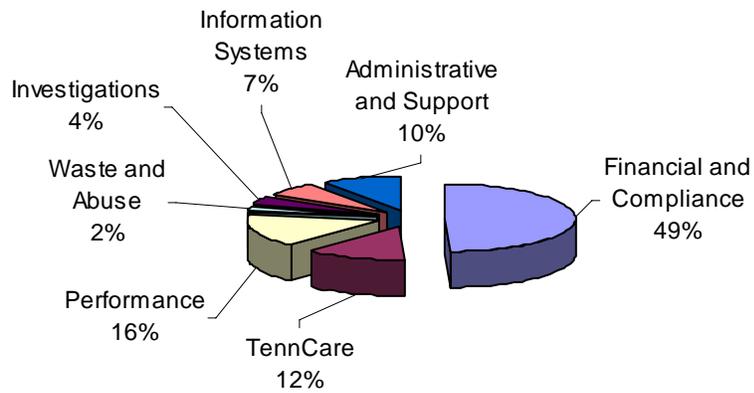
Certified Public Accountant (CPA), Certified Information Systems Auditor (CISA), Certified Fraud Examiner (CFE), Certified Government Financial Manager (CGFM), and Certified Professional Secretary (CPS).

# Department Staff

**Department of Audit  
Employees by Category 2008**

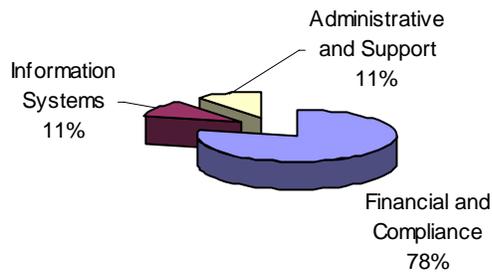


**Employees by Category  
State Audit 2008**

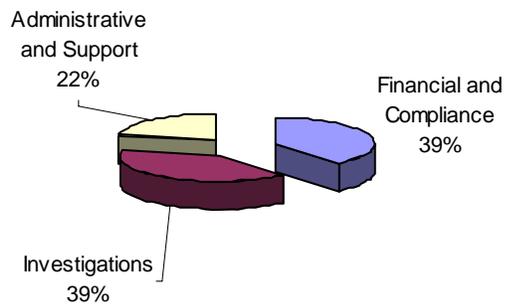


# Department Staff

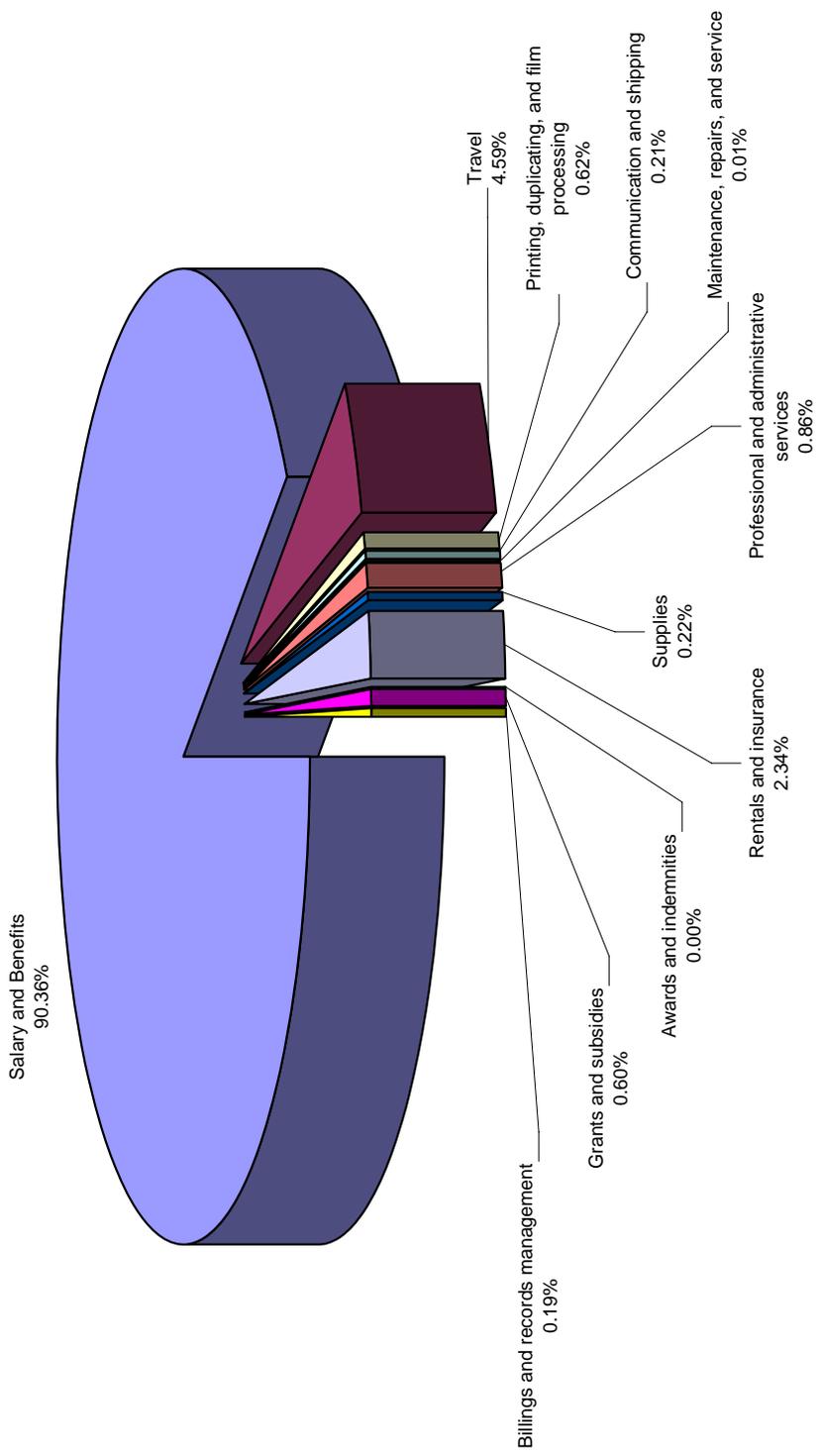
**Employees by Category  
County Audit 2008**



**Employees by Category  
Municipal Audit 2008**

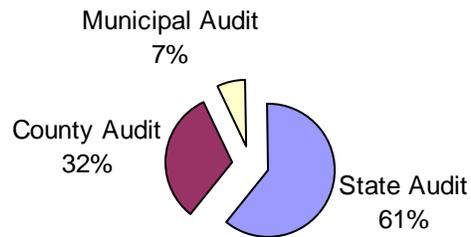


## Department of Audit Expenditures \$25,650,500 for Fiscal Year Ended June 30, 2008



## Financial Information

### Department of Audit Expenditures Fiscal Year Ended June 30, 2008





## Contact Us

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Nashville, Tennessee 37219-1718  
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**Comptroller's Fraud, Waste and Abuse Hotline  
(800) 232-5454**

**Comptroller of the Treasury Website  
[www.comptroller.state.tn.us](http://www.comptroller.state.tn.us)**