AUDIT REPORT

Tennessee Advisory Commission on Intergovernmental Relations

October 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
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John G. Morgan
Comptroller

October 16, 2007

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Dr. Harry A. Green, Executive Director
Tennessee Advisory Commission on Intergovernmental Relations
226 Capitol Boulevard Building, Suite 508
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Advisory Commission on Intergovernmental Relations for the period April 1, 2004, through April 30, 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

John G. Morgan
Comptroller of the Treasury

JGM/cj
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COMPTROLLER OF THE TREASURY
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May 29, 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 Tennessee Advisory Commission on Intergovernmental Relations for the period April 1, 2004, through April 30, 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 Tennessee Advisory Commission on Intergovernmental Relations' compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Tennessee Advisory Commission on Intergovernmental Relations 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 commission's internal control and instances of noncompliance to the Tennessee Advisory Commission on Intergovernmental Relations' management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/cj

State of Tennessee

Audit Highlights

Comptroller of the Treasury Division of State Audit

Financial and Compliance Audit

Tennessee Advisory Commission on Intergovernmental Relations

October 2007

AUDIT SCOPE

We have audited the Tennessee Advisory Commission on Intergovernmental Relations for the period April 1, 2004, through April 30, 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 expenditures, equipment, payroll and personnel, and the Financial Integrity Act. 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 serving as an ex-officio member of the board of directors of the commission; approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; and participating in the negotiation and procurement of services for the state.

AUDIT FINDINGS

The audit report contains no findings.

AUDIT COMMITTEE REQUIREMENT REQUEST FOR EXEMPTION GRANTED

The Tennessee Advisory Commission on Intergovernmental Relations requested an exception from the requirement to form an audit committee on May 23, 2007, due to the small size of the commission's staff, limited budget, and absence of cash receipts. Section 4-35-102, *Tennessee Code Annotated*, allows an entity to be excepted from the requirement to form an audit committee upon the approval of the Comptroller of the Treasury. The Comptroller of the Treasury approved the exception for the commission on June 8, 2007.

Financial and Compliance Audit
Tennessee Advisory Commission on Intergovernmental Relations

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INTRODUCTION

POST-AUDIT AUTHORITY

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

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

BACKGROUND

The Tennessee Advisory Commission on Intergovernmental Relations (TACIR) was created by the General Assembly in 1978 to monitor federal, state, and local government relations and to make recommendations for improvement to the legislature. The commission is comprised of representatives from the executive and legislative branches of state government, county and municipal governments, and the public. The commission serves as a bipartisan forum for the discussion of intergovernmental issues and may initiate studies resulting in legislative proposals and constitutional amendments. The commission responds to requests for technical assistance from the General Assembly, state agencies, and local governments.

Many specific duties and functions are required of the TACIR in its enabling act, and additional duties are often assigned by the General Assembly through legislation. From its broad set of statutory obligations and special charges, the purpose for TACIR's existence can be summarized in four concise yet encompassing goals. The TACIR strives to:

- Advance discussion and deliberation of critical and sensitive intergovernmental policy matters.
- Promote action to resolve intergovernmental problems and improve the quality of government.
- Forge common ground between competing but equally legitimate values, goals, and interests.

- Provide members of the General Assembly and other policymakers with accurate and timely information and analysis to facilitate reasoned decision making.

The Tennessee Advisory Commission on Intergovernmental Relations is accounted for in allotment code 316.12. An organization chart of the commission is on the following page.

AUDIT SCOPE

We have audited the Tennessee Advisory Commission on Intergovernmental Relations for the period April 1, 2004, through April 30, 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 expenditures, equipment, payroll and personnel, and the Financial Integrity Act. 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 serving as an ex-officio member of the board of directors of the commission; approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; and participating in the negotiation and procurement of services for the state.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

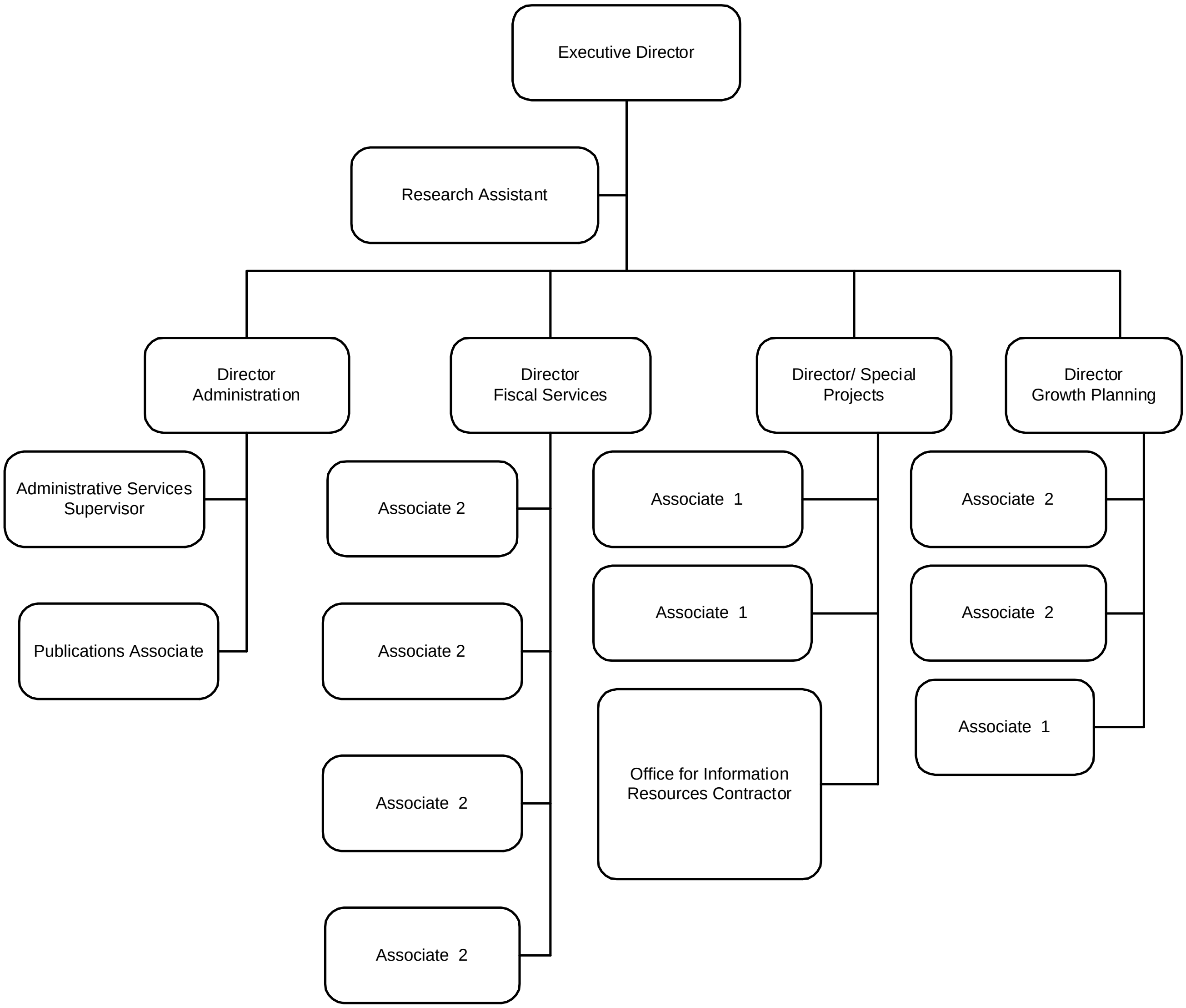
OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

EXPENDITURES

The objectives of our review of expenditure controls and procedures in the Tennessee Advisory Commission on Intergovernmental Relations were to determine whether

- the expenditures made by the commission were reasonable and valid,
- expenditures for travel were made in accordance with the Comprehensive Travel Regulations,
- the commission's staff reconciled expenditure records with reports from the State of Tennessee Accounting and Reporting System (STARS),

Tennessee Advisory Commission on Intergovernmental Relations Organization Chart



- contracts were executed in accordance with Department of Finance and Administration regulations, and
- contract payments were made in compliance with contract terms and applicable purchasing guidelines.

We reviewed the applicable laws and regulations, interviewed key personnel, and reviewed supporting documentation to gain an understanding of the commission's procedures and controls over expenditures to determine whether commission staff reconciled expenditure records with reports from STARS and to determine the reasonableness and validity of the expenditures. We tested all of the executive director's travel expenditures and a nonstatistical sample of other travel expenditures for the period April 1, 2004, through February 28, 2007, to determine whether travel expenditures were in accordance with the Comprehensive Travel Regulations. We tested a nonstatistical sample of contracts to determine whether contracts were executed in accordance with Department of Finance and Administration regulations, and to determine whether contract payments were in compliance with contract terms and applicable purchasing guidelines.

Based on our reviews, interviews, and testwork, we determined that the expenditures made by the commission were reasonable and valid; expenditures for travel were made in accordance with the Comprehensive Travel Regulations, with minor exceptions; the commission's staff reconciled expenditure records with reports from STARS; contracts were executed in accordance with Department of Finance and Administration regulations; and contract payments were in compliance with contract terms and applicable purchasing guidelines.

EQUIPMENT

The objectives of our review of equipment controls and procedures were to determine whether

- the equipment on the Property of the State of Tennessee (POST) property listing was on the commission's listing of physically inventoried items,
- the information on the POST property listing was properly recorded,
- equipment purchases were added to the POST property listing at the correct purchase price, and
- equipment was adequately safeguarded.

We interviewed key personnel and reviewed supporting documentation to gain an understanding of the commission's procedures and controls over equipment and to determine that the equipment on the POST listing was on the commission's listing of physically inventoried items. We selected and tested a nonstatistical sample of equipment purchases during the audit period; the items were located, and the description, tag number, and location were properly recorded on the POST listing. In addition, we determined that the purchase price for each of these items was properly added to the POST listing. We observed and discussed the safeguarding of equipment with commission personnel.

Based on our reviews, interviews, and testwork, we determined that the equipment on the POST property listing was on the commission's listing of physically inventoried items, the information on the POST property listing was properly recorded, equipment purchases were properly added to the POST property listing at the correct purchase price, and equipment was adequately safeguarded.

PAYROLL AND PERSONNEL

The objectives of our review of payroll and personnel controls and procedures were to determine whether

- the State Employee Information System (SEIS) payroll transactions agreed to the State of Tennessee Accounting and Reporting System (STARS) and whether the transactions contained large, unusual, or inappropriate amounts;
- newly hired employees were qualified for their positions and their initial wage was correct;
- terminated employees' final pay was accurate; and
- supplemental pay was appropriate.

We interviewed key personnel and reviewed supporting documentation to gain an understanding of the commission's procedures and controls over payroll and personnel. We obtained the commission's payroll transactions for the period April 1, 2004, through March 31, 2007, from SEIS. The listing was reconciled to STARS and was reviewed for large, unusual, or inappropriate amounts. For employees hired during the above period, we reviewed personnel files and initial payroll registers to determine if the employees met the job qualifications and whether their initial wage was correct. For employees terminated during the above period, we reviewed personnel files and final payroll registers to determine if the employees' final pay was accurate. We reviewed supporting documentation for all supplemental payroll payments for the period April 1, 2004, through March 31, 2007.

We determined that the SEIS payroll transactions reconciled to STARS and there were no large, unusual, or inappropriate transactions; newly hired employees were qualified for their positions and their initial wage was correct; terminated employees' final pay was accurate; and supplemental pay was appropriate.

FINANCIAL INTEGRITY ACT

Section 9-18-104, *Tennessee Code Annotated*, requires the head of each executive agency to submit a letter acknowledging responsibility for maintaining the internal control system of the agency to the Commissioner of Finance and Administration and the Comptroller of the Treasury by June 30 each year. In addition, the head of each executive agency is required to conduct an evaluation of the agency's internal accounting and administrative control and submit a report by December 31, 1999, and December 31 of every fourth year thereafter.

Our objective was to determine whether the commission's June 30, 2006; June 30, 2005; and June 30, 2004, responsibility letters were filed in compliance with Section 9-18-104, *Tennessee Code Annotated.*

We reviewed the June 30, 2006; June 30, 2005; and June 30, 2004, responsibility letters submitted to the Comptroller of the Treasury and the Department of Finance and Administration to determine adherence to the submission deadline. We determined that the Financial Integrity Act responsibility letters were submitted on time.

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

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.

The Tennessee Advisory Commission on Intergovernmental Relations requested an exception from the requirement to form an audit committee on May 23, 2007, due to the small size of the commission's staff, limited budget, and absence of cash receipts. Section 4-35-102, *Tennessee Code Annotated*, allows an entity to be excepted from the requirement to form an audit committee upon the approval of the Comptroller of the Treasury. The Comptroller of the Treasury approved the exception for the commission on June 8, 2007.