AUDIT REPORT

Northeast Community Services Agency

August 2008

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

Arthur A. Hayes, Jr., CPA, JD, CFE
Director

Edward Burr, CPA
Assistant Director

Shirley A. Henry, CPA
Audit Manager

Sam Alzoubi
In-Charge Auditor

Allan Leslie
Staff Auditor

Amy Brack
Editor

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 401-7897

Financial/compliance audits of state departments and agencies are available on-line at www.comptroller.state.tn.us/sa/reports/index.html.
For more information about the Comptroller of the Treasury, please visit our website at www.comptroller.state.tn.us.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

August 12, 2008

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Board of Directors
Northeast Community Services Agency
P. O. Box 2467
Johnson City, Tennessee 37605-2467

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Northeast Community Services Agency (which included the agency formerly known as the East Tennessee Community Services Agency) for the period February 1, 2007, through January 31, 2008.

The review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements resulted in a finding which is detailed in the Objectives, Methodologies, and Conclusions section of this report.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/sah
08/058

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

February 21, 2008

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

Dear Mr. Morgan:

We have conducted a financial and compliance audit of selected programs and activities of the Northeast Community Services Agency (which included the agency formerly known as the East Tennessee Community Services Agency) for the period February 1, 2007, through January 31, 2008.

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. These standards require that we obtain an understanding of internal control significant to the audit objectives and that we design the audit to provide reasonable assurance of the Northeast Community Services Agency's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Northeast Community Services Agency is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

Our audit disclosed a finding which is detailed in the Objectives, Methodologies, and Conclusions section of this report. The agency's management has responded to the audit finding; we have included the response following the finding. We will follow up the audit to examine the application of the procedures instituted because of the audit finding.

We have reported other less significant matters involving the agency's internal control to the Northeast Community Services Agency's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/sah

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit
Northeast Community Services Agency
August 2008

AUDIT SCOPE

We have audited the Northeast Community Services Agency (which included the agency formerly known as the East Tennessee Community Services Agency) for the period February 1, 2007, through January 31, 2008. 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 bank accounts, cash receipts, and expenditures. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

AUDIT FINDING

The Agency's Lack of Control Over the Scott County Probation Program Increased the Risk of Probation Fees Being Stolen and Resulted in Poor Accountability for Cash Receipts, Unsupported and Inaccurate Program Reports, and Possible Noncompliance With the Contract
Several weaknesses were noted in the cash receipting process. Monthly reports prepared by the Program Coordinator were not adequately supported and were not always accurate. We could not determine if contract payments were in compliance with the terms of the contract (page 4).

Financial and Compliance Audit
Northeast Community Services Agency

TABLE OF CONTENTS

Financial and Compliance Audit
Northeast Community Services Agency

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Northeast Community Services Agency. The audit was conducted pursuant to Section 37-5-313, *Tennessee Code Annotated*, which authorizes the Comptroller of the Treasury to "make an annual audit of the program established by this part as part of the comptroller's annual audit pursuant to Section 9-3-211."

BACKGROUND

The Community Services Agency Act of 1996 created the community services agencies. The purpose of these agencies is to coordinate funds and programs designated for care of children and other citizens in the state.

In November 2007, the Commissioner of the Department of Finance and Administration approved the merger between the Northeast Community Services Agency and the East Tennessee Community Services Agency. In January 2008, the combined agencies were named the Northeast Community Services Agency.

The Northeast Community Services Agency serves the following counties: Anderson, Blount, Campbell, Carter, Claiborne, Cocke, Grainger, Greene, Hamblen, Hancock, Hawkins, Jefferson, Johnson, Knox, Loudon, Monroe, Morgan, Roane, Scott, Sevier, Sullivan, Unicoi, Union, and Washington. The agency's administrative offices are in Johnson City and Knoxville, Tennessee.

The governing body of the Northeast Community Services Agency is the board of directors. As of January 31, 2008, the board was composed of 17 members. (See the Appendix.) An executive committee, consisting of the chair, vice chair, secretary, treasurer, and one at-large member, has the authority to act on behalf of the board of directors in the management of the agency's property, affairs, and funds in extraordinary circumstances when the governing board cannot convene.

The agency's programs are carried out by staff under the supervision of the executive director, who was appointed by the Commissioner of the Department of Finance and Administration, subject to the approval of the board.

AUDIT SCOPE

We have audited the Northeast Community Services Agency for the period February 1, 2007, through January 31, 2008. 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 bank accounts, cash receipts, and expenditures. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

BANK ACCOUNTS

Our objectives in reviewing the agency's bank accounts were to determine whether

- duties related to bank accounts were adequately segregated and
- bank reconciliations were performed timely, were properly reviewed, and were accurate.

We reviewed the agency's procedures manual and interviewed key personnel to gain an understanding of the agency's internal controls over bank accounts. We obtained a list of all bank accounts and the bank reconciliations and bank statements. We randomly selected one month's bank reconciliations and agreed book balances to the general ledger, bank balances to the bank statements, and beginning balances to the prior month's ending balances. We also tested the mathematical accuracy of the reconciliations and examined the outstanding check lists and support for deposits in transit and other reconciling items. For all accounts we compared the bank statement receipt dates with the bank reconciliation completion dates and the dates the reconciliations were reviewed.

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

- duties related to bank accounts were adequately segregated and
- bank reconciliations were performed timely, were properly reviewed, and the reconciliations tested were accurate.

CASH RECEIPTS

Our primary objectives in reviewing cash receipts were to determine whether

- cash receipting functions were adequately segregated;
- cash received was deposited to an agency account;
- the agency deposited funds promptly in accordance with policy;
- receipts were posted correctly to the accounting records; and
- amounts collected for the Independent Support Coordination Program equaled the amounts billed and collections were deposited timely and recorded accurately.

We reviewed the agency's procedures manual and interviewed key personnel to gain an understanding of the agency's internal controls over cash receipts. We obtained the cash receipts books and bank statements and examined a random sample of cash receipts to determine if the amounts agreed to the deposit slips and funds were deposited timely. We obtained and reviewed the agency's general ledger to determine if the receipts were posted to the correct account for the correct amount.

We examined the monthly billing statements for the Independent Support Coordination Program and agreed the amounts to the LGIP remittance advices, which showed the transfer of funds to the agency's LGIP account.

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

- cash receipting functions were adequately segregated, except as noted in the finding;
- cash recorded as received was deposited to an agency account;
- the agency promptly deposited funds in accordance with policy, except as noted in the finding;
- receipts were posted to the correct account for the correct amount; and
- amounts collected for the Independent Support Coordination Program equaled the amounts billed and collections were deposited timely and recorded accurately.

<u>The agency's lack of control over the Scott County Probation Program increased the risk of probation fees being stolen and resulted in poor accountability for cash receipts, unsupported and inaccurate program reports, and possible noncompliance with the contract</u>

Finding

The East Tennessee Community Services Agency and the Northeast Community Services Agency merged in January 2008 and retained the name of Northeast Community Services Agency. In April 2006, the agency formerly known as the East Tennessee Community Services Agency entered into a contract with Scott County to administer the county's Probation Program. The contract was renewed in 2007 and is currently effective through June 30, 2008. Through our discussions with management and staff and review of documentation, we determined that the Northeast Community Services Agency lacked control over the administration of the program. The agency's lack of control increased the risk of probation fees being stolen and resulted in poor accountability for cash receipts, unsupported and inaccurate program reports, and possible noncompliance with the contract.

The individuals on probation were required by the court to pay monthly fees, and the agency required the payments to be in the form of money orders or checks. No cash was to be accepted. The agency's Program Coordinator for the Scott County Probation Program collected the fees, and a portion of the fees was remitted to Scott County. When we reviewed the cash receipting process and examined related documents, we found the following weaknesses:

- There was no segregation of duties or other compensating controls. The Program Coordinator handled all transactions, and no independent reconciliation of fees collected to fees deposited was performed. Except for a visit in January 2008, the agency's top management had not monitored or visited the Scott County location since the date of the initial contract in 2006. Furthermore, the Program Coordinator was solely responsible for telling Scott County how much to bill the agency each month. These practices increased the likelihood of fraud occurring without detection.

- Several money orders or checks were written to the Program Coordinator rather than the East Tennessee Community Services Agency. When we inquired as to why this happened, the Program Coordinator stated that the clients used his business card to see to whom to make the money orders or checks payable. Although the business card had the agency's name on it, the clients sometimes copied the Program Coordinator's name instead of the agency's name. The Executive Director stated that the Program Coordinator had been told not to accept checks or money orders that were not payable to the agency. Based on our subsequent follow-up discussed below, these money orders and checks were deposited in the agency's bank account. However, we could not determine if other checks and money orders were written to the Program Coordinator and never deposited or if cash was ever paid to the Program Coordinator.

- The checks and money orders were not stamped “For Deposit Only” to the agency’s bank account at the time of receipt. Instead, they were stamped by accounting staff at the agency after they had been transported from the Scott County site.

- The checks and money orders were not deposited timely because the Program Coordinator would keep the funds received for several days until someone from the Knoxville office picked them up. The agency’s Policy 4.12 states that “. . . if the total amount collected exceeds $50.00 at any time prior to the scheduled date of deposit, such monies must be deposited within one business day of receipt.” For the items that we tested in the cash receipts sample, the days late ranged from 2 to 18 days.

The Program Coordinator prepared a monthly report of the number of clients and total amount collected, which was titled “Adult Probation Services Statistical Report.” The monthly remittance paid to Scott County was based on the monthly report. We obtained these reports from management at the Knoxville office. The Program Coordinator stated that he had prepared these reports from worksheets which he had maintained, but when we asked management for the supporting worksheets, the Program Coordinator stated that he had deleted the file since no one at the agency told him he needed to keep an old file. The only supporting worksheet we were able to obtain was January 2008. The monthly reports prepared by the Program Coordinator were not reviewed for accuracy by anyone at the agency. We noted some mathematical errors in the reports during our review. These were addition errors on the reports which resulted in the total number of probationers paying fees being overstated on three reports by 5, 3, and 1 and being understated on one report by 44.

Based on the terms of the contract, Scott County was to be compensated at a rate of $5 per fee-paying probation client per month. However, because of the lack of supporting documentation for the information on the monthly reports, we were not able to calculate exactly how much Northeast Community Services Agency should have remitted to Scott County based on the contract requirements. When we compared the amount that was paid with the estimates calculated by us and by the Fiscal Director at Northeast Community Services Agency, the differences ranged from an approximate overpayment of more than $6,000 to an underpayment of less than $1,200. Therefore, we could not determine whether the amount paid to Scott County was in accordance with the contract.

We discussed these issues with the current Executive Director, Fiscal Director, and the agency’s overall Program Coordinator. Management informed us that the Probation Program is currently under evaluation and the decision whether to terminate the contract with Scott County has not been made, pending the result of the evaluation. Also, management informed us that close monitoring of this program’s operation is now in place, and the Scott County location will be frequently visited by management. In addition, management is considering hiring a part-time employee to assist with the collection of fees and mitigate the lack of segregation of duties until the decision is made concerning whether to terminate the contract.

We subsequently met with the Coordinator for the Scott County Program at his work location, and we observed his interactions with two of the clients that came in while we were there. We also made inquiries regarding his handling of the fees that he receives. He stated that he writes prenumbered receipts for all fee payments received. One copy is given to the probationer, one copy remains in his receipt book, and the original is sent to the Knoxville office along with the money that he collected. He also stated that all of the money that he collects is sent to the Knoxville office, but if something happened to the money after it was given to the individual from the Knoxville office he would not be able to tell because he does not reconcile the amounts sent to the Knoxville office with his records and does not receive any documents from the Knoxville office showing how much was received.

We obtained the 14 cash receipt books that covered the period January 2007 through January 2008 from the Coordinator and took them to the Knoxville office to compare the receipts to the deposit records. We selected the sample month of March 2007 to try to reconcile the receipts with the deposits, and when the receipts were not easily traced, we discussed the problem with the Fiscal Specialist 3. She told us that the problem was probably related to the post dating of the cash receipts because the former executive director had instructed the Coordinator at Scott County to post date the cash receipts so it would appear the deposits were timely in accordance with the policy, and some of the receipts dated in March 2007 may have been deposited in February 2007. We noted one instance in our testwork where the cash receipt was dated March 7, 2007, but the deposit was on March 6, 2007. We then requested that the Fiscal Specialist 3 reconcile all of the receipts per the receipt books with the deposits. She stated that after going through all of the receipts for the Scott County program she was able to match all receipts with deposits and that all receipts that were missing in a numerical sequence were found to be voided and left in the receipt book with void duly written on them. We reviewed her reconciliation and found no discrepancies.

The lax procedures described in this finding greatly enhance the opportunity for fraud to occur and go undetected. It should also be noted that the risks described in this finding were not identified and assessed in management's documented risk assessment.

Recommendation

The Executive Director should take the steps necessary to ensure adequate accountability over the daily operation of the Scott County Probation Program. The Executive Director should ensure that the revenue collected at Scott County is properly accounted for, including dating the cash receipt on the appropriate date, and making deposits timely. The greatest risk in this type of transaction is that funds can be received and not receipted, so that they never become part of the funds to be accounted for. Hence, the Executive Director along with the audit committee should consider having someone in the Knoxville office obtain the list of probationers directly from Scott County. A subsidiary ledger of probationers with their payments and outstanding balances could be maintained independently from the one person office in Scott County. Notifications to Scott County officials of payments missed by the probationers could be made by staff at the Knoxville office. The Executive Director or his designee should perform a monthly reconciliation of the amounts collected at Scott County to the amount deposited. The Executive Director or his designee should review the program's monthly reports for accuracy and reconcile them with the Scott County invoices prior to payment and ensure that the payments to Scott County are in compliance with the contract terms.

The Audit Committee should determine why the risks noted in this finding were not identified and assessed in management's documented risk assessment. This risk and any similar risks should be addressed in the next risk assessment performed. The Audit Committee should also reiterate to all of management and staff that falsified accounting records will not be tolerated.

Management's Comment

We concur with the finding and have taken appropriate steps to bring the program into compliance. We are in the process of implementing all of the recommendations and plan to monitor the program very closely to make sure it does not lose money. We have taken the following steps: establishing a depository only account in Scott County, utilizing the new spreadsheet developed by the Fiscal Director, and hiring and training a part-time clerical person to assist with the billing. The Program Director and the Executive Director will be onsite often to monitor this program. If at any point there appears to be an audit compliance issue or financial loss, we will immediately utilize the 60-day termination notice.

EXPENDITURES

Our objectives in reviewing expenditures were to determine whether

- expenditure transactions were properly supported and properly approved;
- the agency's purchasing procedures were followed in the procurement of goods and services;
- travel claim reimbursements were adequately supported, properly approved, and in compliance with the Comprehensive Travel Regulations;
- the agency had developed and implemented adequate policies and procedures over the issuance and use of procurement cards; and
- the agency's plans of operation were properly approved.

We reviewed the agency's procedures manual and interviewed key personnel to gain an understanding of the agency's internal controls over expenditures. We selected a random sample of expenditure transactions and examined supporting documentation and approvals. We also examined the transactions to determine if the agency's purchasing procedures were followed. We selected a random sample of employees' travel claims and all of the Executive Director's travel claims and examined them to determine if the reimbursements for the claims were adequately supported, properly approved, and in compliance with the Comprehensive Travel Regulations.

We obtained and reviewed the agency's policies and procedures for procurement cards to gain an understanding of the controls over purchases involving procurement cards. We obtained the procurement card statements and examined transactions to determine if they were in accordance with the policies and procedures. We obtained and reviewed the agency's plans of operation and amendments to determine if they were properly approved.

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

- expenditure transactions were properly supported and properly approved;
- the agency's purchasing procedures were followed in the procurement of goods and services;
- travel claim reimbursements were adequately supported, properly approved, and in compliance with the Comprehensive Travel Regulations;
- the agency had developed and implemented adequate policies and procedures over the issuance and use of procurement cards; and
- the agency's plans of operation were properly approved.

OBSERVATIONS AND COMMENTS

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

Auditors and management are required to assess the risk of fraud in the operations of the entity. The risk assessment is based on a critical review of operations considering what frauds could be perpetrated in the absence of adequate controls. The auditors' risk assessment is limited to the period during which the audit is conducted and is limited to the transactions that the auditors are able to test during that period. The risk assessment by management is the primary method by which the entity is protected from fraud, waste, and abuse. Since new programs may be established at any time by management or older programs may be discontinued, that assessment is ongoing as part of the daily operations of the entity.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. It is management's responsibility to design, implement, and monitor effective controls in the entity. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditor testing is limited and is usually targeted to test the effectiveness of particular controls. Even if controls appear to be operating effectively during the time of the auditor testing, they may be rendered ineffective the next day by management override or by other circumventions that, if left up to the auditor to detect, will not be noted until the next audit engagement and then only if the auditor tests the same transactions and controls. Furthermore, since staff may be seeking to avoid auditor criticisms, they may comply with the controls during the period that the auditors are on site and revert to ignoring or disregarding the control after the auditors have left the field.

The risk assessments and the actions of management in designing, implementing, and monitoring the controls should be adequately documented to provide an audit trail both for auditors and for management, in the event that there is a change in management or staff, and to maintain a record of areas that are particularly problematic. The assessment and the controls should be reviewed and approved by the head of the entity.

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit*, promulgated by the American Institute of Certified Public Accountants requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.

APPENDIX

NORTHEAST COMMUNITY SERVICES AGENCY

Ray Lyons, Executive Director

BOARD OF DIRECTORS

As of January 31, 2008

Executive Committee
Bobby Larkins, Chairperson
Cleo Reed, Vice Chairperson
George Lowe, Secretary
Carol Kiener, Treasurer
Carolynn Kinser, Member at large

Audit Committee
Carolynn Kinser, Chairperson
Carol Kiener
George Lowe

Other Members of the Board of Directors
Linda Buck
Sherrie Claiborne
Eddie R. Davis
James Gaddis
Paula R. Gibson
Michael Harrison
Leif Jeffers
Brenda Kegley
Anne Phillips
Bobby Renfore
Ann Richardson
Robert A. Webb