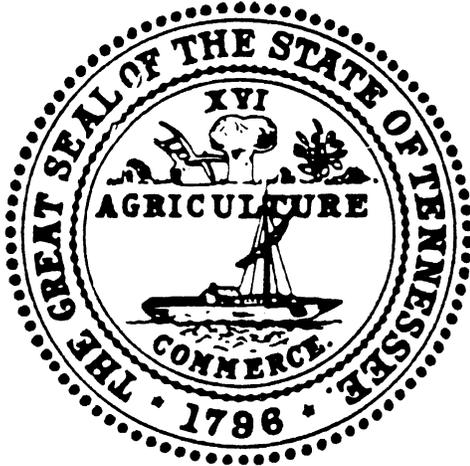


AUDIT REPORT

Department of Human Resources
(Formerly Department of Personnel)

March 2008



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit
Division of State Audit



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

Kandi B. Thomas, CPA, CFE
Assistant Director

Ronald E. Anderson, CPA, CFE
Audit Manager

Herb Kraycirik, CPA
In-Charge Auditor

Nicholas Hudson
LaShanda Mott, CFE
Staff Auditors

Amy Brack
Editor

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

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



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

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

John G. Morgan
Comptroller

March 11, 2008

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

The Honorable Deborah E. Story, Commissioner
Department of Human Resources
First Floor, James K. Polk Building
505 Deaderick Street
Nashville, Tennessee 37243-0635

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Department of Human Resources, formerly the Department of Personnel, for the period March 12, 2004, through March 31, 2007.

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/cj
07/064



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

April 10, 2007

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

Dear Mr. Morgan:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Human Resources, formerly the Department of Personnel, for the period March 12, 2004, through March 31, 2007.

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. These standards require that we obtain an understanding of internal control significant to the audit objectives and that we design the audit to provide reasonable assurance of the Department of Human Resources' compliance with laws, regulations, and provisions of contracts or grant agreements significant to the audit objectives. Management of the Department of Human Resources 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 Human Resources' management in a separate letter.

Sincerely,

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

Arthur A. Hayes, Jr., CPA
Director

AAH/cj

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Department of Human Resources
March 2008

AUDIT SCOPE

We have audited the Department of Human Resources, formerly the Department of Personnel, for the period March 12, 2004, through March 31, 2007. Our audit scope included a review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements in the areas of equipment, contracts, hiring registers, performance evaluations, travel related expenditures, payroll supplementals and differentials, payment cards, 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

The Department Allowed Its Staff to Override Contract Requirements, Resulting in Improper Payments and Negatively Affecting the Control Environment

The department permitted expected attendance at certain training classes to be overstated in order to the make fees being charged by the training contractors agree with the terms of a Delegated Purchase Authority (DPA); approved payments to another contractor without a written agreement; and

approved a payment to another contractor although the required supporting documentation was lacking (page 5).

The Department Did Not Make Timely Employee Performance Evaluations in Violation of Its Own Policies**

The department continues not to comply with its own personnel policies requiring annual employee performance evaluations (page 10).

The Department of Human Resources Has Developed Leave Policies Which Were Not Congruous With State Law and Has Allowed Departments to Circumvent Statutory Limitations On Employee Benefits

The department's rules and the department's policies are conflicting in that the department's

rules require the Commissioner of Human Resources to approve all discretionary leave. However, the department's policies allow discretionary leave of up to 30 days without approval from the Department of Human Resources (page 14).

** This finding is repeated from prior audits.

Financial and Compliance Audit Department of Human Resources

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
Post-Audit Authority	1
Background	1
AUDIT SCOPE	3
PRIOR AUDIT FINDINGS	3
Repeated Audit Finding	3
OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS	4
Equipment	4
Contracts	5
Finding 1– The department allowed its staff to override contract requirements, resulting in improper payments and negatively affecting the control environment	5
Hiring Registers	9
Performance Evaluations	9
Finding 2 – The department did not make timely employee performance evaluations, in violation of its own policies	10
Travel Expenditures	11
Payroll Supplementals and Differentials	12
Payment Cards	13
Discretionary Leave With Pay	13
Finding 3 – The Department of Human Resources has developed leave policies which were not congruous with state law and has allowed departments to circumvent statutory limitations on employee benefits	14

TABLE OF CONTENTS (CONT.)

	<u>Page</u>
Financial Integrity Act	16
OBSERVATIONS AND COMMENTS	17
Management's Responsibility for Risk Assessment	17
Fraud Considerations	17
APPENDIX	18
Allotment Codes	18

Financial and Compliance Audit Department of Human Resources

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Department of Human Resources. 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.”

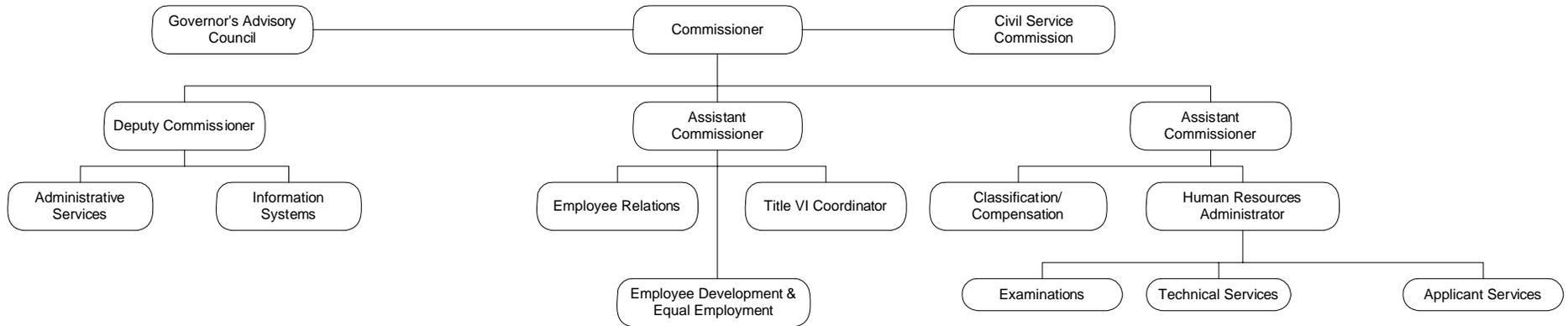
Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

On April 24, 2007, the Department of Personnel changed its name to the Department of Human Resources. The Department of Human Resources is responsible for designing and implementing policies and procedures to effectively and efficiently manage the personnel needs of state government. This department initiates and monitors legislation affecting state employees and government operations relevant to human resource programs. The department advises the Governor on human resource issues, implements the Governor’s Affirmative Action plan and assists in the development of agency Affirmative Action plans, and administers the provisions of the Civil Service Act. The Department of Human Resources also approves, coordinates, and conducts training and career development courses for all state departments and agencies. The department consists of three major functioning areas: Executive Administration, Personnel Development, and Technical Services.

The department is organized into eight divisions: Administrative Services, Information Systems, Employee Relations, Employee Development and Equal Employment Opportunity, Classification/Compensation, Examinations, Technical Services, and Applicant Services. An organization chart of the Department of Human Resources is on the following page.

Department of Human Resources Organization Chart



AUDIT SCOPE

We have audited the Department of Human Resources, formerly the Department of Personnel, for the period March 12, 2004, through March 31, 2007. Our audit scope included a review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements in the areas of equipment, contracts, hiring registers, performance evaluations, travel related expenditures, payroll supplementals and differentials, payment cards, 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 Human Resources filed its report with the Department of Audit on October 14, 2004. A follow-up of the prior audit finding was conducted as part of the current audit.

REPEATED AUDIT FINDING

The prior audit report contained a finding about untimely performance evaluations of department employees. This finding has not been resolved and is repeated in the applicable section of this report.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

EQUIPMENT

The objectives of our audit of the department's equipment were to determine whether

- all equipment assigned to the department was physically inventoried by the end of the most recent fiscal year;
- equipment could be located and had been properly recorded in the Property of the State of Tennessee (POST) system;
- access to the POST system was limited to only those employees whose job duties require it, and the access permitted proper oversight of changes made to the POST system; and
- expenditures charged to equipment in the State of Tennessee Accounting and Reporting System (STARS) during the audit period reconciled to POST additions during the audit period.

We interviewed key personnel to gain an understanding of management's procedures to ensure that equipment was properly accounted for. We reviewed a current listing of all equipment to determine if the physical inventory date for each item was during the most recent fiscal year. From the POST system, we selected all equipment costing at least \$5,000 and 25 other items to determine if the items could be located and whether the equipment information had been properly recorded in POST. We obtained a current listing of all persons with access to POST to determine if access was limited to only those persons whose job duties require it and if the access permitted proper management oversight of changes made to POST. We obtained a listing of all expenditures charged to equipment and compared this listing with POST's list of acquisitions during the same period to determine if the two lists could be reconciled.

As a result of our discussions and testwork we have concluded that

- the department's equipment was physically inventoried by the end of the most recent fiscal year;
- the department's equipment could be located and the related information in the POST system was accurate in all material respects;
- access to the POST system was limited to only those employees whose job duties require it, and the access permitted proper management oversight of changes made to POST; and
- expenditures charged to equipment in STARS reconciled to POST additions during the audit period.

CONTRACTS

The objectives of our review of contracts were to determine whether

- the explanations for sole source contracts were properly approved; and
- sole source contract expenditures were allowable, sufficiently documented, and in the proper amount.

We interviewed key personnel to gain an understanding of management's procedures to ensure that the state's contract regulations were followed. We obtained a listing of sole source contracts approved during the audit period. We also reviewed written explanations as to why these goods or services could only be supplied by one business and determined whether the contracts had been properly approved. We randomly selected 25 transactions from a list of all sole source contract expenditures and determined if the supporting documentation was adequate, the billing amount had been properly calculated, and the contract expenditure documentation was reviewed by someone other than the preparer.

One of the assistant commissioners told us that the attendance at some of the training classes conducted by other contractors had been inflated. We discuss this further in Finding 1. We obtained a complete list of all contract expenditures, not just those that were identified as sole source. We reviewed this listing and selected eight items based on the amount of the expenditure and the name of the vendor; and tested them for the same attributes described above.

Based on our interviews and testwork, we concluded that

- the explanations for sole source contracts were properly approved, and
- the expenditures charged to the sole source contracts and the others tested were not always allowable or sufficiently documented enough to determine if the amount was properly calculated.

1. The department allowed its staff to override contract requirements, resulting in improper payments and negatively affecting the control environment

Finding

We were advised by the Deputy Commissioner that the department's training manager allowed an administrative services assistant to overstate projected attendance at certain training classes in order to make terms of a Delegated Purchase Authority agree with the fees charged by certain training contractors. In addition, the training manager approved a payment to a contractor for training classes not specifically provided for in the contractor's agreement. Finally, the department's information systems consultant approved a payment to a computer applications contractor without required supporting documentation.

Misstatement of Projected Attendance and Rates to Meet Minimum Contractor Fees

The department uses a Delegated Purchase Authority (DPA) to purchase most of its training programs, which allows the department greater discretion in selecting the training contractors. This DPA sets the limit that contractors can be paid based on a per participant per training hour rate, and specifically states that the contractor will be paid “. . . at a rate not to exceed twenty one dollars (\$21.00) per training participant hour.” However, some contractors required a minimum fee in order to conduct a training class. In order to satisfy these contractors’ minimum fees, an administrative services assistant routinely overstated the projected attendance for the classes, thereby violating the DPA and the state’s purchasing regulations. In addition, the administrative services assistant would on a few occasions ignore the \$21 limit and pay the contractor at a rate that would meet the contractors’ minimum fee. In most of the training events that violated the provisions of the DPA, we noted that if there were not enough scheduled participants to satisfy both the maximum DPA rate and the trainer’s minimum fee, the administrative services assistant would calculate the number of participants needed to reach the flat fee total and use that as the number of scheduled participants; even though she was aware that the expected number of attendees would be less.

According to an affidavit from the administrative services assistant, it was her understanding from the training manager that a consultant’s flat fee was to be paid, regardless of the actual number of attendees. The assistant’s interpretation of her supervisor’s guidance was to take the total charge for the sessions and back into the hourly rate, using the training hours and estimating trainees to make sure that the per hour rate per participant did not exceed the maximum rate in the DPA. She further stated that she had shared her calculation method with her supervisor and she had approved it.

The training manager’s affidavit acknowledged that she approved the administrative services assistant’s requests for payment, and that she was aware that sometimes the estimated number of participants was overstated. She stated her objectives were to provide the requested training and pay the flat fee, and she did not believe the ramifications of changing the number of participants was as serious or as prevalent as it turned out to be. It was in late January or early February 2007 when she received a request from another department to train one individual for a specific course that was provided by a flat fee contractor. When reviewing other DPA payments for similar requests, the training manger noticed a case of significant overstatement of participants. She discussed the matter with the Deputy Commissioner, who, in turn, discussed it with the Commissioner. Additional training requests and payments were reviewed for similar overstatements of participants. The Deputy Commissioner reported the matter to the auditors in February 2007.

Our review found that expenditures charged to the Delegated Purchase Authority during the audit period totaled \$268,538.04, of which a total of \$59,091.98 was paid for training costs that did not comply with the terms of the DPA. In fact, we found that payments to one contractor accounted for 77% of the expenditures in which the training manager allowed staff to ignore the terms of the DPA. We also found that the usual class size for this contractor’s class was eight, but through most of the audit period, a class size of at least 12 was needed in order for the

contractor's flat fee not to exceed the DPA limitations. Sometimes classes were scheduled only a few days apart, even when the contractor was providing the training to the same department. Deliberately falsifying attendance records in order to facilitate contractor payments undermines the integrity of the department's control environment and sets the tone for staff that rules, regulations, and controls are not important. A lack of the proper tone at the top, increases the risk that fraud, waste, or abuse related to attendance recordkeeping, reporting an artificially understated training cost per participant hour, and overstating the extent of training provided could occur and not be detected.

Training Courses Approved Which Were Outside the Scope of the Agreement

Testwork also revealed that the training manager approved payments of \$8,987 to a contractor for two classes which were not provided for in a written agreement with the department. The department had an agreement with the contractor to provide certain continuing education classes for attorneys. Although the payments for the classes were within the overall payment limits of the existing agreement and there were sufficient attendance records and support for the training, the two aforementioned classes provided were not listed in the agreement.

Insufficient Documentation for Payment of Invoices

The department's information systems consultant approved and paid an invoice for \$10,000 from an information technology contractor for the completion of a computer programming project. The Payment Methodology section of the contract reads as follows:

The Contractor shall submit monthly invoices. . . Such invoices shall . . . include the project name and number, the name of each individual, the individual's service title, the number of hours worked, the applicable hourly rate, individual travel expenses, and the total amount due the Contractor for the period invoiced.

The contractor did not include the required information in the invoice. Specifically, the contractor did not list the individuals who worked on the project, the number of hours worked, or the applicable hourly rate. The description section of the invoice read "Rater Coordinator Completion Tool" and then listed the amount billed: \$10,000. Without all required information, the department cannot determine whether the charges are in accordance with the contract provisions.

Allowing the falsification of participant attendance at certain training classes in order to make it appear that contractor payments comply with the terms of a Delegated Purchase Authority, allowing payments for training classes not specifically provided for in the contractor's agreement, and approving contract payments without the contractually required supporting documentation are examples of management's override of established control procedures. Such a control environment increases the risk that fraud will occur and go undetected.

Recommendation

Once discovered, the Commissioner addressed, investigated, and reported the department's noncompliance with the Delegated Purchase Authority's cost limitations. Although her reaction to this matter is commendable, we recommend that she take a more proactive approach toward controls to prevent future instances of noncompliance such as this. The training manager should limit the use of the current Delegated Purchase Authority to only those training events which comply with its limitations. Any other arrangements for training should be made in strict compliance with state procurement regulations. The Commissioner should require that all contract invoices be closely reviewed by the Director of Administrative Services to ensure that the services provided are clearly identified either on the invoice or with other attached documentation and that there is enough information provided by the contractor to determine if the amount of the invoice complies with the terms of the contract. The Commissioner should also direct her staff to begin a formal risk assessment of the entire department. This would include the design and implementation of adequate internal controls, and a system for monitoring compliance with the necessary written policies.

Management should ensure that the risks noted in this finding are adequately identified and assessed in their documented risk assessment activities. Management should identify specific staff to be responsible for the design and implementation of internal controls to adequately mitigate those risks and to prevent and detect exceptions timely. Management should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt action should exceptions occur. All controls and control activities, including monitoring, should be adequately documented.

Management's Comment

We concur. The department identified the misstatement of attendance and rates in the first instance and reported it to the Comptroller's Office. Once it self-reported, the Commissioner took immediate action and ordered an immediate review of all contract payments and rescinded the involved employees' signature and spending authority pending the outcome of the investigation.

Previously, the contract review and approval for payment resided with one person in the program area and, after that one review, the invoice was remitted to the Division of Administrative Services for confirmation of available funding in the contract and payment. Now, the process has been restructured to consist of a three-step approval process which includes the following: (1) an employee in the program area confirms, by initialing the invoice, the services or goods have been provided, the invoice is correct in amount and conforms to the invoicing requirements outlined in the contract, and attendance rosters are attached, when required, to support the invoice; (2) a subsequent review is conducted by the appropriate Assistant Commissioner of all materials relevant to the invoice(s) and only then approved for payment; and (3) a final review is performed by the Division of Administrative Services to ensure compliance

with all contract requirements, necessary documentation and funding availability. Once all these reviews have occurred, the Director of Administrative Services approves the invoice payment.

In addition, all staff involved in any phase of the procurement of and payment for good and/ or services have undergone additional training on the new approval process. Furthermore, the Commissioner has personally emphasized to those involved in the process the importance of full compliance with contract and /or purchasing requirements. These additional steps in the process should eliminate instances where payments are made outside the scope of a contract or are made with insufficient documentation as well as correcting the self-reported instance noted above.

HIRING REGISTERS

One of the department's responsibilities is providing other state departments and agencies with lists, or registers, of applicants qualified for career service jobs. The lists are arranged with the most qualified applicant shown first. Some jobs require the applicants to take a skills test. Others evaluate the applicants based on education and experience. The focus of this audit was on those jobs in which the applicants are rated based on education and experience.

The objective of this review was to determine whether education and experience points were calculated in compliance with the department's established policies.

We interviewed key personnel to gain an understanding of management's procedures to ensure that the department's established policies are followed. We obtained a current register for an accountant 3 position and the applications for the 10 applicants with the most points. Using the information on the applications, we recalculated the number of points assigned to each and determined if the points shown on the register were properly calculated.

Based on our interviews and testwork we concluded that education and experience points are being calculated in compliance with the department's established policies.

PERFORMANCE EVALUATIONS

The objective of the review of performance evaluations was to determine whether departmental staff received timely performance evaluations.

We interviewed key personnel to gain an understanding of management's procedures to ensure that employee performance evaluations were made timely. Career service employees are required to have annual performance evaluations. From a current list of all active career employees we selected a sample of 25 career service employees with at least one year's service and determined if they received a timely evaluation.

As a result of our interviews and testwork we concluded that departmental staff did not always receive timely performance evaluations. We discuss this problem further in Finding 2.

2. The department did not make timely employee performance evaluations, in violation of its own policies

Finding

For the third consecutive audit, the department failed to follow its own policies about performance evaluations of career service employees. Page 17 of the employee orientation handbook states the following: “A formal written evaluation of the performance of major job duties and responsibilities for all career service employees will be conducted at the end of probationary periods and on an annual basis thereafter.”

We selected a sample of 25 career service employees with at least one year of service and found that eight (32%) employees were not evaluated between 13 months to 24 months, with the average time between evaluations of 17.4 months. Although this is an improvement from the last audit, it is clearly not in compliance with the department’s policy.

Management concurred with the prior finding and stated that they were using a performance evaluation tracking system to monitor performance evaluations. In the audit follow-up memo from the Commissioner of the Department of Human Resources to the Director of State Audit, dated October 13, 2004, the Commissioner stated that the Deputy Commissioner, Assistant Commissioner, and division directors had been provided with monthly reports on the status of performance evaluations. At each monthly executive staff meeting, division directors were expected to report on the status of performance evaluations in their division. In spite of these assurances, the problem remains.

The *Rules of Tennessee Department of Personnel*, Chapter 1120-5-01, “Job Performance Planning and Evaluation,” states that the purpose of the job performance evaluation is “to promote employee development, enhance employee productivity, serve as a basis for sound personnel decisions, and provide a permanent record of the performance of major duties and responsibilities for employees in the State service.” In order to properly motivate employees, the department needs to give employees timely evaluations.

Recommendation

Of all the departments in state government, this department should be committed to timely employee evaluations and should set an example of full compliance with evaluation policies. The Commissioner should determine why prior efforts to address this repeat finding have failed and to take remedial action. She should also direct the Assistant Commissioners to begin an immediate review of the personnel files of all career service employees with at least one year of service. Those who have not received a performance evaluation in more than one year

should be given one immediately. The Commissioner should then appoint someone to provide her with a monthly report of those employees whose annual evaluations are due that month along with the name of the supervisor for each of those employees. Each supervisor would then be expected to complete the evaluation by the end of that month.

Management should ensure that risks such as these are adequately identified and assessed in their documented risk assessment activities. Management should identify specific staff to be responsible for the design and implementation of internal controls to prevent and detect exceptions timely. Management should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and take prompt action should exceptions occur.

Management's Comment

We concur. In light of this finding, the department has taken a very proactive approach to addressing past due performance evaluations. The Commissioner has directed that all supervisors in the department enroll in performance evaluation training. This training will reemphasize the importance of the performance evaluation process for providing feedback and developing employees. Furthermore, the Commissioner has required all supervisors have, as part of their job plans, the processing of performance evaluations prior to the due date for their employees. Failure to complete those performance evaluations on a timely basis will result in appropriate disciplinary action.

The department will continue the process of using the performance evaluation tracking system currently in place. The process requires the Director of Administrative Services to provide monthly notification, by e-mail, of past due PE's to the appropriate Assistant Commissioner (s) and Directors (s). Periodic reminders are sent to the Directors and Assistant Commissioners during the following thirty days to help ensure those past due PE's are completed. If PE's appear on the subsequent report as past due, the Commissioner is notified by e-mail as well as the aforementioned parties. One important enhancement being made will be to include the Commissioner in all notifications. This will ensure she is continually apprised of the status of performance evaluations for Department of Human Resources employees.

The Department has confidence these additional steps will result in all performance evaluations being completed on a timely basis, which has always been our goal. The Department strives to be a model for all agencies to follow in the area of employee development including the performance evaluation process.

TRAVEL EXPENDITURES

The objectives of our review of travel expenditures were to determine whether

- expenditures were in compliance with state policies, and

- advances were made in compliance with the state’s travel policies.

We interviewed key personnel to gain an understanding of management’s procedures to ensure that state travel policies were followed. We obtained a list of all expenditures charged to travel during the audit period. We selected a total of 25 travel expenditures during the audit period and determined if they were reviewed by someone other than the preparer, were adequately supported, and complied with state policies. We found no instances in which the department had paid an employee a travel advance.

Based on our interviews and testwork, we concluded that

- travel expenditures were in compliance with state policies, and
- the department did not pay any travel advances.

PAYROLL SUPPLEMENTALS AND DIFFERENTIALS

Payroll supplementals are salary payments made to employees that could not be incorporated into the regular salary payment made at the end of each pay period. The types of supplementals include longevity pay, payments for accrued leave after a person has left state employment, the first salary payment after a person is hired, and salary adjustments for retroactive raises. Differentials are additional amounts added to an employee’s normal salary; because the requirements of the job are greater than what is normally required of a particular job classification.

The objectives of our review of payroll supplementals and differentials were to determine whether

- payroll supplementals were properly calculated, complied with applicable rules and regulations, and were properly approved; and
- the circumstances which required the payroll differential existed for the payment periods, and the differential was properly calculated and approved.

We interviewed key personnel to gain an understanding of management’s procedures to ensure that rules and regulations pertaining to supplementals and differentials were followed. We obtained a list of all payroll supplementals made during the audit period. We selected the largest longevity supplemental, salary supplemental, annual leave supplemental, the largest supplementals paid to the last two Commissioners, plus 25 additional transactions selected at random. We tested each to determine if it had been reviewed by someone other than the preparer, the amount had been calculated properly, and the supplemental complied with applicable rules and regulations. Management provided a list of the employees who were currently being paid a differential. We tested each to determine if the differential was properly approved and properly calculated, and the circumstances which required the differential existed for the payment periods.

As a result of our interviews and testwork we concluded that

- payroll supplementals were properly calculated, complied with applicable rules and regulations, and were properly approved; and
- the circumstances which required the differential existed for the payment periods, and the differential was properly calculated and approved.

PAYMENT CARDS

The objectives of the review of payment card expenditures were to determine whether

- employees assigned payment cards had job duties which required them, and
- expenditures complied with the Department of Finance and Administration's (F&A) payment card rules.

We interviewed key personnel to gain an understanding of management's procedures to ensure that F&A's payment card rules were followed. We obtained a list of all employees who had been assigned a card during the audit period, and determined if the employees with active cards had job duties that required it and those who no longer had cards had their access revoked as soon as their job duties no longer required it. We selected 27 payment card expenditures made during the audit period, and tested each to determine if the payment card log contained the signature of the cardholder and reviewer, the information on or with the receipt was adequate, and the purchased goods or services were allowable.

As a result of our interviews and testwork we concluded that

- employees assigned payment cards had job duties which required them, and
- expenditures complied with the Department of Finance and Administration's payment card rules.

DISCRETIONARY LEAVE WITH PAY

The objective of our review of the department's rules and policy was to determine whether the department's application of discretionary leave was in compliance with state law.

We obtained and compared provisions of the department's rules and policy on discretionary leave. We also compared the policy's provisions with the legislation cited as the source for the policy's establishment. We also considered the policy's application at various state departments and agencies. We found that the Department of Human Resources has allowed a very liberal application of its policy and, as a result, has permitted appointing authorities and designees the ability to grant up to 30 days additional leave to any and all employees without justification. See Finding 3.

3. The Department of Human Resources has developed leave policies which were not congruous with state law and has allowed departments to circumvent statutory limitations on employee benefits

Finding

Chapter 1120-6.25(3) of the *Rules of the Tennessee Department of Personnel* [Human Resources] state that employees may be granted discretionary leave under the following circumstances:

(3) *Discretionary*. An appointing authority with the approval of the Commissioner may place an employee on leave with pay any time it is considered necessary for the welfare of the employee or the proper operation of the agency.

Chapter 3 of the *Tennessee Department of Human Resources Attendance and Leave Policies and Procedures Manual* states:

Discretionary leave may be for reasons or situations where an employee is removed from normal duties with approval of the appointing authority or other authorized supervisor for a period of thirty (30) calendar days or less when considered necessary for proper operation of the agency or welfare of the employee. Periods of discretionary leave with pay that exceed thirty (30) calendar days must be approved by the Commissioner of the Department of Personnel [Human Resources]. This leave is coded as administrative leave with pay on the attendance and leave record.

The Department of Personnel [Human Resources] cites Section 8-30-215, *Tennessee Code Annotated* as its authority for both the rules and the policies and procedures manual citations.

Section 8-30-215, *Tennessee Code Annotated*, entitled “Rules; mandatory and discretionary provisions,” states:

The rules shall provide for the hours of work, holidays, attendance regulations and leaves of absence in the various classes of positions in the state service. They may contain provisions for annual, sick, and special leaves of absence, with or without pay.

We do not believe that the department’s interpretations of the rule and policy cited above are as restrictive as the legislature intended the “special leaves of absence” to be under Section 8-30-215. We believe the intent of Chapter 3 of Personnel’s [Human Resources] policies and procedures should be to grant management the authority to place an employee on paid leave in unusual circumstances where it is necessary to protect the operations of the employer, the employee, or others. Instead the department’s policy, as it is interpreted by the department, permits all appointing authorities or their designees to grant up to 30 days of additional leave to

any and all employees under their supervision without justification. Furthermore, the department has defended liberal applications of the policy to provide certain employees with additional leave with pay for:

- participation in a now closed Worksite Wellness Program of the Department of Health
- additional sick leave benefits beyond those authorized by TCA, and
- termination of employment, in lieu of severance pay

These occurrences are actually employee benefits which were awarded in addition to and outside of the normal employee leave benefits specifically authorized by legislative action by Title 8, Chapter 50, of *Tennessee Code Annotated*. Furthermore, we do not believe that granting leave under the above circumstances meets the criteria of “being removed from normal duties” as described in the policy. Considering the level of specificity with which Title 8, Chapter 50, of *Tennessee Code Annotated* and the remainder of the department’s policies describe, define, and narrowly interpret attendance and leave provisions, allowing such a liberal use of discretionary leave effectively negates the department’s other regulations and the other provisions in state laws regarding leave benefits.

Furthermore, the department’s rules and the department’s policies are conflicting in that the department’s rules require the commissioner of Human Resources to approve all discretionary leave. However, the department’s policies allow discretionary leave of up to 30 days without approval from the Department of Human Resources. Therefore, the department has conflicting requirements for the authorization and approval of discretionary leave.

Management’s Comment

We concur, in part. While the department believes that enabling statutes give it broad discretion to set leave policies, the department acknowledges that its practices related to administrative leave have been inconsistent with its rule. Accordingly, the department will henceforth adhere to the rule’s requirement that the agency request the commissioner’s approval for any amount of administrative leave with pay. The department will issue a policy to executive branch agencies explaining the revised procedure.

Rebuttal

We disagree with the department’s premise that the special leaves of absence, with or without pay provision referred to in section 8-30-215, *Tennessee Code Annotated*, was intended to enable the department to broadly grant employees leave with pay. As stated above, although the department may believe that Section 8-30-215, *Tennessee Code Annotated* granted it power to establish leaves of absences, it is clear that other provisions of state law were implemented

with the intention to provide a uniform system of attendance and leave provisions statewide and to control the circumstances under which the state provides employee benefits.

As noted in the finding, this practice has resulted in providing select employees with additional benefits and compensation, and was used in such a manner as to circumvent limitations of the other leave benefits provided in *Tennessee Code Annotated*.

We do agree that the department should define in its rules the circumstances which are allowable and unallowable for granting administrative leave in order to mitigate the risk of abuse such as those noted in the finding.

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 submitted to the Comptroller of the Treasury and the Department of Finance and Administration to determine adherence to the submission deadline. We determined that the Financial Integrity Act responsibility letters were submitted on time.

OBSERVATIONS AND COMMENTS

MANAGEMENT’S RESPONSIBILITY FOR RISK ASSESSMENT

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

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

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

FRAUD CONSIDERATIONS

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

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

APPENDIX

ALLOTMENT CODES

- 319.01 Division of Executive Administration
- 319.02 Division of Human Resources Development
- 319.03 Division of Technical Services
- 319.99 Sick Leave Bank