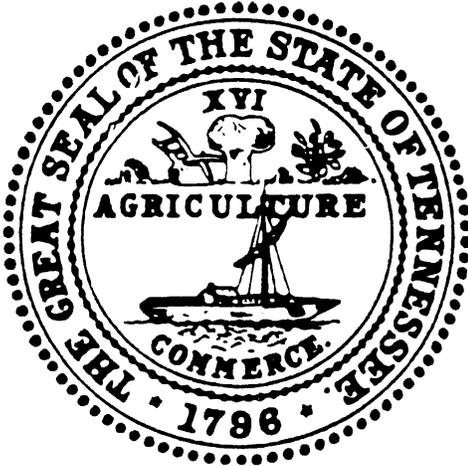


AUDIT REPORT

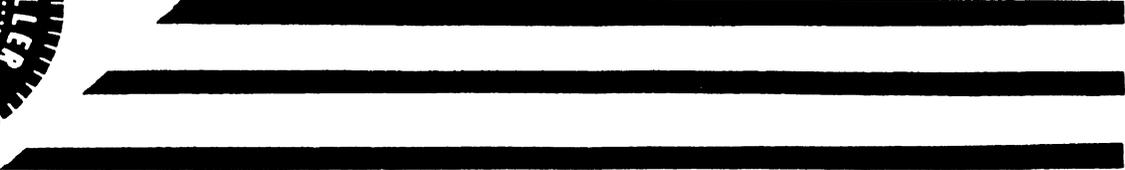
Department of General Services

August 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
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John G. Morgan
Comptroller

August 30, 2007

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and

The Honorable Gwendolyn Sims Davis, Commissioner
Department of General Services
Suite 2400, William R. Snodgrass Tennessee Tower
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Department of General Services for the period May 1, 2004, through August 31, 2006.

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

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/ddb
06/090



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COMPTROLLER OF THE TREASURY
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August 31, 2006

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 Department of General Services for the period May 1, 2004, through August 31, 2006.

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 Department of General Services' compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Department of General Services 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 certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. The department's management has responded to the audit findings; we have included the responses following each finding. We will follow up the audit to examine the application of the procedures instituted because of the audit findings.

We have reported other less significant matters involving the department's internal control and instances of noncompliance to the Department of General Services' management in a separate letter.

Sincerely,

A handwritten signature in black ink, reading "Arthur A. Hayes, Jr." in a cursive style.

Arthur A. Hayes, Jr., CPA
Director

AAH/ddb

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Department of General Services
August 2007

AUDIT SCOPE

We have audited the Department of General Services for the period May 1, 2004, through August 31, 2006. 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 travel expenditures, contracts, payment cards, surplus property inventory, access to state computer systems, 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 approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; participating in the negotiation and procurement of services for the state; and providing support staff to various legislative committees and commissions.

AUDIT FINDINGS

Management of the Department of General Services Did Not Monitor Compliance With Established Internal Control Policies Within the Division of Motor Vehicle Management, Increasing the Risk of Fraud, Waste, and Abuse and Resulting in an Improper Sales Tax Payment of \$127,620

Sales tax was charged on several Fuelman transactions during the period of January 2006 through June 2006. The Director of Motor Vehicle Management, who was responsible for monitoring the Fuelman reports, had not identified these charges as

incorrect, though clearly evident on the Fuelman reports, and had not requested a refund from the Fuelman account. In addition, the fleet maintenance assistant responsible for reviewing discrepancy reports did not follow up on discrepancies identified in the reports (page 5).

The Department Did Not Adequately Restrict Access to the State's Primary Computer Systems, Which Increased the Risk of Fraud and Malicious Mischief

Access to the state's primary computer systems was not always terminated in a

timely manner for former employees (page 17).

The Department Had Not Established and Documented Payment Card Procedures to Follow in Emergency Situations, Trained All Card Holders on the Use of Payment Cards Prior to Use of the Cards, Ensured That Single Purchase and Monthly Dollar Limits Were Not Exceeded, Canceled in a Timely Manner Payment Cards for Some Terminated Employees, Prevented Circumvention of Purchasing Controls, Ensured That Sales Tax Was Not Paid on Purchases, and Caught Split Invoices, Which Increased the Risk of Fraud, Waste, and Abuse

The department did not always follow payment card procedures during emergency situations, nor did the procedures provide for

exceptions during emergency situations; card holders were not always properly trained before using their payment cards; payment card forms were not always revised when changes were made to the cardholders' accounts; payment cards were not always canceled in a timely manner for employees who terminated employment with the department; routine purchases for vehicle maintenance, photography products, janitorial products, and paper products were charged to payment cards and not obtained through the bidding process; payment cards were sometimes used by someone other than the cardholder; sales tax was paid on exempt purchases; and purchases were sometimes split to avoid the \$400 payment card limit (page 9).

Financial and Compliance Audit Department of General Services

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Financial and Compliance Audit Department of General Services

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Department of General Services. 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 mission of the Department of General Services is to provide quality goods and services to all state agencies to facilitate the operation of state government in the most timely, efficient, and economical manner. To accomplish this mission, the department provides a broad range of support services to other departments and agencies of state government. Those services include procurement of equipment and materials, building management and security, motor vehicle and equipment management, surplus property utilization, printing and photographic services, postal services, food services, records management, and central stores.

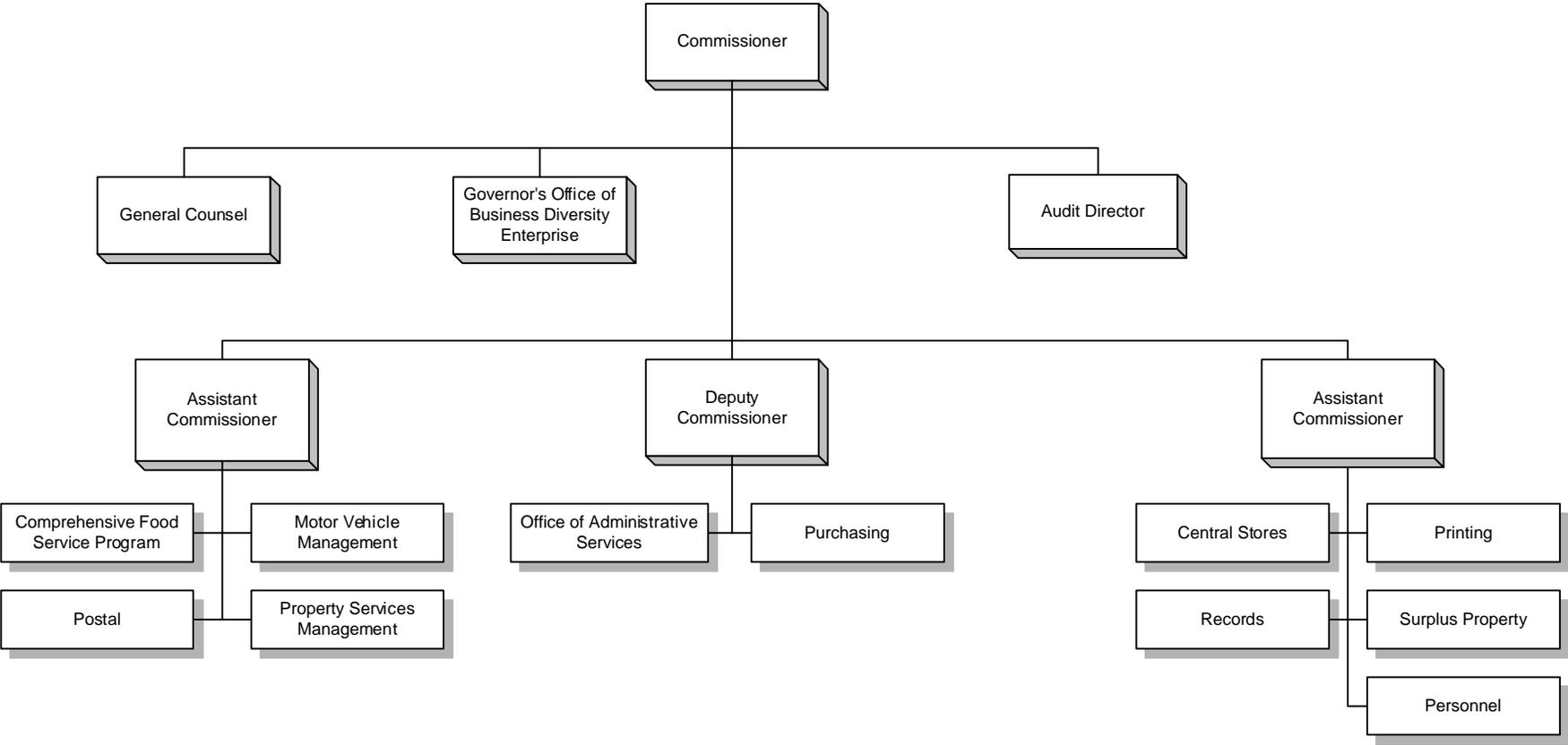
The department comprises four main areas: the Commissioner’s Office, Administrative Services, Property Management, and Purchasing Management. Each area consists of several divisions.

An organization chart of the department is on the following page.

AUDIT SCOPE

We have audited the Department of General Services for the period May 1, 2004, through August 31, 2006. Our audit scope included a review of internal control and compliance with

Department of General Services Organization Chart



laws, regulations, and provisions of contracts or grant agreements in the areas of travel expenditures, contracts, payment cards, surplus property inventory, access to state computer systems, 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 approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; participating in the negotiation and procurement of services for the state; and providing support staff to various legislative committees and commissions.

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Department of General Services filed its report with the Department of Audit on October 5, 2005. A follow-up of all prior audit findings was conducted as part of the current audit.

The current audit disclosed that the Department of General Services has corrected the previous audit findings concerning the lack of documented approval for out-of-state travel; noncompliance with state purchasing rules when obtaining routine automotive services; the need for improved controls over the inventory and sale of surplus property; and the need to limit access to the Tennessee On-Line Purchasing System on a state-wide basis.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

TRAVEL EXPENDITURES

Our objectives in reviewing internal controls and procedures over travel expenditures were to determine whether

- travel claims complied with the Comprehensive Travel Regulations, and
- commissioner travel was in compliance with the Comprehensive Travel Regulations.

To accomplish our objectives, we reviewed the applicable laws and regulations, interviewed key department personnel to gain an understanding of procedures and controls for travel expenditures, and reviewed travel claims and related receipts. We obtained and reviewed a listing of all travel transactions for the audit period. From this listing, we selected the five employees who received the most travel reimbursements as well as the commissioner and tested

their travel claims to determine if the travel claims complied with the Comprehensive Travel Regulations. In addition, we tested a nonstatistical sample of other travel transactions to determine if the charges were reasonable and in compliance with the Comprehensive Travel Regulations.

As a result of our interviews and reviews of travel claims and related receipts, we determined that travel claims complied with the Comprehensive Travel Regulations, including commissioner travel claims.

CONTRACTS

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

- emergency purchase procedures were followed,
- emergency purchases were limited to true emergencies,
- delegated purchase authority contracts were justified and properly approved,
- Fuelman purchasing procedures were followed,
- procedures for sole-source contracts were followed,
- procedures for establishing the supplies contract with Corporate Express were followed, and
- performance by the vendor and the state under the supplies contract was proper.

To accomplish our objectives, we interviewed key department personnel to gain an understanding of procedures and internal controls over contracts. We selected a nonstatistical sample of emergency purchases and reviewed the Tennessee On-Line Purchasing System for documentation of approval and an explanation for emergency purchases to verify that procedures were followed and purchases were limited to true emergencies. We reviewed a nonstatistical sample of delegated purchase authority contracts to determine if the contracts were justified and properly approved. We reviewed Fuelman billings and discrepancy reports and tested a nonstatistical sample of Fuelman purchases to determine if Fuelman purchasing procedures were followed. We also scanned a listing of Fuelman purchases to determine if state sales tax was paid on any of the purchases and, if so, to determine if a credit was requested and received for the amount of the sales tax. We interviewed key department personnel to gain an understanding of the procedures for sole-source contracts and selected a nonstatistical sample to determine whether the procedures for sole-source contracts were followed. We reviewed documentation and inquired of management to determine if procedures for establishing the supplies contract with Corporate Express were followed and if performance by the vendor and the state under the supplies contract was proper.

As a result of our testwork, we determined that emergency purchase procedures were followed and that emergency purchases were limited to true emergencies. We determined that

the delegated purchase authority contracts were justified and properly approved. We determined that the department has not utilized certain control components of the Fuelman credit card and FleetTracker systems. One result was that state sales tax was sometimes charged on Fuelman purchases and departmental employees did not always identify these transactions and request a credit from Fuelman. See finding 1. We determined that procedures for sole-source contracts were followed. We determined that procedures for establishing the supplies contract with Corporate Express were followed and performance by the vendor and the state under the supplies contract was proper.

1. Management of the Department of General Services did not monitor compliance with established internal control policies within the Division of Motor Vehicle Management, increasing the risk of fraud, waste, and abuse and resulting in an improper sales tax payment of \$127,620

Finding

The department has not utilized certain control components of the Fuelman credit card and FleetTracker systems. Fuelman, a fleet fuel management program permits the department to track various transaction information pertaining to motor vehicles. Fuelman tracks fleet fueling and maintenance purchases. The Division of Motor Vehicle Management receives weekly downloads of fuel and maintenance transactions in an electronic format from Fuelman. This data is downloaded into FleetTracker each week. The Director of Motor Vehicle Management can use this data to track and monitor vehicle and driver information to help control the costs of operating the department's fleet of motor vehicles and to identify possible fraud, waste, and abuse for appropriate action.

Our audit disclosed that management had not utilized the capabilities of the Fuelman and FleetTracker systems. Our examination of 25 fuel and maintenance transactions processed through Fuelman found that state and local sales tax was improperly paid on 6 of the 25 transactions (24%). These transactions should have been tax exempt. However, the Director of Motor Vehicle Management, who was responsible for monitoring the Fuelman reports, had not identified these charges as incorrect, though clearly evident on the Fuelman reports, and had not requested a refund from the Fuelman account.

Because of the results of our sample, we held a discussion with Motor Vehicle management personnel and representatives of the Fuelman company and performed further analysis of all fuel transactions data for the six-month period of January 2006 through June 2006. Our analysis identified additional transactions that included sales tax charges. The total amount of sales tax charges that had not been recovered was \$127,620. After our examination, the department requested and received a credit for the above amount.

In addition to our initial examination of 25 Fuelman transactions, we also examined the department's use of certain specialized Fuelman reports. The Division of Motor Vehicle Management runs three special discrepancy reports to monitor purchases made with the Fuelman

card for possible indications of fraud: Report of Fuel Purchases with Incorrect Fuel Grade, Over Capacity Purchases Report, and a Time Fueling Report. The first report, Fuel Purchases with Incorrect Fuel Grade, shows the approved fuel cost versus the actual fuel cost when an individual selects a higher grade of fuel than is recommended for the vehicle. The second report, Over Capacity Purchases, shows purchases of more fuel than the vehicle's fuel capacity. The last report, Time Frame Fueling, shows multiple fuel purchases within a certain time period. The fleet maintenance assistant reviews these reports and sends a letter to each state agency identified in the reports detailing the discrepancy or discrepancies identified in these reports and asking for a response within five days from receipt of the letter explaining why the discrepancy occurred or what corrective action was taken.

Based on our interviews with the fleet maintenance assistant and our reviews of the discrepancy reports and the department's discrepancy letters to state agencies, the fleet maintenance assistant did not follow up on the discrepancies after the initial letter was mailed to ensure that a response was received. We saw no documentation that the fleet maintenance assistant performed any meaningful review of the discrepancies to identify consistent problems by department or operator so that corrective action could be taken. The discrepancy letters were merely filed in a cabinet for two months and then archived.

In addition to the previously mentioned Fuel Grade, Over Capacity, and Time Reports, the FleetTracker system has the potential to further aid in fraud detection. This could be accomplished through an analysis of fuel mileage. However, we found that information in FleetTracker was not complete; thus, Motor Vehicle Management personnel were unable to use FleetTracker to analyze data for unusual trends between usage and vehicle mileage that could indicate possible fraud. Odometer readings recorded in FleetTracker were frequently missing or incorrect. In addition, dispatch personnel did not always verify that the mileage reported in FleetTracker agreed with the vehicle mileage when fleet vehicles were returned. Mileage discrepancies prevent Motor Vehicle Management personnel from calculating accurate vehicle mileage which can then be used to flag unusually low mileage, which could be an indication that fuel purchased is not being used in state vehicles.

By not ensuring that proper internal control procedures are actually in place and functioning as intended, management has increased the risk of

- state employees' misuse of Fuelman cards for personal gain;
- improper payment of taxes from which the state is exempt; and
- improper charges by vendors for fuel or maintenance not received.

Recommendation

The Director of Motor Vehicle Management should ensure that risks related to fuel and maintenance transactions are adequately identified, assessed, and documented in the formal risk assessment of all of the division's activities. The Director of Motor Vehicle Management should ensure that adequate and appropriate internal controls are designed and implemented to mitigate

these risks. There should be adequate documentation linking specific risks with specific controls. For example, the Director of Motor Vehicle Management should ensure that procedures are in place and properly working to ensure the accuracy of information processed and produced by FleetTracker. The Director of Motor Vehicle Management should ensure that dispatch personnel verify that the mileage reported in FleetTracker agrees with the mileage reported when fleet vehicles are returned. The fleet maintenance assistant should follow up on the discrepancy letters to ensure that agencies have taken the proper corrective actions to resolve the discrepancies including identifying potentially fraudulent situations and immediately notifying the Comptroller of the Treasury pursuant to Section 8-19-501, *Tennessee Code Annotated*. The Director of Motor Vehicle Management should further examine fuel transactions both before and after the six-month period ended June 30, 2006, to determine if additional overpayments of sales tax occurred.

Management's Comment

We concur. Proper odometer readings are important to the MVM's operation. The FleetTracker System is dependent on both MVM staff and the vehicle operators to key in the correct odometer readings both at the Fuelman pumps and in the dispatch office. MVM continues to educate its own staff on the importance of reducing keying errors as well as making corrections in a timely manner. Annually, at MVM's agency meetings, all state departments are told of the importance of recording the correct mileage information for billing purposes. Additionally, MVM will be following up with the agency contacts on any errors in mileage that occur on the dispatch vehicles.

Unfortunately, because the odometer readings involve a manual process, errors are going to occur; however, all errors will be corrected when identified. MVM will continue to strive to improve the process of eliminating these mistakes.

The audit disclosed that MVM had not done any follow-up on the fuel purchase discrepancy reports, incorrect fuel grade, over-capacity and multiple purchases after notices had been sent out. MVM has implemented a plan for staff to notify the user agency up to two times for a response. If after the second attempt the agency has still not made contact, the information is turned over to upper management for the final notice on all discrepancy letters. Any situations of suspected abuse are forwarded to Internal Audit for review.

The Division of Motor Vehicle Management (MVM) had been charged state and local sales tax by Fuelman. A system download modification performed by Fuelman had accidentally removed the sales tax block that prevented sales tax from being charged. During the audit the sales tax block was added back to the system which eliminates the risk of any sales tax being charged. Also during the audit, a credit was requested and received for the full amount of sales tax charged. As an additional control, MVM staff is scanning the monthly detailed invoice and backup documentation for any errors including sales tax errors. And finally, before the bill is approved for payment, the MVM Director and Assistant Director review the invoices and documentation before the bill is forwarded to the Office of Administrative Services for payment.

PAYMENT CARDS

Our objectives in reviewing policies and procedures over payment cards were to determine whether

- cardholders were current Department of General Services employees;
- cardholders received proper training prior to use of the card;
- an up-to-date payment card application and maintenance form was on file;
- the cardholder agreement was signed by the employee prior to card use;
- cardholders' privileges were terminated in a timely manner for terminated and suspended employees;
- payment card purchases complied with the purchasing policies and procedures;
- purchases were made from approved vendors;
- purchases were split to circumvent purchasing rules,
- expenditures exceeded the preset daily and monthly dollar limits;
- payment card transactions were reasonable and valid;
- payment card statements were reconciled to the cardholder's transaction log;
- reconciliations were submitted to the central office and the Department of Finance and Administration, Division of Accounts, in a timely manner; and
- an independent review of transactions was performed to determine the propriety of payment card transactions.

To accomplish our objectives, we interviewed key department personnel and reviewed policies and procedures to gain an understanding of the internal controls over the payment cards. We selected a nonstatistical sample of 25 active payment cardholders to determine if the cardholder was a current Department of General Services employee, the cardholder received proper training prior to use of the card, an up-to-date payment card application and maintenance form was on file, and the cardholder agreement was signed by the employee prior to use of the card. We reviewed a listing of terminated and suspended employees to determine whether their cardholder privileges were terminated in a timely manner. We analyzed a listing of payment card transactions from May 1, 2004, through August 4, 2006, to determine if payment card purchases were made from approved vendors and if purchases were split to circumvent purchasing rules. We also used this listing to select a nonstatistical sample of 25 payment card transactions to determine whether the purchases complied with the purchasing policies and procedures; expenditures exceeded the preset daily and monthly dollar limits; payment card transactions were reasonable and valid; payment card statements were reconciled to the cardholder's transaction log; and reconciliations were submitted to the central office and the Department of Finance and Administration, Division of Accounts, in a timely manner. We interviewed the department's payment card coordinator to determine if she was aware of any misuse of cards and whether she

performs an independent review of transactions to determine the propriety of payment card transactions.

As a result of our interviews, reviews of policies and procedures, analysis of payment card transactions, and testwork, we determined that the cardholder agreement was signed by the employee prior to card use; purchases were made from approved vendors; payment card transactions were reasonable and valid; payment card statements were reconciled to the cardholder's transaction log; reconciliations were submitted to the central office and the Department of Finance and Administration, Division of Accounts, in a timely manner; and an independent review of transactions was performed to determine the propriety of payment card transactions. We determined that the department's policies and procedures for payment cards were inadequate, some cardholders were not current Department of General Services employees, cardholders did not always receive proper training prior to the use of the card, up-to-date payment card application and maintenance forms were not on file, cardholder privileges were not terminated in a timely manner for terminated and suspended employees, payment card purchases did not always comply with the purchasing policies and procedures, purchases were sometimes split to circumvent purchasing rules, and expenditures sometimes exceeded the preset daily and monthly dollar limits. See finding 2.

2. **The department had not established and documented payment card procedures to follow in emergency situations, trained all card holders on the use of payment cards prior to use of the cards, ensured that single purchase and monthly dollar limits were not exceeded, canceled in a timely manner payment cards for some terminated employees, prevented circumvention of purchasing controls, ensured that sales tax was not paid on purchases, and caught split invoices, which increased the risk of fraud, waste, and abuse**

Finding

The Department of General Services did not establish adequate internal controls over payment card purchases, nor did departmental personnel comply with existing policies and procedures for payment card purchases. The Department of Finance and Administration implemented the State Payment Card system in March 2002 to provide departmental personnel an alternative payment method for small purchases. A review of the department's purchasing and payment card system revealed the following problems:

Lack of documented procedures for emergency situations

- Based on our inquiries of management, reviews of payment card invoices, reviews of payment card billings, and testwork, we determined that during emergency situations the department did not always follow the payment card procedures required by the *State of Tennessee Payment Card Cardholder Manual*. The department works with the Tennessee Emergency Management Agency (TEMA) during disasters and emergency situations by purchasing needed materials, goods, and supplies to provide

relief. According to the purchasing administrator, as a practical matter, the policies and procedures that govern ordinary purchasing “go out the door” when the Governor issues an Executive Order to provide emergency and disaster relief allowing the department to purchase anything with the payment cards that is deemed “necessary.” However, the manual does not address the use of payment cards or provide for exceptions to the stated policies in case of a disaster or emergency.

Based on our review of all payment card invoices and bank statements, we noted that payment cards were used to pay for travel expenses including hotels, restaurants, and gasoline for both employees and disaster victims. The *State of Tennessee Payment Card Cardholder Manual*, section 4.1, paragraph 4, states that “**NO** Travel Expenses shall be charged to the card. Hotel, restaurant, and other travel related expenses are not to be charged to a State Payment Card.” In addition, departmental personnel used the cards for car repair and maintenance in violation of the *State of Tennessee Payment Card Cardholder Manual*, section 4.1, paragraph 9, which states that “the card is **not** to be used for repairs, maintenance, supplies or any other type charge for any vehicle or equipment belonging to the Department of General Services’ Division of Motor Vehicle Management.”

Management acknowledged that without establishing and implementing adequate policies, procedures, and/or guidelines to follow during an emergency or disaster, the state’s funds would be subject to fraud, waste, and/or abuse. In June 2006, the fiscal director informed us that a committee was created to discuss putting formal, documented emergency policies in place.

We received a copy of a *State Payment Card Exception Request* from the department showing that on November 3, 2005, the Director of Statewide Accounting approved the department’s request for exceptions from September 9, 2005, through November 14, 2005, for certain cardholders who were helping to provide immediate relief to evacuees as a result of Hurricane Katrina. The exceptions increased the single-dollar and cycle-dollar limits and allowed purchases such as food, fuel, lodging, and car rentals. The *State Payment Card Exception Request* states that it represents “follow-up documentation for verbal and email approvals given to [expedite] General Services’ response to Hurrican[e] Katrina.”

Card holders were not always properly trained on the use of payment cards

- During our review of the payment card application forms, maintenance forms, and cardholder agreements for all employees who were issued payment cards, we determined that 4 of 108 employees (4%) did not receive proper training prior to using their payment cards. Three of these employees signed the Cardholder Agreement for State of Tennessee Payment Card issued by U.S. Bank and agreed to the terms of the payment card prior to September 2005. The other employee signed the required forms in January 2006. These employees made several food, fuel, and lodging purchases totaling \$17,481 during September and October 2005, when

disaster relief for Hurricane Katrina was under way, for which they did not provide detailed invoices. An internal memo dated November 30, 2005, and addressed to the fiscal office explained why this occurred by stating:

for those charges relating to TEMA transactions . . . where no detailed invoices were submitted, the ruling in effect at that time of an emergency situation signed by the Governor placed these [employees] on the road with credit cards for the first time. They had not been trained and were not aware that a detailed receipt was needed.

The *State of Tennessee Payment Card Cardholder Manual*, section 2.2, states that “**prior to a Cardholder receiving a State Payment Card, the cardholder must:** • Attend a *Cardholder Training* class by your Agency Coordinator • Read this Cardholder Manual in its entirety • Agree to and sign the *Cardholder Agreement for State of Tennessee Payment Card issued by U.S. Bank.*” In addition, section 5.1 provides additional cardholder responsibilities including explicit requirements to obtain and retain receipts. Cardholders are to “retain receipts for all purchases and VISA charge signature slips for in-person transactions.” Section 5.2 also requires that cardholders “obtain a detailed receipt at the time of purchase.”

Payment card dollar limits were occasionally exceeded

- The State Payment Card Application and Maintenance Forms were not always revised when changes were made to the cardholders’ accounts. The *State of Tennessee Payment Card Cardholder Manual*, section 2.5, states that “Changes to existing State Payment Cards can be made using the *State Payment Card New Account Application & Maintenance Form.* . . . Only a Division Director’s signature is required for changes to Cycle Dollar Limits and Single Purchase Dollar Limits.” An analysis of charges disclosed that the daily and monthly dollar limits as documented on the state payment card application and maintenance forms for 6 of 47 cardholders tested (13%) were occasionally exceeded. Through discussions with the fiscal director, we determined that the cardholders’ limits had been increased by the issuing bank at the request of the department, but the increase and approval were not documented by departmental personnel.

Untimely cancellation of payment cards for terminated employees

- Payment cards were not canceled in a timely manner for employees who terminated employment with the department. We compared a listing of terminated employees during the audit period to a listing of active payment card holders. Based on the comparison, we determined that cardholder privileges were not canceled in a timely manner for 5 of 104 terminated employees (5%). The payment cards had been physically turned in to the fiscal office upon termination. However, card privileges were not canceled until between 6 and 350 days after the employees’ termination dates. The *State of Tennessee Payment Card Cardholder Manual*, section 2.4, states:

A State Payment Card must be cancelled in the event of one of the following conditions:

- separation from the State for any reason
- transfer to another State department or agency
- change in job duties which no longer require the Cardholder to use the card
- intentional misuse/abuse of Card policies and procedures

A Cardholder's approver/supervisor must notify the Agency Coordinator immediately if such an event occurs. The Agency Coordinator can call the U.S. Bank Account Coordinator or request via C.A.R.E. [Customer Automation and Reporting Environment] that a card account be cancelled.

We reviewed the payment card transaction listing to determine if any charges were made to the terminated employees' payment cards. No charges were made to these cards. Without immediately canceling the payment card after an employee's termination, the risk of fraud increases and the state may be liable for unauthorized purchases. Many purchases (on-line, by phone) can be made without presenting the physical card for swiping through a machine.

Circumvention of purchasing controls

- Routine purchases for vehicle maintenance, photography products, janitorial products, and paper products were charged to payment cards and not obtained through the bidding process, in violation of the state purchasing rules. We reviewed a listing of all payment card charges for the period May 2004 through March 2006 totaling \$5,877,277. We identified 17 vendors with total charges of \$750,140 that provided these types of services and regularly exceeded \$2,000 in monthly purchases before July 1, 2005, and/or \$5,000 after July 1, 2005. The Department of General Services' *Agency Purchasing Procedures Manual*, Section 11.6, specifically states:

Statutes authorize Delegated Purchase bid procedures for use by all State agencies to purchase all commodities or services, provided the amount of a single purchase does not exceed \$2,000 [\$5,000 effective July 1, 2005] (Tenn. Code Ann. § 12-3-210) and the commodities or services are not covered by a Statewide or Agency Term Contract. . . . This local purchase authority should not be used for purchases of a **recurring** nature where purchases by the Purchasing Division in a larger volume will result in savings. When the purchase of items of less than \$2,000 [\$5,000 effective July 1, 2005] is foreseen to be repetitive to the extent that total purchases of a specific type of commodity or service will exceed \$2,000 [\$5,000

effective July 1, 2005] for a single calendar month, the using agency should procure the items through the Purchasing Division.

Some purchases should have been made through the statewide contract, and other purchases that were not on the statewide contract should have been bid.

- On at least two occasions, payment cards were used by someone other than the cardholder in violation of the *State of Tennessee Payment Card Cardholder Manual*, Section 4.5, which states, “The State Payment Card is only to be used by the State employee whose name is embossed on the face of the card. The card may not be loaned to or used by any other individual for any reason. . . . Do not provide your card information to a vendor for use on a standing or blanket basis.” The items purchased were food, tools, building materials, and relief supplies totaling approximately \$1,500.

During the Gallatin tornado disaster in 2006, an employee’s payment card number was obtained from a purchase order so that purchases could be made while the employee took a break from a long TEMA shift. The employee had the only TEMA payment card at that time. The employee stated that she did not find out about the charges until she began reconciling the bank statement. She brought this unauthorized charge to the attention of her supervisor. However, no disciplinary action was taken.

In another instance, a vendor kept a payment card number on file and used that number while the employee was on medical leave. Another employee placed an order with the vendor and told the vendor to “handle the purchase like you would for the other employee.” Instead of obtaining new payment card information, the vendor retrieved the other employee’s information and charged the purchase. This was discovered during the reconciliation process. However, no disciplinary action was taken.

Inappropriate payment of sales tax

- The department paid sales tax on purchases that were exempt from sales tax. We tested a nonstatistical sample of 25 charges. We determined that sales tax totaling \$61.68 was paid on 5 of the 25 transactions (20%). Section 67-6-329(a), *Tennessee Code Annotated*, exempts from the collection of sales tax “all sales made to the state of Tennessee or any county or municipality within the state.” These purchases occurred in response to Hurricane Katrina relief and tornado damage within the state.

Split invoices

- Based on a review of the department’s exception reports and testwork performed, we noted that several employees split purchases to avoid the \$400 single purchase card limit. Our examination of these reports disclosed that 50 transactions totaling

\$32,188.13 were split. The *State of Tennessee Payment Card Cardholder Manual*, Section 4.1, paragraph 14, expressly states that “purchases **shall not** be artificially divided so as to appear to be purchases under \$400. Such practice is referred to as a ‘split invoice’ and is specifically prohibited under TCA section 12-3-210.” It should be noted that the single purchase card limit was increased to \$2,000 as of July 1, 2006.

Absent effective internal control, the risk of fraud in payment card transactions is very high. Even when controls are in place, the inherent risk of fraud is great. When established controls are not followed, management and personnel cannot ensure that purchases are necessary, authorized, and in compliance with purchasing policies and procedures. When established controls such as those set forth in the *State of Tennessee Payment Card Cardholder Manual* are circumvented or ignored, the risk of fraud, waste, or abuse is increased. When such abuses are not detected through proper monitoring, the integrity of the control environment is called into question.

Recommendation

The Commissioner should develop and implement payment card procedures to use during disaster and emergency situations. The department’s fiscal and purchasing personnel should provide training to all payment card applicants before payment cards are issued and used. The department’s payment card coordinator should ensure that the State Payment Card Application and Maintenance Forms are updated when changes, including changes in daily and monthly dollar limits, are made to a cardholder’s account. The department’s payment card coordinator should also ensure that payment cards are canceled immediately after an employee terminates employment with the department. The department’s payment card coordinator should review payment card billings to ensure compliance with all requirements and take prompt action should exceptions including, but not limited to, payments in excess of card dollar limits, circumvention of purchasing controls, inappropriate payment of sales tax, or split invoices occur. Payment card holders should be reminded of their responsibility for purchases made on their card and the possibility that they can be held liable for any unauthorized charges.

The Commissioner should ensure that appropriate disciplinary action is taken for employees who fail to follow established guidelines and controls related to the payment card process. This disciplinary action should include holding employees financially liable as authorized by Section 6.0 of the *State of Tennessee Payment Card Cardholder Manual*, which allows the department to hold the supervisor liable for any charges that the supervisor approves for payment which are subsequently determined to be improper. The manual also allows the department to hold the cardholder financially responsible for misuse of the card. Failure to do so could subject the Commissioner to personal liability per Section 12-3-105(c), *Tennessee Code Annotated*, which states:

If any such department, institution or agency, including the department of general services, purchases any supplies, materials, or equipment contrary to the

provisions of this chapter or the rules and regulations made hereunder, the head of such department, institution or agency shall be personally liable for the costs thereof, and if such supplies, materials, or equipment are so unlawfully purchased and paid for out of state moneys, the amount thereof may be recovered in the name of the state in an appropriate action instituted therefor.

The Commissioner should ensure that other risks associated with the payment cards are adequately identified and assessed in management's documented risk assessment. Management should implement effective controls to adequately mitigate those assessed risks and to ensure compliance with applicable requirements and should assign personnel to be responsible for ongoing monitoring of the risks and mitigating controls and take action if deficiencies occur.

Management's Comment

We concur. In August 2005, Hurricane Katrina was the costliest and one of the deadliest hurricanes in the history of the United States. Because of the Governor's Executive Order to provide emergency and disaster relief, General Services worked very closely with the Tennessee Emergency Management Agency (TEMA) to provide much needed materials, goods, and supplies to provide relief for those seeking refuge in the State of Tennessee. Since that time, in response to the need to have documented procedures for emergency situations, the department formed an inter-agency committee with the Department of Finance and Administration, Accounts Division, to establish new policies and procedures for emergency situations. Significant progress has been made and published procedures are anticipated to soon be in place.

All cardholders prior to receiving a payment card are required to attend a training class with the agency coordinator. The class details the cardholder's responsibilities on the use of the card and detailed documentation required for purchases. In addition, the department developed and presented a series of comprehensive training classes for department cardholders detailing the procedures and rules on the use of the card. The classes, which were presented in February 2007, were attended by 129 cardholders. The class was held in conjunction with a class on purchasing methods and the rules, policies, and procedures that are to be adhered to.

The department has performed a comprehensive review of all cardholder's maintenance forms to ensure the card limits agree with the limits listed in the vendor bank's system. In addition, the Payment Card Coordinator is working with each division director and our Human Resource Director to ensure proper and timely notification is received when a cardholder leaves the department. In such cases, the card is cancelled, upon notification, to ensure no charges are made to a terminated employee's card.

We continue to review cardholders' transactions to attempt to ensure that the cardholder is not violating purchasing controls. If such instances are found, the Payment Card Coordinator discusses the situation with the cardholder and division director to reinforce the purchasing rules and regulations. If a second such purchasing violation occurs, the payment card is cancelled.

In recognition of the seriousness of the need to monitor purchasing controls that have been put in place, the department has not only placed an increased emphasis on payment card training, but has increased the level of staffing devoted to administering the payment card program. Cardholders' transactions are reviewed in an attempt to ensure that the cardholder is not paying sales tax or attempting to "split invoices" by artificially dividing purchases.

SURPLUS PROPERTY INVENTORY

We reviewed the department's internal controls over surplus property inventory. Our objectives were to determine whether

- transactions related to GovDeals.com were maintained so revenue was properly recorded,
- inventory records were accurate and updated in a timely manner, and
- surplus inventory was properly monitored by management.

To accomplish our objectives, we interviewed key department personnel to gain an understanding of the internal controls and the policies and procedures over the surplus property inventory. We also interviewed key department personnel to gain an understanding of procedures related to sales through GovDeals.com. We selected a nonstatistical sample of 25 GovDeals.com sales from a listing of sales between January 1, 2005, and June 30, 2006. We reviewed the sales invoice, inventory records on FoxPro, the cash receipts ledger on TRACS, and cash receipts to determine if the items sold were properly removed from the system in a timely manner and if the transactions were properly posted to the accounting records. We obtained a listing of existing surplus inventory items for state property, federal property, and vehicles. From this listing, we selected a nonstatistical sample of 75 items, 25 from each category, to determine if the inventory items could be physically located and if the inventory records were accurate and updated in a timely manner. We interviewed key department personnel to determine if surplus inventory was properly monitored by management.

As a result of our interviews, reviews of policies and procedures, and other testwork, we determined that transactions related to GovDeals.com were maintained so that revenue was properly recorded. We determined that inventory records were adequate and updated in a timely manner. We also determined that surplus inventory was properly monitored by management. At the end of fieldwork, the Division of Property Utilization was updating and implementing new written policies and procedures including monitoring of the various surplus activities.

ACCESS TO STATE COMPUTER SYSTEMS

Our objectives for reviewing the access to state computer systems were to determine whether

- persons with access to the State of Tennessee Accounting and Reporting System (STARS), the Tennessee On-Line Purchasing System (TOPS), and the Property of the State of Tennessee (POST) were current employees;
- the level of access resulted in an adequate segregation of duties; and
- access to STARS, TOPS, and POST was deactivated in a timely manner when employees terminated employment.

To accomplish our objectives, we obtained lists of user access information for STARS, TOPS, and POST. We reviewed the lists to determine if access to the systems was only for current employees and to identify any individuals whose duties were not adequately segregated, who had the ability to initiate payments in STARS and also had the ability to initiate, enter, and approve purchase requisitions; enter and approve purchase orders; record receipt of purchased items; and approve the invoice for payment in TOPS. For any former employees noted, we talked to the assistant commissioner to determine when access was deactivated.

Based on our review, we determined that the level of access resulted in an adequate segregation of duties. However, we determined that persons with access to STARS, TOPS, and POST included former employees whose access to these systems was not deactivated in a timely manner. See finding 3.

3. The department did not adequately restrict access to the state's primary computer systems, which increased the risk of fraud and malicious mischief

Finding

Access to the state's primary computer systems was not always terminated in a timely manner for former employees. The state's primary computer systems include the State of Tennessee Accounting and Reporting System (STARS), the Tennessee On-Line Purchasing System (TOPS), and the Property of the State of Tennessee (POST) system. STARS is used to record all revenues and disbursements as well as processing other accounting entries at various levels of detail; TOPS is used to initiate and process most purchases; and POST is used to record the property of the state.

We obtained a listing of the department's terminated employees and a listing of the department's employees who had access to STARS, TOPS, or POST during the period May 1, 2004, through August 31, 2006. We compared and analyzed the listings and found that some employees continued to have access to the state's primary computer systems (i.e., their user names and passwords were not cancelled) from 2 to 12 months after they left employment with the department. We discovered that one former employee had access to STARS, eight former employees had access to TOPS, three former employees had access to POST, and two former employees had access to both TOPS and POST.

Based on a discussion with all of the assistant commissioners, we determined that

employees of the department's various divisions did not adequately communicate with each other regarding the last date of employment for terminated employees. The personnel director did not always notify the applicable assistant commissioner on an employee's last day with the department so he/she could approve the termination of access to STARS, TOPS, or POST and notify the information technology (IT) personnel to terminate the former employee's access.

If a former employee is allowed continued access to STARS, TOPS, or POST, the risk increases that a disgruntled former employee could compromise the state's financial or purchasing records.

Recommendation

The Commissioner should develop a procedure that provides for better communication between divisions to ensure that system access is immediately denied for all employees who leave employment with the department.

The Commissioner should ensure that risks associated with system access are adequately identified and assessed in management's documented risk assessment. The Commissioner should implement effective controls to adequately mitigate those assessed risks and should assign personnel to be responsible for ongoing monitoring of the risks and mitigating controls and take action if deficiencies occur.

Management's Comment

We concur. If an employee is separated involuntarily (discharged), the General Services Personnel section now known as General Services Human Resources immediately sends a DGS Employee Report to IT Security, John Bissell in Purchasing, and the Payroll Unit in the Office of Administrative Services. Additionally, HR now sends a *weekly* DGS Employee Report update of employee status changes (separations, hires, transfers, promotions/demotions, etc.) to IT Security, John Bissell, and the Payroll Unit.

Once notified that a person is leaving, IT Security uses the RACF ID to determine to what systems the separated employee had access. IT Security then terminates a person's RACF ID which eliminates the employee's access to the mainframe. An e-mail is sent to each system administrator to terminate access. IT Security will also be copying General Services, Office of Administrative Services, on e-mails to terminate access. This will be an added control to ensure that proper communication has been made.

Timely communication from HR to IT Security and to the applicable General Services Divisions should provide better controls so that access to STARS, TOPS, and POST will be terminated for employees leaving General Services employment.

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 department'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 to determine whether they had been properly submitted to the Comptroller of the Treasury and the Department of Finance and Administration.

We determined that the Financial Integrity Act responsibility letters were submitted on time.

OBSERVATIONS AND COMMENTS

INVESTIGATION

The Department of General Services' Office of Internal Audit is investigating allegations of fraud related to employees making personal purchases with state funds.

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 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.

TITLE VI OF THE CIVIL RIGHTS ACT OF 1964

Section 4-21-901, *Tennessee Code Annotated*, requires each state governmental entity subject to the requirements of Title VI of the Civil Rights Act of 1964 to submit an annual Title VI compliance report and implementation plan to the Department of Audit by June 30 each year. The Department of General Services filed its compliance reports and implementation plans on

June 30, 2006; June 30, 2005; and June 30, 2004.

Title VI of the Civil Rights Act of 1964 is a federal law. The act requires all state agencies receiving federal money to develop and implement plans to ensure that no person shall, on the grounds of race, color, or origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal funds. The Tennessee Title VI Compliance Commission is responsible for monitoring and enforcement of Title VI.

APPENDIX

ALLOTMENT CODES

Department of General Services divisions and allotment codes:

- 321.01 Administration
- 321.02 Postal Services
- 321.04 Property Utilization
- 321.06 Motor Vehicle Management
- 321.07 Property Management
- 321.09 Printing
- 321.10 Purchasing
- 321.15 Systems Management
- 321.17 Records Management
- 321.18 Central Stores
- 321.19 Comprehensive Food Services Program
- 501.01 Facilities Revolving Fund – Building Maintenance
- 501.02 Facilities Revolving Fund – Project Maintenance