# AUDIT REPORT

## Office of Legislative Administration

**December 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**
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**John G. Morgan**
**Comptroller**

December 13, 2007

The Honorable Ron Ramsey
Speaker of the Senate
and
The Honorable Jimmy Naifeh
Speaker of the House of Representatives
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Ms. Connie Frederick, Director of Administration
Office of Legislative Administration
War Memorial Building
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Office of Legislative Administration for the period April 1, 2004, through October 31, 2006.

The review of internal control and compliance with laws 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/ah
07/035

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COMPTROLLER OF THE TREASURY
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November 30, 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 Office of Legislative Administration for the period April 1, 2004, through October 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 Office of Legislative Administration's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Office of Legislative Administration 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 office'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 office's internal control and an instance of noncompliance to the Office of Legislative Administration's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/ah

State of Tennessee

# A u d i t   H i g h l i g h t s

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit
**Office of Legislative Administration**
December 2007

## AUDIT SCOPE

We have audited the Office of Legislative Administration for the period April 1, 2004, through October 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 risk assessments, equipment, and expenditures. 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 Office of Legislative Administration Has Not Fulfilled Its Responsibility to Formally Assess the Office's Risks of Fraud, Waste, and Abuse and to Document the Risk Assessment**
Management of the Office of Legislative Administration has not fulfilled its responsibility to formally assess the office's risks of fraud, waste, and abuse, and to document the risk assessment. The risk assessment by management is the primary method by which the entity is protected from fraud, waste, and abuse (page 4).

**As Noted in the Prior Audit, the Office of Legislative Administration Has Not Established Adequate Controls Over Supplies Inventory, Which Not Only Increases the Risk of Fraud, Waste, or Abuse, but Also Increases the Likelihood That Theft of Inventory Items May Occur and Not Be Detected Timely by Management***
The Office of Legislative Administration did not maintain a perpetual inventory system, did not perform regular physical inventories of its supplies, and was unable to properly account for supplies inventory usage (page 7).

* This finding is repeated from the prior audit.

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## INTRODUCTION

### POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Office of Legislative Administration. 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 Office of Legislative Administration processes the expenditures and revenues of the General Assembly and its committees, commissions, and support agencies, except for the Fiscal Review Committee. Legislative Administration is also responsible for human resource issues and staff administration including the Legislative Intern Program.

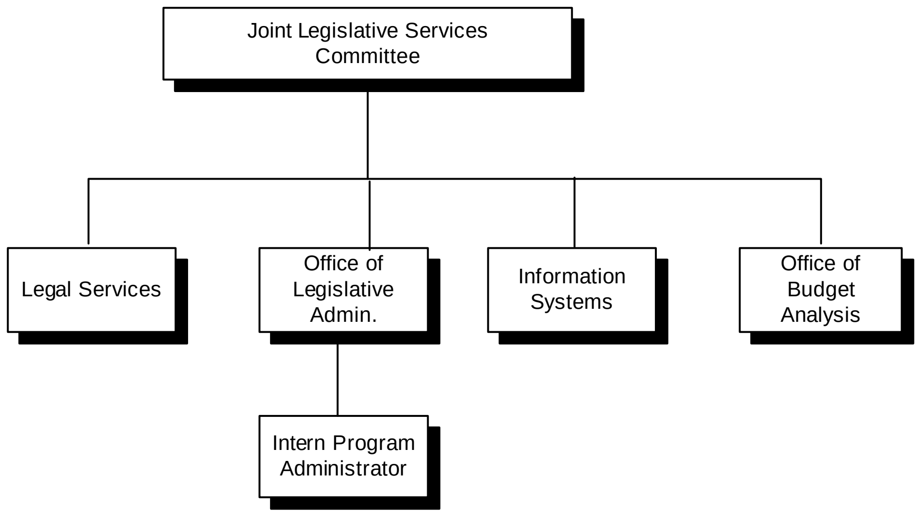
An organization chart of the office is on the following page.

## AUDIT SCOPE

We have audited the Office of Legislative Administration for the period April 1, 2004, through October 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 risk assessments, equipment, and expenditures. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

The Office of Legislative Administration is in the legislative branch of state government. The office has chosen to follow certain executive branch policies and procedures including those prescribed by the Department of Finance and Administration. Tennessee statutes, in addition to

## Office of Legislative Administration
## Organization Chart



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 Office of Legislative Administration filed its report with the Department of Audit on September 15, 2006. A follow-up of all prior audit findings was conducted as part of the current audit.

### RESOLVED AUDIT FINDINGS

The current audit disclosed that the Office of Legislative Administration has corrected previous audit findings concerning

- lack of controls over and lack of proper monitoring of the use of the state's Federal Express account;
- inadequate controls over purchasing; and
- the untimely reporting of lost or stolen equipment to the Comptroller's office.

### REPEATED AUDIT FINDING

The prior audit report also contained a finding concerning inadequate controls over supplies inventory. This finding has not been resolved and is repeated in the applicable section of this report.

## OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

### RISK ASSESSMENTS

The objectives of our testwork were to determine whether risk assessments were performed and documented by management. See the Observations and Comments section of the report on page 11 for further information on management's responsibility for risk assessments.

We interviewed management to gain an understanding of the process used to assess risks. However, based on our interviews, we determined that management had not performed risk assessments, as discussed in finding 1.

**1. <u>Management of the Office of Legislative Administration has not fulfilled its responsibility to formally assess the office's risks of fraud, waste, and abuse and to document the risk assessment</u>**

### Finding

Management of the Office of Legislative Administration has not fulfilled its responsibility to formally assess the office's risks of fraud, waste, and abuse and to document the risk assessment.

The Office of Legislative Administration is an office under the Joint Legislative Services Committee. The other offices under the committee are Legal Services, Information Systems, and Budget Analysis. The Office of Legislative Administration handles the personnel functions of the other offices such as processing new hires, terminations, insurance and benefits, and maintaining personnel files. The Office of Legislative Administration is also responsible for processing the expenditures incurred by the other offices, paying invoices, and processing payroll and travel claims. The Office of Legislative Administration is responsible for its own internal controls; therefore, it is responsible for its own risk assessment.

All organizations, regardless of their size or nature, are vulnerable to fraud, waste, and abuse. And so, in all organizations, management is required by basic tenets of internal control 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 fraud could be perpetrated in the absence of adequate controls. The risk assessment by management is the primary method by which the entity is protected from fraud, waste, and abuse. Consideration should be given to the fact that risks of fraud do not just originate at the beginning or end of an entity's fiscal year. Since the operating environment is dynamic, management's assessment should be an ongoing part of the daily operations of the entity.

Our discussions with management of the Office of Legislative Administration disclosed that they have not fulfilled their responsibility to formally assess the office's risks of fraud, waste, and abuse and to document the risk assessment as of the end of our audit, November 30, 2006. This responsibility is of paramount importance.

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. This too should be an ongoing process.

## Recommendation

Management should conduct regular periodic risk assessments. Each assessment should be well documented, complete, and clear. The process should involve the active participation of staff; however, management is ultimately responsible for the results of the assessment.

The risk assessment should include consideration of the risks of fraud, waste, and abuse related to the Office of Legislative Administration. Management should begin with prior audit findings, ensuring that corrective actions recommended by us have been fully implemented. Management should also think about the general types of problems that can occur, such as conflicts of interest in the procurement processes, overbillings, and theft of funds. The relative materiality of the risks should be considered as well. The results of the risk assessment should be used by management to design appropriate internal controls to mitigate the identified risks. As such, the risks should be prioritized, so that management can focus their initial attention on the greatest risks.

During the next audit, we will review the risk assessment documentation prepared by management. The results of this review will be part of the basis of our conclusions about the control environment of the entity.

## Management's Comment

Management does not concur with this finding. The management of the Office of Legislative Administration reviews all aspects of the performance of individual tasks of staff. While this review is not formally documented in written form, the reviews are performed on an ongoing basis to assure that all tasks performed by individuals within the office are void of fraud, waste, and abuse.

At the time of the closing of the previous audit, there was no mention of failure to formally assess the office's risks of fraud, waste, and abuse or the requirement to document the risk assessments for all upcoming audits. Management does confirm that no formal written documentation has occurred during the audit period; however, there is no requirement in statute or law that states that formal documentation is required. Since this requirement has now been set out by the Office of the Comptroller, the Office of Legislative Administration will prepare the required documentation.

## Auditor's Comment

The finding specifically addresses management's responsibility for risk assessments. Management does not concur with this finding and states that its internal control structure serves as its risk assessment. However, management's control environment is only part of the formal documented risk assessment. Management must first identify the office's risks of fraud, waste, and abuse and then mitigate those risks by establishing the appropriate effective control environment. In addition, management cannot rely on auditors or the requirements in statutes or laws to create or maintain an effective operating environment. Management has sole responsibility to do so. Furthermore, management states that its review of an individual's work is to assure that it is "void of fraud, waste, and abuse." There should always be adequate review of activities, but this review is only one part of a proper internal control environment. It is not possible to effectively review every individual transaction in any organization and such efforts tend to be inefficient. Also, this review alone would not be effective enough to completely eliminate the possibility of fraud, waste, and abuse. This is why risk assessments are so critical.

This audit covers the period April 1, 2004, through October 31, 2006. We provided our draft findings to management on December 12, 2006. We did not receive management's first draft responses until May 30, 2007. We continued to work with management through October 4, 2007, to obtain their final responses to our draft findings.

Recently issued auditing standards require financial statement audit reports to be issued in a more timely fashion. As a timely report is of increasing usefulness to the users of the report, our office will be implementing this standard on our non-financial-statement audits as well. One of the impacts of this implementation is that we will establish a deadline within which management has to respond to any audit findings. Once the deadline has passed, we will publish the audit report with the comments we have received from management or we will note that management failed to respond.

Our next audit of the Office of Legislative Administration will cover the period November 1, 2006, through August 31, 2008, approximately. We will likely begin fieldwork in the summer of 2008. During the next audit, we will determine whether management has taken the corrective actions promised in their responses.

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## EXPENDITURES

Our objective in the area of expenditures was to follow up on the prior audit findings by determining whether

- controls over the expenditures process described by management were adequate;
- corrective actions, as described by management, were taken in regard to the supplies inventory process;
- purchases of goods or services were made by personnel other than the employee requesting the good or service, were documented as received, were properly approved, and were bid, where necessary; and
- Federal Express expenditures were entered into the shipping log, properly classified, and deducted from annual allotments.

We interviewed key personnel to gain an understanding of the procedures used by the office to process expenditures, and we assessed the adequacy of the controls. We also interviewed key personnel and performed observations to ensure that corrective actions, as described by management, were taken in regard to the supplies inventory process. We tested a sample of all expenditures from April 1, 2004, through September 30, 2006, that exceeded $2,500, excluding salaries and benefits, to ensure the purchases of goods or services were made by personnel other than the employee requesting the good or service, were documented as received, were properly approved, and were bid when necessary. We also tested a sample of all Federal Express expenditures from April 1, 2004, through September 30, 2006, that exceeded $10 to ensure they were entered into the shipping log, properly classified, and deducted from annual allotments.

Based on our interviews and testwork, we concluded the following:

- controls over the expenditures process described by management were adequate;
- corrective actions, as described by management, were not taken in regard to the supplies inventory process, as discussed in finding 2;
- purchases of goods or services were made by personnel other than the employee requesting the good or service, were documented as received, were properly approved, and were bid when necessary; and
- Federal Express expenditures were entered into the shipping log, properly classified, and deducted from annual allotments.

**2. As noted in the prior audit, the Office of Legislative Administration has not established adequate controls over supplies inventory, which not only increases the risk of fraud, waste, or abuse, but also increases the likelihood that theft of inventory items may occur and not be detected timely by management**

**Finding**

As noted in the prior audit, the Office of Legislative Administration did not maintain a perpetual inventory system and did not perform regular physical inventories of its supplies. Therefore, the office was unable to properly account for supplies inventory usage.

Discussions with the supply custodian and an evaluation of controls during the current audit disclosed that when supplies are requested by staff or members of the General Assembly, the custodian records each issuance from the supply inventory into a log book that shows a description of the item, the date, the name of the person who picked up the item, and the name of the legislator that the item was for. When the custodian notices that the quantity of a particular item is low, he contacts the procurement officer, when available, who purchases supplies to replenish the supplies inventory.

Management concurred with the prior audit finding and stated that

> . . . the Office of Legislative Administration did not have adequate controls over the supply room and its content. The Director of Legislative Administration has been instructed to purchase a bar code system for the purpose of establishing a perpetual inventory control system and to assign a staff person not assigned any responsibilities for purchasing or distributing supplies to perform a physical inventory of supplies annually. The Director of Legislative Administration has limited staff authorized to distribute supplies. Staff authorized to distribute supplies do not have responsibility for purchasing or conducting the physical inventory.

However, management has not yet accomplished all of the specified actions. In fact, we found that management no longer has adequate segregation of duties relating to the supply inventory process as it had in the previous audit.

In response to the prior finding, the Director purchased a bar code system in October 2006, in order to help with the inventory; however, the system was not yet functioning as of the end of our audit, November 30, 2006. The estimated date of implementation is January 2007.

When we asked why the system had not been purchased sooner, the Director stated that "[the supply custodian] was on a year-long leave of absence, [and she] had no one else to give the assignment to." However, we believe that the procurement process for the system should not have been dependent on the supply custodian. The Director further stated that the aforementioned issues also contributed to the physical inventory not being performed.

Management also stated in the previous audit report that "staff authorized to distribute supplies do not have responsibility for purchasing . . . inventory." However, according to the custodian, when the procurement officer was unavailable, he purchased supply inventory items. Without adequate segregation of these duties, the risk of fraud, waste, or abuse increases.

During the current audit, we observed the contents of the Office of Legislative Administration's supply room and found that the supply inventory included office supply items and various United States and Tennessee flags. The custodian stated that the inventory's estimated value was between $10,000 and $15,000 at any point in time. However, since records were not maintained and an inventory was not performed, we could not substantiate the value.

If management does not maintain a perpetual inventory, maintain adequate segregation of duties in the inventory process, and periodically perform a physical inventory, theft of inventory items may occur and not be detected timely by management, and the risk of fraud, waste, or abuse increases.

**Recommendation**

As recommended in the prior audit, the Director should instruct the custodian to take a physical inventory and should include someone who does not normally work in this area for that endeavor. The Director should follow through with the bar code system and ensure that the perpetual inventory system is established so that the amounts actually on hand can be easily compared to the balance that should be on hand. The Director should ensure that staff perform physical inventories at least once per year and that they compare the inventory results with amounts on the perpetual inventory system. Also, the Director should not allow the custodian to purchase inventory.

The Director should document her risk assessment of the supplies inventory, and she should establish effective controls over inventory to mitigate the identified risks. She should also monitor procedures to ensure the controls are implemented correctly and operating effectively, and she should take corrective action if deficiencies occur. The risk assessments, monitoring, and corrective actions should be ongoing and should not be limited to the specific deficiencies noted in this finding.

The Director should set the proper tone in the organization by taking the actions promised in the prior audit finding on the same subject matter. The Director should stress to staff that they play a critical role in ensuring the effective operation of controls when they are proactive in identifying and correcting such issues before they become findings.

## Management's Comment

Management does concur that the perpetual inventory system had not been fully installed and implemented at the time of the conclusion of this audit. However, management does not concur that adequate controls are not in place. Management does adequately segregate duties so that the ordering of supplies, delivery of supplies, and payment of invoices are all handled separately. Management does not concur with the statement that there is no longer adequate segregation of duties.

The perpetual inventory system was delayed in installation due to the absence of the supply room custodian, who was on a leave of absence for over a year. Management does not concur that the inventory system should have been purchased and installed in the absence of the supply room custodian, whose responsibility it is to maintain and operate the system.

On file in the Office of Legislative Administration is written certification that the perpetual inventory system has been fully installed and is fully operational as directed in the previous audit. This written documentation also reflects that a complete inventory of supplies is accurate and concise to the best of our knowledge.

The function of purchasing items for the supply room has been combined with the supply room custodian's duties due to the retirement of the procurement officer. All supplies are delivered to staff not responsible for ordering supplies so that there is assurance that no items are missing upon delivery. The Director reviews all incoming invoices prior to payment to ensure that actual invoices match the delivery tickets. Staff who do not order supplies check delivery tickets against actual products delivered. The Director confirms that all final invoices match delivery tickets. As a result, fraud, waste, and abuse are avoided.

## Auditor's Comment

Although management does not concur that controls over the supply room are inadequate, we believe our position is well supported. Effective controls over inventory not only include proper segregation of duties, but also include maintaining a perpetual inventory system and performing periodic physical inventories. As noted in our finding, we were unable to substantiate the value of the supplies inventory because these controls did not exist.

As of the end of our current audit, November 30, 2006, the perpetual inventory system had not been implemented, so we cannot substantiate or refute management's claim that "a complete inventory of supplies is accurate." We will follow up on this during our next audit. Also as of the end of our current audit, the procurement officer was still on staff. We will follow up during our next audit to determine whether there are segregation of duties issues regarding the combination of the supply custodian's and procurement officer's job duties.

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## EQUIPMENT

Our primary objective in the area of equipment was to follow up on the prior audit finding and to determine whether

- the procedures described by management to account for and safeguard equipment were adequate;
- access to the Property of the State of Tennessee (POST) system was limited to those individuals whose job duties required it; and
- lost or stolen equipment was properly reported to the Office of the Comptroller and deleted from the POST system.

We interviewed key personnel to gain an understanding of the procedures used to account for and safeguard equipment and then assessed the adequacy of the procedures. We tested access to the POST system to ensure it was limited to those individuals whose job duties required it. We obtained from the office's correspondence to the Comptroller of the Treasury a list of equipment reported as lost or stolen from April 1, 2004, through October 17, 2006, and determined if the equipment was properly reported to the Office of the Comptroller and deleted from the POST system.

Based on our interviews and testwork, we determined that

- the procedures described by management to account for and safeguard equipment were adequate;
- access to the POST system was appropriately limited; and

- lost or stolen equipment was properly reported to the Office of the Comptroller and deleted from the POST system.

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## OBSERVATIONS AND COMMENTS

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### 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.

# APPENDIX

## ALLOTMENT CODES

Office of Legislative Administration allotment codes:

| | |
|---|---|
| 301.01 | General Assembly - Legislative Expenditures |
| 301.07 | House of Representatives |
| 301.08 | State Senate |
| 301.13 | General Assembly Committees |
| 301.16 | General Assembly Support Services |
| 301.17 | Tennessee Code Commission |