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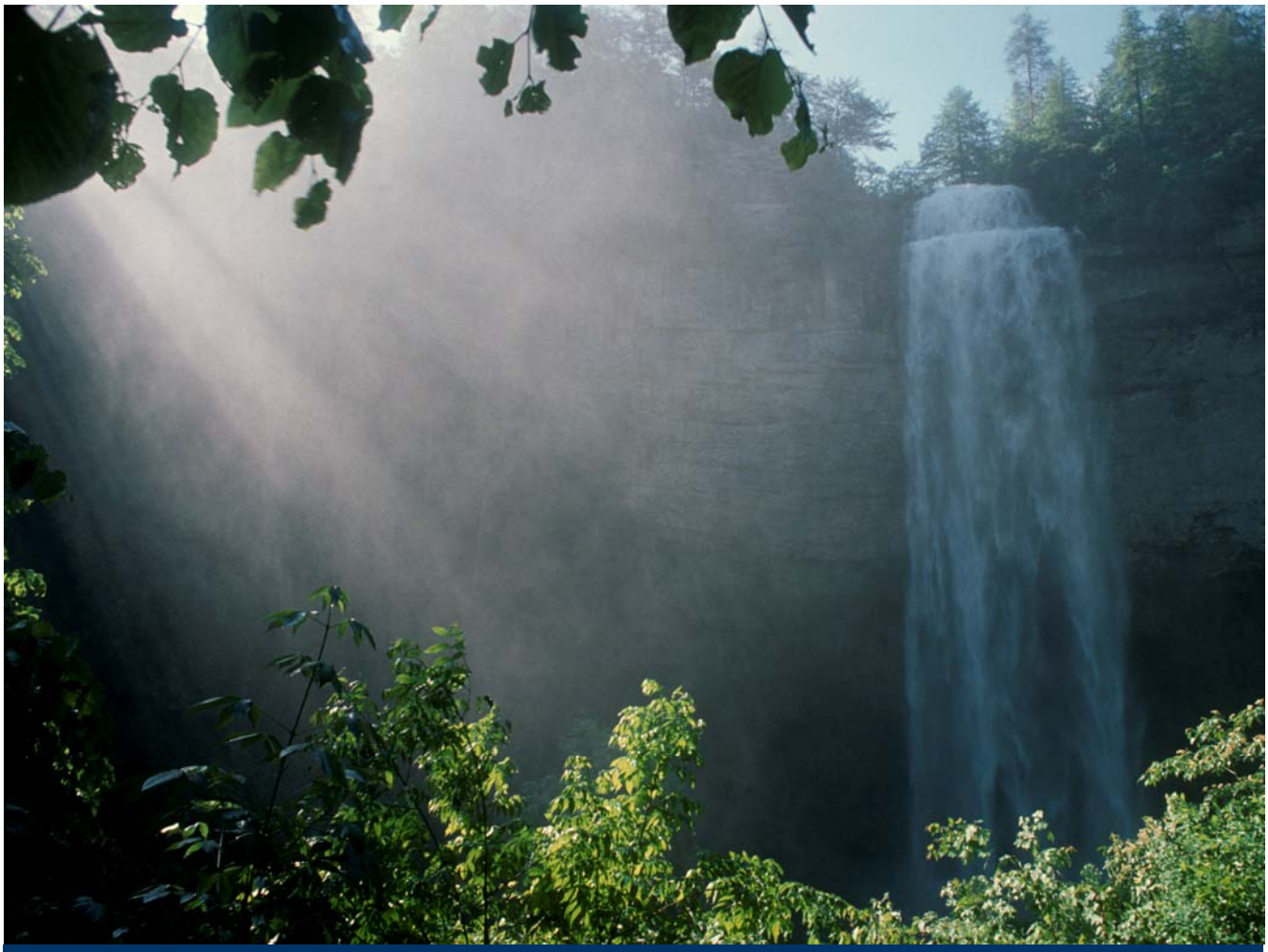
Tennessee Comptroller of the Treasury

Department of Audit

2014 Annual Report



Justin P. Wilson, Comptroller



Comptroller of the Treasury
Justin P. Wilson

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
STATE CAPITOL
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Justin P. Wilson
Comptroller

December 31, 2014

The Honorable Bill Haslam, Governor
The Honorable Ron Ramsey, Speaker of the Senate
The Honorable Beth Harwell, Speaker of the House of Representatives, and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

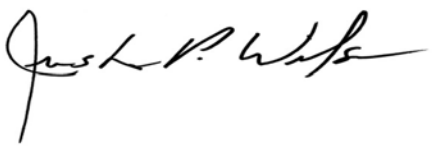
Ladies and Gentlemen:

The 2014 annual report of the Department of Audit is submitted herewith in accordance with Section 4-3-304, *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,



Justin P. Wilson
Comptroller of the Treasury

JPW/ab

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Department of Audit
2014 Annual Report

The General Assembly created the Department of Audit in 1937. The authority to audit state, county, municipal and other local governmental entities as well as recipients of grant funds is established in *Tennessee Code Annotated*. The department is required to:

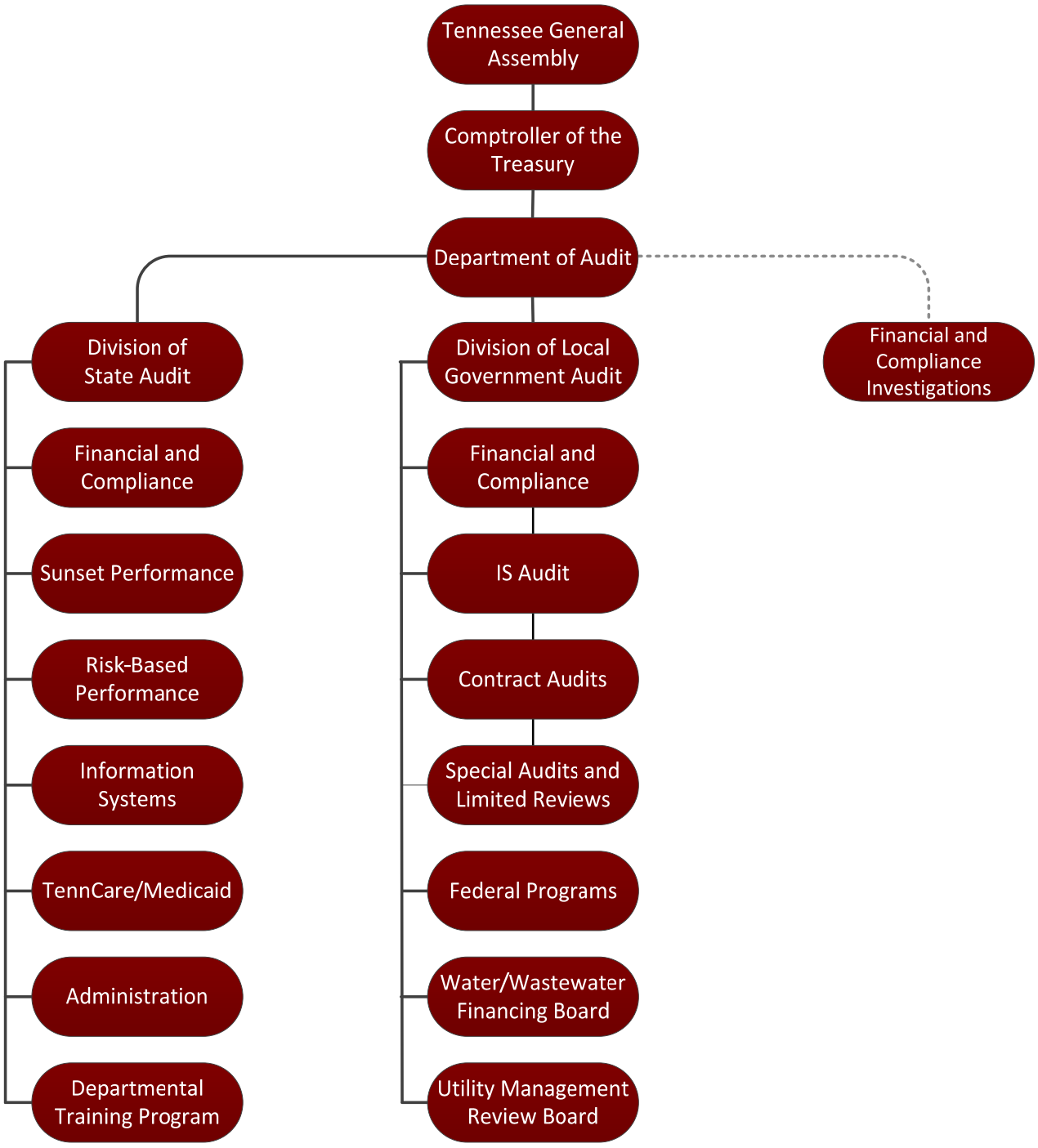
- perform currently a post-audit of all accounts and other financial records of the state government . . . in accordance with generally accepted auditing standards and . . . such procedures as may be established by the comptroller . . .
- make annually, and at such other times as the general assembly 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 . . . in accordance with standards established by the comptroller . . .
- require that all persons, corporations or other entities receiving grants from or through this state shall cause a timely audit to be performed, in accordance with auditing standards prescribed by the comptroller . . .
- establish minimum standards for the performance of audits by the internal audit staffs of local governments, special taxing districts, utility districts, political subdivisions, state departments, boards, commissions, institutions, agencies, authorities or other entities of the state . . .
- ensure that the audits of municipalities, utility districts, emergency communications districts, internal school funds, charter schools, public housing authorities, human resource agencies, development districts, and other special purpose governments are prepared in accordance with generally accepted governmental auditing standards and the minimum standards as prescribed by the Comptroller of the Treasury.

The Department of Audit comprises two divisions—State Audit and Local Government Audit—and employs approximately 300 people. State Audit and Local Government Audit are each administered by a director who is responsible for the audit function and addresses audit concerns and issues in the division. The Financial and Compliance Investigations Unit is administratively attached to the Division of State Audit.

The Department of Audit is a post-audit agency. As such, it audits an entity's basic financial statements and related notes to the financial statements; an entity's compliance with applicable statutes, grant agreements, 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.

Department of Audit Organizational Chart



For additional information on the Department of Audit and the Comptroller, go to www.comptroller.tn.gov.



The Tennessee State Capitol in Nashville, Tennessee, houses the state legislature and the Governor's Office and is listed on the National Register of Historic Places.

The basic purpose of post-audits is to identify and report material misstatements or noncompliance, whether due to fraud or errors, and recommend improvements. Pre-audits, in contrast, are performed by an entity's staff to prevent fraud and errors, detect problems, and suggest improvements. The most important distinction between the two is that post-audits are independent of the audited entity. In this respect, a post-audit agency in government is comparable to an independent certified public accounting firm in the private sector.

Auditing Standards

The Department of Audit performs audits in accordance with auditing standards generally accepted in the United States of America promulgated by the American Institute of Certified Public Accountants (AICPA) and generally accepted government auditing standards issued 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 promulgated by the AICPA.

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 July 2014 by certified public accountants and other federal and state government professionals. The purpose of the review was to ensure that the department is following auditing standards generally accepted in the United States of America and Yellow Book standards.

The peer review for the year ended June 30, 2014, rendered an unmodified 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, 2013, through June 30, 2014, has been suitably designed and was complied with during the period to provide reasonable assurance of conforming with applicable auditing standards." The next review is scheduled for July 2016.



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

Honesty and Integrity	***Accuracy and Reliability***	***Accountability***

Division of State Audit

The Division of State Audit conducts financial and compliance audits and performance audits. 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 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 65 reports during the year ended June 30, 2014; an additional 85 audits were in progress at year-end.

This division includes five sections: Financial and Compliance, Information Systems, Sunset Performance, Risk-Based Performance, and TennCare. Highlights of the division's work from July 1, 2013, through June 30, 2014, are presented. Complete reports are available at www.comptroller.tn.gov/sa/AuditReportCategories.asp.

In addition to auditing, the division reviews and comments on due process documents 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 state departments, agencies, and institutions.

Financial and compliance audits are conducted in accordance with auditing standards generally accepted in the United States of America and generally accepted government auditing standards issued by the United States Comptroller General. The objectives of financial and compliance audits are

- to consider the entity's internal control over financial reporting as a basis for designing auditing procedures to express an opinion on the financial statements;
- to determine compliance with certain provisions of laws, regulations, contracts, and grant agreements;
- to determine the fairness of the presentation of the financial statements; and
- to recommend appropriate actions to correct deficiencies.

Information Systems

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

To provide information for audit fieldwork, the data retrieval staff 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 internal control in the computerized accounting and management information systems of entities undergoing audits by other sections of the division.

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 Financial and Compliance Investigations Unit 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.

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 their organization and use of resources,
- developing recommendations for management or legislative action that might improve the efficiency and effectiveness of the agencies' operations, and
- providing program and financial data.

Sunset Performance Audit work is directed by the Tennessee Governmental Entity Review Law, known as the Sunset Law (Section 4-29-101 et seq., *Tennessee Code Annotated*), which requires the Joint Government Operations Committee to review each entity at least once every eight years to determine whether the entity should be continued, restructured, or terminated.



Risk-Based Performance Audit work is based on risk assessments of state department and agency programs. Audits are selected based on identified risks of inefficient or ineffective statewide processes and programs and agency-specific operations and activities. Auditors focus on issues with the greatest risks of fraud, waste, and abuse, as well as noncompliance with laws, regulations, contracts, and grant agreements.

Performance audits are conducted in accordance with *Government Auditing Standards* issued by the United States Comptroller General and move through six phases: planning, fieldwork, report writing, agency comments, report publication, and often presentation at a legislative hearing. Performance audits generally include the following:

- Review of relevant laws, cases, Attorney General's opinions, executive orders, rules, and regulations.
- Review of the agency's procedures, plans, and records.
- Interviews with staff of the agency and related agencies.
- Observation of the agency's operations and activities.
- Analysis of the agency's revenue and expenditure data, program data, performance, and results.
- Review of comparative data from other states.
- Surveys of individuals, agencies, and organizations served or affected by the agency.
- Tests for compliance with legal requirements.
- Evaluation of the extent to which the agency achieved desired results at the lowest reasonable cost.
- Legislative or administrative recommendations for accomplishing the agency's legislative mandate.

The Government Operations Committee held 11 public hearings on 61 entities in the year ended June 30, 2014. At these hearings, Performance Audit staff presented audit reports covering 14 entities. Another 41 entities submitted written responses to staff-prepared questions based on the entities' statutory authority and responsibility. Additionally, the committee held a follow-up hearing on six entities.

TennCare

Under an agreement with the Department of Finance and Administration, staff in the TennCare section perform the following audit and rate-setting functions for the state's TennCare program:

- Reimbursable rate computation and examinations for nursing homes and Intellectual and Developmental Disabilities facilities participating in the Medicaid Program.
- Computations 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.
- Cost settlements for state-operated Developmental Centers serving individuals with intellectual disabilities.
- Technical, financial, and budgeting support to the Bureau from nursing home paid claims extracts.
- Examinations of TennCare Managed Care Contractors (MCCs), who contract with the state to provide medical services under the program, performed jointly with the Department of Commerce and Insurance.

Results of Audits

During the year ended June 30, 2014, a major endeavor of the division was the Single Audit of the State of Tennessee for the year ended June 30, 2013, conducted in accordance with Office of Management and Budget (OMB) Circular A-133. The *Single Audit Report* reflected federal awards of over $15 billion.

We noted instances of noncompliance that resulted in a qualified opinion on compliance for 1 of the state's 30 major federal programs. In addition, we noted other instances of noncompliance that met the reporting criteria contained in OMB Circular A-133. We also noted material weaknesses and significant deficiencies in internal control over compliance with requirements related to federal programs.

As a result of testing the state's compliance with the requirements of laws, regulations, contracts, and grant agreements applicable to each major federal program, costs of $4,917,932.35 were questioned. We noted three deficiencies that we considered to be material weaknesses in internal control over financial reporting. We noted one instance of noncompliance we considered material to the state's basic financial statements.

The Single Audit included an audit of the state's basic financial statements. This audit resulted in an unmodified opinion on the basic financial statements of the State of Tennessee for the year ended June 30, 2013.

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

In addition to the *Single Audit Report,* separate audit reports were issued on many agencies and institutions of state government. 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 OMB 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.

Including the *Single Audit Report,* the division published 35 financial and compliance audit reports containing 71 audit findings and issued opinions on 66 sets of financial statements. In addition, the division performed certain other audit procedures for higher education facilities to assist them in meeting regulatory requirements.

The division's financial and compliance reports included the following:

- Austin Peay State University (2012)
- Austin Peay State University (2013)
- Chattanooga State Community College
- Clean Water State Revolving Fund
- Cleveland State Community College
- Columbia State Community College
- Department of the Treasury
- East Tennessee State University
- Endowment for Educational Excellence – Tennessee State University Foundation (2012)
- Endowment for Educational Excellence – Tennessee State University Foundation (2013)
- Executive Department
- Jackson State Community College
- Local Government Group Insurance Fund
- Middle Tennessee State University
- Motlow State Community College

- Post-Conviction Defender Oversight Commission
- Retiree Health Funds (2012)
- Retiree Health Funds (2013)
- Single Audit Report
- Southwest Tennessee Community College
- Teacher Group Insurance Fund
- Tennessee Consolidated Retirement System
- Tennessee Education Lottery Corporation
- Tennessee Housing Development Agency
- Tennessee Local Development Authority
- Tennessee Residence Foundation
- Tennessee Sports Hall of Fame
- Tennessee State School Bond Authority
- Tennessee State University (2012)
- Tennessee State University (2013)
- Tennessee State Veterans' Homes Board
- Tennessee Technological University
- The University of Memphis
- The University of Tennessee
- Volunteer State Community College

The division released the following 22 performance audit reports:

Sunset

- Board of Parole
- Department of Agriculture
- Department of Children's Services
- Department of Revenue
- Department of Safety and Homeland Security
- River Basin Agencies
- Tennessee Board of Regents
- Tennessee Community Services Agency
- Tennessee Corrections Institute
- Tennessee Fish and Wildlife Commission / Tennessee Wildlife Resources Agency
- Tennessee Higher Education Commission
- Tennessee Rehabilitative Initiative in Correction
- Tennessee Student Assistance Corporation
- University of Tennessee Board of Trustees

Risk-Based

- Department of Finance and Administration
- Department of General Services
- Department of Intellectual and Developmental Disabilities
- Office of Legislative Administration
- Office of the Comptroller of the Treasury

Special Reports

- Annual Report on the Status of Submission of Title IX Implementation Plans
- Memo to Chairman Bell and Chairman Matheny Regarding the State Fair and Exposition Commission
- Purchase of Property for Pellissippi State Community College

The division completed examinations of the following 8 nursing facilities:

- Claiborne and Hughes Health Center, Inc.
- Clover Bottom Developmental Center
- Grace Healthcare of Cordova
- Greene Valley Developmental Center
- Greystone Healthcare Center
- Memphis Jewish Home
- Signature HealthCARE, LLC
- West Hills Health and Rehab

The division's TennCare section also assisted the Department of Commerce and Insurance in one Managed Care Contractor (MCC) examination. The summary of findings included financial, claims processing, and compliance deficiencies.

The state, legislature, or federal government often requests that the Division of State Audit work on special TennCare projects. In one such project, the state, under a consent decree with the federal court, has agreed to comply with requirements with respect to TennCare enrollee grievances and appeals. The TennCare MCCs and providers are also subject to the decree, so it has widespread implications. The agreement, commonly referred to as the "Grier Consent Decree," became effective November 1, 2000. The decree requires the state to enter into an agreement with the Comptroller's Office to monitor compliance and to report quarterly. Reports through September 2014 have been completed and released. A report for the quarter ended in December 2014 is in progress.

Audits in Progress at Year-End

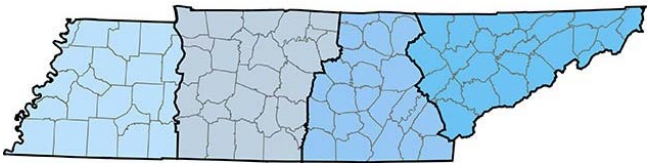
On June 30, 2014, 41 financial and compliance audits, 8 information systems audits, 16 performance engagements, and 20 nursing facility examinations were in progress.

Division of Local Government Audit

Through the Division of Local Government Audit, the Department of Audit is responsible for the audits of all local governmental entities with statutory audit requirements as well as certain nonprofit and for profit organizations that are publicly funded. The division may conduct the audit for governmental entities or accept an audit prepared by the certified public accountant provided the audit meets minimum standards established by the Comptroller of the Treasury. The division conducts the annual audits for 89 of the state's 95 counties. Through a contractual process with independent certified public accounting firms, the division ensures the performance of over 1,600 audits for the state's remaining counties, municipalities, public internal school funds, charter schools, utility districts, housing authorities, local government created entities, quasi-governmental organizations, and other government-funded agencies.

Financial and Compliance Audits

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 Local Government 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 accounting principles generally accepted in the United States of America.
- 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 Local Government Audit conducted audits in 89 of the state's 95 counties for the 2012-2013 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 fiscal year ended June 30, 2013. 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 and released. The division also prepares audits of two special school districts and performs special audits and reviews as requested or as deemed necessary.

Results of Audits

Audits of financial transactions for the year ended June 30, 2013, conducted by the Division of Local Government Audit revealed an increase in cash shortages of $211,849 and total ending cash shortages of $775,221. Details of the latest cash shortages report are available on the Comptroller's website at www.comptroller.tn.gov/la.

The audits conducted or reviewed by this division disclosed fund deficits totaling $242,803,763 in 17 governmental fund accounts in 13 counties. Audits also reflected net asset deficits totaling $56,971,864 in 14 enterprise funds and 1 internal service fund account in 15 counties.

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, 2014.

Contract Audits

The division fulfills its audit responsibility through a contractual process with independent certified public accounting firms who perform the audits for the following Tennessee local governments:

Counties

- 6 of the state's 95 counties
- 268 county-related entities

Municipalities

- 342 municipalities
- 106 municipal-related entities

Quasi Governments

- 183 utility districts
- 85 housing authorities and 3 housing authority related entities
- 18 human resource agencies and development districts
- 103 other quasi governmental entities

Schools

- 143 public internal school funds
- 50 charter schools
- 13 of the 15 special school districts

The division further ensures that 297 nonprofit and for-profit organizations are audited as required by state contracts and agreements.

The entities use standard contracts, prepared by the Comptroller of the Treasury, which must be approved by the Comptroller's designees in the Division of Local Government Audit before audit work begins. These audits must be performed in accordance with generally accepted government auditing standards and certain other minimum requirements prescribed by the Comptroller of the Treasury. In addition, the auditor must comply with other federal and state provisions.

For the six counties, the division monitors the contract audits in accordance with a four-year monitoring plan, which includes a review of working papers prepared by certified public accountants.

The Division of Local Government Audit approves the audit contracts of the certified public accountants and reviews each audit report to verify that it adheres to applicable reporting requirements. If a local governmental unit fails or refuses to have an audit, the

Comptroller may direct the Division of Local Government Audit, or may appoint a certified public accountant, to perform the audit. If a nonprofit or for-profit organization refuses to have an audit, the division works in connection with the respective state funding agency to obtain an audit. The division evaluates the audit working papers of certified public accounting firms that audit the entities. The objective of this review is to ensure that in addition to standards prescribed by the American Institute of Certified Public Accountants and Government Auditing Standards issued by the United States Comptroller General, standards prescribed by the Comptroller of the Treasury have been followed. 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.

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 Davidson and Knox counties were monitored for the year ended June 30, 2013, and the audit of Hamilton County will be monitored for the year ended June 30, 2014. For the year ended June 30, 2014, the division reviewed 1,863 audit reports submitted by certified public accountants for audits of local governments and other publicly funded entities.



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; requesting technical data for pension and other postemployment benefits note disclosures from the State of Tennessee; maintenance of the uniform chart of accounts used by county governments; and participation in the review of notifications 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.

Statutory Referral of Utility Systems

Sections 68-221-1010(a) and 7-82-703(a), *Tennessee Code Annotated*, require the Comptroller to refer financially distressed municipal water and/or wastewater systems and public utility districts to the state's Water and Wastewater Financing Board and/or the Utility Management Review Board. Sections 68-221-1010(d) and 78-82-401(h) of *Tennessee Code Annotated* require the Comptroller to refer water systems with excessive unaccounted for water losses. After the Division of Local Government Audit refers applicable facilities to the appropriate board, the respective board obtains and reviews a proposed plan for correction by the facility. If the board finds the facility's plan unacceptable, the board will recommend an alternate course of action.

During the year ended June 30, 2014, the division referred 102 utility systems to the Water and Wastewater Financing Board and/or the Utility Management Review Board. As a result, several utility districts and municipal utility systems are now operating or are on their way to operating on a financially sound basis and/or are in the process of taking measures to decrease their water loss rates.

Reviews of Funds Administered by District Attorneys General

During 2013, 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, 2012, through June 30, 2013. 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.

Financial and Compliance Investigations Unit

The Financial and Compliance Investigations Unit conducts investigations which support the financial and compliance audit and Single Audit report timelines of State Audit and Local Government Audit. The unit investigates allegations of fraud as well as certain allegations of waste and abuse of public funds. These cases may result in criminal prosecution.

Investigations are performed as a result of allegations received through the Comptroller's toll-free hotline; statutorily required fraud reporting forms, misappropriations, or other significant issues indicative of fraud noted during routine audit work or audit report reviews; information received from certified public accountants, other state agencies, and concerned citizens and/or officials; and requests received from local District Attorneys General, Tennessee's Office of the Attorney General, the Federal Bureau of Investigation, and other prosecutorial and law enforcement agencies. Results of investigations are presented in reports or letters that document occurrences of improper activity. Reports are forwarded to Tennessee's Office of the Attorney General, the local District Attorney General, and, when applicable, the local Office of the United States Attorney General for any legal action deemed necessary. 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.



The unit's investigations also include an assessment of internal controls and compliance with applicable laws relative to the issues investigated. Investigators have often found that weak internal controls or ineffective management were contributing factors in most of the losses incurred as a result of fraud. In the resulting reports or letters, the unit identifies these internal control and compliance weaknesses and recommends corrective action. The investigations point out to officials the importance of sound internal controls and compliance with applicable laws and regulations. The investigators also share the information with State Audit and Local Government Audit for consideration in audits of the affected entity.

During the fiscal year ended June 30, 2014, the unit released 17 investigative reports and letters revealing losses of at least $713,051 due to fraud and cited an additional $189,107 of questioned costs due to apparent waste and/or abuse. Most investigations revealed weaknesses in (or the absence of) internal controls; lack of compliance with applicable laws and regulations; or other problem areas that created an environment conducive to fraud, waste, and abuse.

Comptroller's Hotline

Pursuant to Section 8-4-403, *Tennessee Code Annotated,* the Office of the Comptroller is required to "establish, maintain, and publicize a toll-free telephonic and web-based hotline for the purpose of receiving allegations of fraud, waste, or abuse of public funds." Since its inception, the hotline has received over 20,000 calls, including 1,522 calls between July 1, 2013, and June 30, 2014. In addition, on January 1, 2013, the Comptroller's Office introduced an online form that allows citizens to report allegations of fraud, waste, or abuse over the Internet. The website received 107 notifications. Of the 1,629 total notifications, 435 concerned allegations of fraud, waste, or abuse. The substantive notifications—those relating to fraud, waste, or abuse—concerned a wide range of entities, including municipalities, counties, state agencies and departments, and federal agencies and departments. A more detailed analysis is below. Substantive notifications are investigated by Comptroller staff or are referred to the appropriate agency or program.

Of the 435 notifications referred for action, responses have been received on 334, and these are considered closed. The remaining 101 continue to be considered open.

The remaining 1,194 notifications were not assigned for review because they were either repeat notifications or were not relevant to the purpose of the hotline. Notifications 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 person making the notification is referred to the appropriate agency or department that can provide assistance.

Results of Hotline Notifications

The following summaries are the results of hotline notifications upon which corrective action was taken for the year ended June 30, 2014.

Board of Regents—Time and Attendance Violation

The notification alleged that a school employee was not taking the required annual/sick leave when absent from work. The allegation was partially verified. The employee was verbally warned, corrective measures were implemented, and supported unreported leave was corrected.

Board of Regents—Insufficient Instruction

The notification alleged that certain instructors were not providing sufficient instruction in their fields. The review determined that the instructors were not using classroom time wisely or teaching effectively. Audit recommendations were made to management that it should extend the probation period for one instructor and not extend the employment of another instructor.

Comptroller Investigations—Conflicts of Interest

The notification alleged that city officials were violating the state's conflict-of-interest law. The review determined an official had an impermissible direct conflict of interest and another official had failed to disclose an indirect conflict of interest. The matter was referred to the district attorney general.

Comptroller Investigations—Conflict of Interest

The notification alleged that the school department was purchasing from a business owned by a school employee. The review determined that the school had made approximately $97,000 in purchases from the business owned by the employee, in violation of the school department's conflict-of-interest policy. The finding was reviewed with the applicable district attorney.

Comptroller Investigations—Employee Misappropriation

The notification alleged that a school employee had misappropriated funds from the school. The review determined that the employee was responsible for a cash shortage of approximately $12,000. The matter was turned over to the applicable district attorney.

Comptroller Investigations—Employee Misappropriation

The notification alleged that a county employee had misappropriated county equipment. The review determined that the employee had done so. The employee was indicted on theft of over $500 and official misconduct charges.

Comptroller Investigations—Inappropriate Actions by School Support Organization

The notification alleged that board and club members were inappropriately spending the school support organization's funds. The review did not determine that fraud had occurred, but did determine that payments were made in noncompliance with board policy, that there was inadequate supporting documentation for collections and disbursements, and that collections were turned over to the club rather than the school. The findings were shared with the Director of Schools and the current organization president.



Comptroller Investigations—Inappropriate Actions by Utility District

The notification alleged mismanagement and misuse of funds and property by officials of a utility district. The review determined that the utility district had not followed its purchasing policies by not bidding purchases over $1,000 and that the utility district improperly used grant funds for the construction of the district's office building. The findings were reviewed with the applicable district attorney.

Comptroller Investigations—Inappropriate Actions by Volunteer Fire Department

The notification alleged that department members were receiving loans from department funds and an overall lack of internal controls. The review determined that loans were issued and no documentation of repayment could be found. Audit findings were taken on several internal control and compliance deficiencies. The findings were reviewed with the applicable district attorney.

Comptroller Investigations—Inappropriate Actions by Volunteer Fire Department

The notification alleged mishandling of funds by the department. The review determined loans were issued to fire chiefs and department members as personal loans with no documentation of repayment for almost all loans. Audit findings were also taken on several internal control and compliance deficiencies. The findings were reviewed with the applicable district attorney.

Comptroller Local Government Audit—Cash Missing from Money Bag

The notification alleged that there was cash missing from the Clerk's Office money bag. The review determined the allegation to be true. Further review could not identify the source of the theft. An audit finding was taken against the county.

Comptroller Local Government Audit—Conflict of Interest

The notification alleged that a county official failed to disclose an indirect conflict of interest. The review determined that minutes did not indicate that the official had disclosed an indirect conflict of interest. An audit finding was taken against the county.

Comptroller Local Government Audit—City Project with County Funds

The notification alleged that the county highway department was working on city property using county funds. The review determined that the county did not have formal written contracts with the city and the city was not reimbursing the county for its costs. An audit finding was taken against the county.

Comptroller Local Government Audit—Failure to Pay Payroll Taxes

The notification alleged that the school finance director failed to get proper approvals before paying penalties and interest for failure to timely report employee payroll taxes. The review determined that the finance director failed to properly notify the Internal Revenue Service, resulting in penalties and interest exceeding $166,000. The finance director failed to get proper approvals before issuing checks to the IRS. The finance director is no longer employed by the school department.

Comptroller Local Government Audit—Gas Misappropriation

The notification alleged that an employee of the county highway department was allowed to put county fuel in a personal vehicle. The review determined that the county highway department allowed the employee to do so, but auditors were unable to determine the extent of loss due to the department's poor recordkeeping. An audit finding was taken against the county.

Comptroller Local Government Audit—Misappropriation in Clerk's Office

The notification alleged that a deputy clerk was taking cash from the office for personal use. The review determined that the deputy clerk had misappropriated approximately $10,000. The finding was shared with the applicable district attorney.

Comptroller Local Government Audit—Time and Attendance

The notification alleged overpayments to full-time school employees being paid simultaneously with their part-time school employment. The review determined that the employees were overcompensated for at least 30 minutes a day, resulting in a total overpayment of approximately $4,500. The finding was shared with the applicable district attorney.

Comptroller State Audit—Long Wait Time for Unemployment Assistance

The notification alleged that the Department of Labor and Workforce Development was unable to timely provide assistance to callers seeking unemployment assistance. The review determined that the department did not provide timely assistance to callers. An audit finding was taken against the department.

Health—Unqualified Staff

The notification alleged that a doctor allowed an unqualified staff member to treat patients. The review determined that the allegation was true. The department suspended the doctor's license.

Labor—Unemployment Fraud

The notification alleged that an individual had improperly received unemployment benefits. The review determined that the individual had received approximately $7,100 in fraudulent overpayments. The department is pursuing repayment.

Mental Health and Substance Abuse Services—Document Falsification

The notification alleged that a grantee was requiring a service recipient to falsify an application in order to receive grant funds. The review determined that no fraud existed in the program, but serious deficiencies existed in program administration. The grantee was required to enter into a corrective action plan and was subject to additional oversight by the department to ensure the integrity of services.

Mental Health and Substance Abuse Services—Time and Attendance Violation

The notification alleged that an employee was not properly recording work time and attendance. The review determined that the employee had not accurately reported time. The department disciplined the employee as a corrective action.

University of Tennessee—Equipment Misuse by Contractors

The notification alleged that contractors were using university materials, tools, and equipment in violation of their contract. The review determined the allegation to be true, thereby increasing cost to the university and exposing the university to additional liability. Management instructed staff not to provide contractors with tools, equipment, supplies, and materials unless the contract allows them to do so.

Comptroller of the Treasury Fraud Hotline



1-800-232-5454



Notifications can also be submitted at
http://www.comptroller.tn.gov/hotline.

Analysis of Substantive Hotline Notifications
Fiscal Year Ended June 30, 2014

Reviewing Agency	Notifications	Closed	Open
State Government			
Agriculture	3	3	0
Board of Regents	9	7	2
Children's Services	13	13	0
Commerce and Insurance	4	2	2
Comptroller of the Treasury	292	224	68
Correction	9	6	3
Education	1	1	0
Environment and Conservation	3	2	1
Finance and Administration	1	0	1
General Services	2	2	0
Health	12	12	0
Human Resources	3	2	1
Human Services	15	11	4
Intellectual and Developmental Disabilities	5	4	1
Labor and Workforce Development	9	7	2
Mental Health and Substance Abuse Services	14	12	2
Revenue	2	0	2
Safety	5	1	4
TennCare	4	2	2
Tennessee Corrections Institute	1	1	0
Tennessee Housing Development Agency	5	4	1
Tourist Development	1	1	0
Transportation	12	9	3
Treasury	3	3	0
University of Tennessee	5	5	0
Federal Government			
Housing and Urban Development	2	0	2
Total	**435**	**334**	**101**

About the Department of Audit

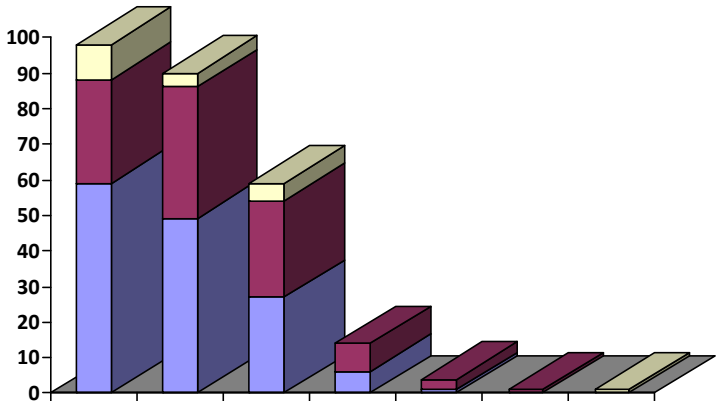
Professional Staff

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 80 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.

As of June 30, 2014, more than 200 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 13,000 hours of training were completed during the fiscal year ended June 30, 2014. The Department of Audit fully supports its staff's active participation in local and national professional organizations, recognizing that these organizations contribute to the staff's continued growth.

Staff Certifications
As of June 30, 2014

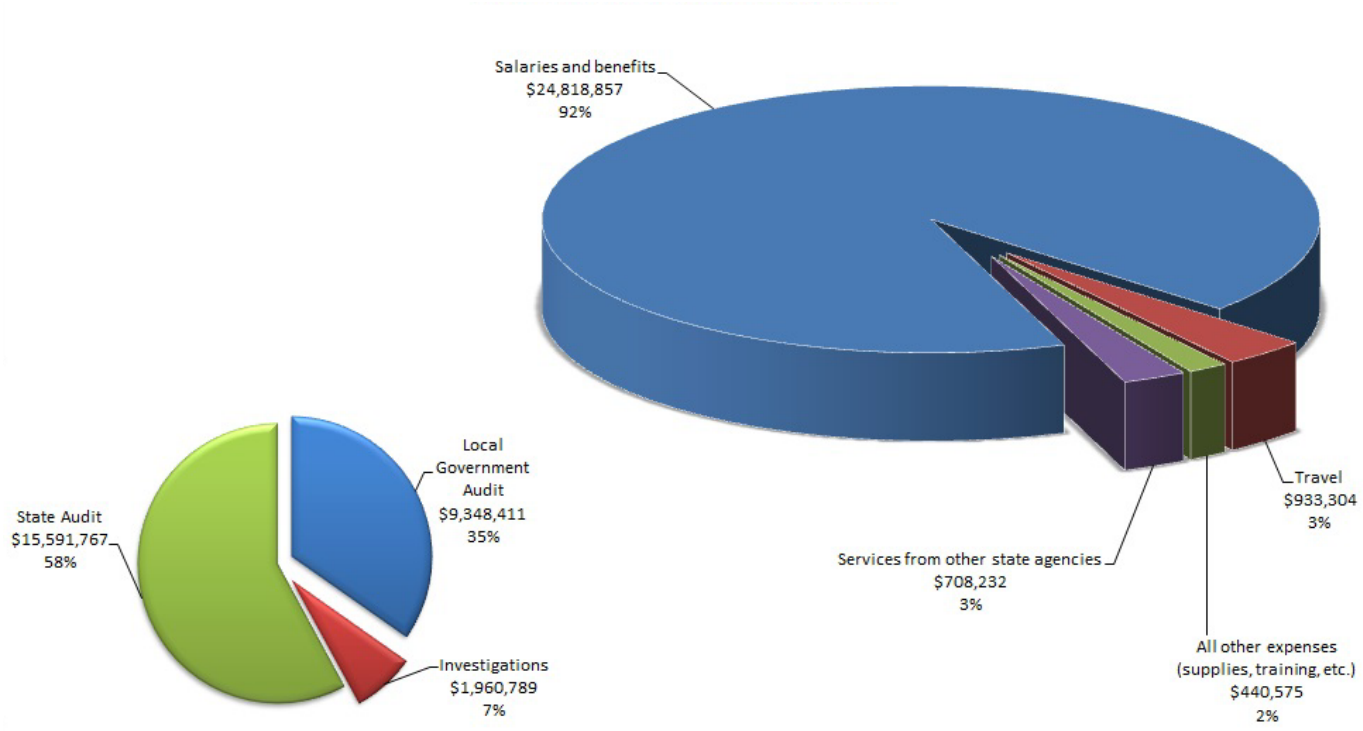


	CFE	CPA	CGFM	CISA	CPS	CIA	RN
F&C Investigations	10	4	5				1
Local Government Audit	29	37	27	8	3	1	
State Audit	59	49	27	6	1		

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

Departmental Expenditures

Fiscal Year 2014



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