Military Department of Tennessee

For the Years Ended
June 30, 1996, and June 30, 1995

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July 21, 1997

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Major General Jackie D. Wood, Adjutant General
Military Department of Tennessee
3041 Sidco Drive
Nashville, Tennessee 37204

Ladies and Gentlemen:

We have conducted a financial and compliance audit of selected programs and activities of the Military Department of Tennessee for the years ended June 30, 1996, and June 30, 1995.

We conducted our audit in accordance with generally accepted government auditing standards. These standards require that we obtain an understanding of management controls relevant to the audit and that we design the audit to provide reasonable assurance of the Military Department of Tennessee's compliance with the provisions of laws, regulations, contracts, and grants significant to the audit. Management of the Military Department of Tennessee is responsible for establishing and maintaining the internal control structure and for complying with applicable laws and regulations.

Our audit disclosed certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. In addition, two special investigations disclosed certain findings which are detailed in the Special Investigations section of this report. The department's administration has responded to the 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 findings.

We have reported other less significant matters involving the department's internal controls and/or instances of noncompliance to the Military Department of Tennessee's management in a separate letter.

Very truly yours,

W. R. Snodgrass
Comptroller of the Treasury

WRS/cr
97/032

State of Tennessee

Audit Highlights

Comptroller of the Treasury | Division of State Audit

Financial and Compliance Audit
Military Department of Tennessee
For the Years Ended June 30, 1996, and June 30, 1995

AUDIT SCOPE

We have audited the Military Department of Tennessee for the period July 1, 1994, through June 30, 1996. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of internal controls, the Emergency Management–State and Local Assistance program, the Station Commanders' Upkeep and Maintenance Funds, the Active State Duty Payroll, and utilization of the STARS grant module. The audit was conducted in accordance with generally accepted government auditing standards. In addition, two special investigations were conducted by staff of the Division of State Audit regarding misappropriation of equipment and improper purchases.

AUDIT FINDINGS

Inadequate Segregation of Duties**
Duties involving cash-receipting and inventory procedures and access to the State of Tennessee Accounting and Reporting System, the Tennessee On-line Purchasing System, and the State Employee Information System were not adequately segregated (page 4).

Noncompliance With the Financial Integrity Act
For the last two years, the department has not submitted its annual internal control evaluation to the Commissioner of Finance and Administration and the Comptroller of the Treasury (page 6).

Inadequate Controls Over the Station Commanders' Upkeep and Maintenance Funds**
Visits to selected armories and reviews of selected quarterly reports disclosed inadequate segregation of duties and noncompliance with applicable regulations (page 8).

Active State Duty Payroll Documentation Not Maintained*
The files used to calculate the active state duty payroll are not always complete (page 10).

Failure to Utilize Grant Module**
The department has not fully implemented the procedures established by Department of Finance and Administration Policy 20, "Recording of Federal Grant Expenditures and Revenues" (page 12).

SPECIAL INVESTIGATIONS

Misappropriation of Equipment
The former department photographer manipulated the state purchasing system by creating bogus bid abstracts and falsifying invoices to obtain photography equipment which he sold or pawned. The misappropriation is attributable, in part, to weak internal controls. The department's procurement office did not require original invoices to be independently submitted by vendors, and the fiscal office processed copied invoices submitted directly by the photographer for payment without any justification as to why the original invoice was not obtained (page 14). For additional information concerning this matter, refer to the May 1997 Special Report released by this office.

Improper Purchases
The improper action of some department personnel in testing, procuring, and installing four water stabilizers and an emission control device resulted in the inappropriate use of department funds for the modification of equipment. The department allowed the installation of these devices on department equipment without proper authorization and without a written agreement about the test period. In addition, the department's chief of procurement authorized payment for the devices through a Delegated Purchase Authority (DPA) reserved for emergency repairs when, in fact, the devices were accessory items. Furthermore, the department's chief of procurement, with the cooperation of the vendor, split the original $13,080 invoice submitted by the vendor into five separate invoices, each below $5,000, to avoid other purchasing requirements and possible scrutiny of the transaction. As of June 4, 1997, no refund has been made, and the equipment has not been removed (page 17). For additional information concerning this matter, refer to the May 1997 Special Report released by this office.

* This finding is repeated from the prior audit.
** This finding is repeated from prior audits.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

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Audit Report
Military Department of Tennessee
For the Years Ended June 30, 1996, and June 30, 1995

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Military Department of Tennessee
For the Years Ended June 30, 1996, and June 30, 1995

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Military Department of Tennessee. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes 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 Adjutant General is responsible for the administration of the Military Department of Tennessee. The department's three major divisions are outlined below.

Administrative Services

Management Services provides the following state-financed services: preparation and execution of the budget; fiscal and accounting services; management and training of personnel; procurement, inventory control, and issue of supplies, material, and equipment; and management of the various Station Commanders' Upkeep and Maintenance Funds throughout the state. The Bureau of War Records compiles and preserves records of Tennessee war veterans.

The department's Public Affairs Office deals with the news media. Included in the department are the federally oriented sections—United States Property and Fiscal Office, Inspector General, and Support Personnel Military Office—and their federal employees.

Military Defense

Included in this division are the Tennessee Army National Guard and the Tennessee Air National Guard, which are under the direction of an Assistant Adjutant General. Also included is

the Tennessee Defense Force, which is under the direction of the Tennessee Army National Guard. The state, under the provisions of the National Defense Act, is required to furnish armory, office, and storage facilities for the care and safekeeping of materials and equipment furnished by the federal government, and to provide the maintenance and operating costs of these facilities; the Tennessee Army National Guard performs that duty. The Tennessee Air National Guard is responsible for the operation and maintenance of Air National Guard facilities in Nashville, Memphis, Chattanooga, and Alcoa. The Tennessee Defense Force is a voluntary organization that would provide personnel for the armory locations throughout the state in the event the National Guard were placed on active duty.

Emergency Management

The Tennessee Emergency Management Agency is under the administration of the Military Department of Tennessee. The division administers a statewide system of civil preparedness and coordinates the efforts of state departments and local civil defense organizations in emergency and disaster assistance and planning.

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

AUDIT SCOPE

We have audited the Military Department of Tennessee for the period July 1, 1994, through June 30, 1996. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of internal controls, the Emergency Management–State and Local Assistance program, the Station Commanders' Upkeep and Maintenance Funds, the active state duty payroll, and utilization of the STARS grant module. The audit was conducted in accordance with generally accepted government auditing standards. In addition, two special investigations involving the department were conducted by staff of the Division of State Audit. The results of these investigations are discussed in the Special Investigations section of this report and also in separate reports issued by the division in May 1997.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

INTERNAL CONTROLS

Our objectives in reviewing internal controls and procedures focused on determining whether

- the department properly restricts access to the State of Tennessee Accounting and Reporting System (STARS);
- the department properly restricts access to the Tennessee On-Line Purchasing System (TOPS);
- the department properly restricts access to the State Employee Information System (SEIS);
- the department segregates the cash-receipting duties; and
- the department adequately segregates the inventory functions.

We interviewed key department personnel to gain an understanding of the department's procedures and controls related to the above areas. We also reviewed supporting documentation.

While interviewing personnel and reviewing documentation, we found that the controls were either not effectively designed or were not in place. This is discussed further in finding 1.

In addition, we discovered that the department had not submitted its annual internal control evaluation for the last two years. This is discussed further in finding 2.

1. <u>The department does not adequately segregate duties</u>

Finding

As noted in the prior two audits, the department does not adequately segregate duties in the following areas:

a. One employee who can enter data in the State of Tennessee Accounting and Reporting System (STARS) also has approving authority and reconciles the department's records with the STARS monthly accounting reports.

b. Three employees can enter purchase orders and requisitions, approve them, and enter the receipt of the goods or services on the Tennessee On-line Purchasing System (TOPS).

c. Three personnel analysts have the ability to add new employees, change personnel data, change deductions, update payroll records, and enter data on leave and attendance on the State Employee Information System (SEIS). Additionally, one of these personnel analysts can sign the payroll register for the fiscal director.

d. Two employees are able to write receipts, make the deposits, and record the receipts in the accounting records.

e. One individual in the Nashville procurement office serves as both the recordkeeper and custodian of the warehouse. No physical count of this warehouse inventory was conducted at June 30, 1996.

Effective internal controls require that the duties of authorizing transactions, recording transactions, and maintaining assets be separate. The failure to segregate duties significantly increases the potential for errors and irregularities to occur and go undetected. Management concurred with the prior audit finding and stated in its response that procedures had been implemented to segregate and monitor the duties of authorizing transactions, recording transactions, and maintaining assets; however, improvement is still needed.

Recommendation

Management responsible for the areas noted above should take measures for appropriately and adequately segregating the duties of authorizing transactions, recording transactions, and maintaining assets. Access to the STARS, TOPS, and SEIS systems should be reviewed to ensure employees are not performing incompatible functions. Management should also frequently review the activities of the employees carrying out these functions to ensure that the measures are being implemented.

Management's Comment

We concur. Management has taken steps to segregate duties. New signature authorization forms have been completed. Access to the STARS, TOPS, and SEIS systems has been reviewed. Plans are being developed for ongoing review by management.

2. <u>The department did not comply with the Financial Integrity Act</u>

Finding

The Military Department failed to submit an internal control evaluation to the Commissioner of Finance and Administration and the Comptroller of the Treasury for the calendar years ended December 31, 1995, and December 31, 1996.

Tennessee Code Annotated, Section 9-18-104, states:

> (a) By December 31 of each year, the head of each executive agency shall prepare and transmit to the commissioner of finance and administration and the comptroller of the treasury a report which states that:
>
> (1) The agency's systems of internal accounting and administrative control fully comply with the requirements specified in this chapter; or
>
> (2) The agency's systems of internal accounting and administrative control do not fully comply with such requirements.
>
> (b) In the event that the agency's systems do not fully comply with such requirements, the report shall include and identify any material weaknesses in the agency's systems of internal accounting and administrative control and the plans and schedule for correcting such weaknesses.

Recommendation

The Director of Administrative Services should establish a policy requiring each director within the department to complete an annual evaluation and submit it to the Director of Administrative Services in time for the director to evaluate each report and submit a department-wide report by the December 31 deadline.

Management's Comment

We concur. The Director of Administrative Services will establish a policy requiring each director within the department to complete an annual evaluation.

EMERGENCY MANAGEMENT–STATE AND LOCAL ASSISTANCE

Our review of this program focused on determining whether

- expenditures were reasonable and necessary;
- the information on the Federal Financial Status Report and the Federal Cash Transactions Report reconciled to STARS reports;
- federal reports were submitted timely;
- the agreements with the local governments were properly executed;
- payments to the local governments were properly approved;
- the local governments were not paid more than 50% of the total cost of the program; and
- there is evidence that the local governments were monitored for compliance with grant requirements.

We selected a nonstatistical sample of expenditures charged to this grant to examine for proper support and grant compliance. We also selected a sample of local governments for a review of their agreements with the state and payments made to them. No significant deficiencies were noted.

STATION COMMANDERS' UPKEEP AND MAINTENANCE FUNDS

Money received for National Guard armory rentals is deposited into the Station Commanders' funds and used for upkeep and maintenance of armories. The objectives of our review were to determine whether

- the duties involved in the processing of receipts and the payment of expenditures were properly segregated;
- appropriate accounting records were properly maintained;
- quarterly reports were submitted timely with the required information;
- receipts were prepared for all money received and the money was deposited promptly;

- expenditures for goods and services were authorized and allowable;

- contracts were executed for all rentals of the armories; and

- all payments for armory rentals were made in advance.

We selected a sample of armories to visit and a sample of armories for which we only reviewed a quarterly report. For those armories that were visited, we interviewed key personnel to gain an understanding of the armories' procedures. We also reviewed supporting documentation for one quarterly report. For the armories that received a desk review, we reviewed all documentation that was included with one quarterly report. As a result of the interviews and testwork, we discovered that some armories did not adequately segregate the receipting and disbursement duties. Additionally, we found that applicable regulations were not always followed. This is discussed further in finding 3.

3. <u>Controls over the Station Commanders' Upkeep and Maintenance Funds are weak</u>

Finding

As stated in the ten previous audits, the Military Department needs to improve controls over the Station Commanders' Upkeep and Maintenance Funds. During the audit, visits were made to the Chattanooga, Murfreesboro, Columbia, and Nashville Army National Guard sites. Also, selected quarterly reports were reviewed in the central office for the following armories: Brownsville, Dresden, Maryville, Memphis, Ripley, and Union City. The following discrepancies were noted:

a. The Station Commanders at the Dresden, Columbia, and Murfreesboro armories did not submit all quarterly reports timely. *Tennessee Army National Guard Regulation* (TARNGR) 37-5, paragraph 9, states that Station Commanders are to furnish quarterly reports to the Adjutant General before "the last day of the month following the end of each quarter." The Dresden, Columbia, and Murfreesboro reports examined were submitted from four to 11 days late. In addition, the quarterly reports from Union City and Brownsville were not stamped with a receipt date, so it could not be determined if these reports were received timely.

b. The Station Commanders at Brownsville, Columbia, Nashville, and Ripley did not deposit receipts timely as required by *Tennessee Code Annotated*, Section 9-4-301, which states that "it is the duty of every department . . . collecting or receiving state funds . . . to deposit them immediately into the appropriate departmental account." The receipts examined were deposited from one to four days late.

c. The Station Commanders at Columbia and Murfreesboro did not have contracts on file for all armory rentals as required by TARNGR 37-5, paragraph 6a(2).

d. The Station Commanders at Memphis and Chattanooga did not always receive fees in advance for armory rentals as required by TARNGR 37-5, paragraph 6a(2). Fees were received from one to three days after the rentals.

e. The Station Commanders at Chattanooga, Columbia, Murfreesboro, and Nashville have authorized individuals other than the Station Commander and fund custodian to sign checks. TARNGR 37-5, paragraph 5h, states, "All checks should be prepared and then signed by the Station Commander/Fund Custodian."

f. The Station Commanders at Murfreesboro, Columbia, Chattanooga, and Nashville did not properly segregate cash-receipting duties.

    1) The fund custodian at Murfreesboro wrote receipts, signed checks, mailed checks, and reconciled bank statements.

    2) The Station Commander at Columbia approved payments, prepared checks, signed checks, mailed checks, and reconciled bank statements.

    3) The fund custodian at Chattanooga approved payments, prepared checks, signed checks, mailed checks, and reconciled bank statements.

    4) The administrative assistant to the fund custodian at Nashville restrictively endorsed checks, prepared and made deposits, reconciled bank statements, and reconciled receipts to bank statements.

In response to the previous audit finding, management stated that the Division of Management Services would monitor compliance with fund requirements. However, deficiencies remain.

Recommendation

The Assistant Adjutant General of the Army National Guard should initiate an evaluation of each armory's controls over its Upkeep and Maintenance Funds, make any necessary changes, and monitor the armories for compliance. The Assistant Adjutant General should establish procedures at the division level to ensure that quarterly reports comply with TARNGR 37-5.

Management's Comment

We concur. State rule 0930-1-1 will be effective on the 28th day of September 1997. This rule establishes new procedures for the Station Commanders' Upkeep and Maintenance Funds.

ACTIVE STATE DUTY PAYROLL

Our objectives in reviewing the active state duty payroll focused on determining whether

- the withholding amounts agreed to the tax code and the W-4 information on file;
- the gross salary matched the approved salary rate for that rank and years of service;
- all allowances were adequately documented;
- properly prepared time sheets were on file to support the active state duty payroll;
- the pay grade and years of service used to calculate the payroll agreed to the Request for Special Orders and to the person's military file; and
- the person on active state duty did not also receive payment from the federal government for the same period of active duty.

We interviewed key personnel to gain an understanding of the department's procedures and controls. We then selected a sample of payments made during the audit period to determine if the above objectives had been met. We found a significant number of instances in which they were not. The details of this are discussed further in finding 4.

4. Documentation supporting the active state duty payroll is not adequately maintained

Finding

As noted in the prior audit, the Military Department's files used to calculate the active state duty payroll are not always complete. A review of 26 payroll expenditures revealed the following discrepancies:

a. Twelve of the 26 payments tested (46.2%) were not supported by a properly completed time sheet. Seven payments were supported only with a memorandum from the station commander; none of the memos or other related documents were signed by the individual who served the active state duty. Time sheets for two payments did not show the month and year. Time sheets for two other payments were signed by the timekeeper and supervisor but not by the person who served the active state duty. One payment was not supported by a time sheet or any other verification of time spent on duty.

b. For four of 26 payments tested (15.4%), the years of service and pay grade used to calculate pay could not be agreed to the Request for Special Orders. In three of these

cases, no request was on file. For the fourth case, the request did not contain the date of entry into the service.

c. None of the 25 applicable payments tested for Basic Allowance for Quarters were supported by the required DA Form 5960.

d. For 25 of 26 payments tested (96.2%), the support for income tax withholdings (Form W-4) could not be located.

e. For seven of 21 applicable payments tested (33.3%), the filing status used to calculate federal withholding was different than the filing status on hand at the United States Property and Fiscal Office.

Not maintaining accurate and complete payroll information increases the probability that an error or irregularity could occur and go undetected. Management concurred with the prior finding and stated that procedures had been established to maintain and monitor an accurate payroll system with supporting documentation. However, adequate documentation is still not being maintained.

Recommendation

Top management should establish procedures to ensure that the fiscal director and staff maintain a complete file for each person on active state duty. Each file should include a properly completed W-4, DA Form 5960, and time sheets. The fiscal director should ensure that the person who prepares the active state duty payroll does not process payments until all supporting documentation has been received.

Management's Comment

We concur. Management is reducing the amount of state active duty and is requiring that the fiscal director establish proper procedures accounting for active state duty payments.

DEPARTMENT OF FINANCE AND ADMINISTRATION POLICY 20, "RECORDING OF FEDERAL GRANT EXPENDITURES AND REVENUES"

The Department of Finance and Administration Policy 20 requires that state departments whose financial records are maintained on the State of Tennessee Accounting and Reporting System (STARS) fully utilize the STARS grant module to record the receipt and expenditure of all federal funds. Our objectives focused on determining whether

- appropriate grant information was entered into the STARS grant control table upon notification of the grant award, and related revenue and expenditure transactions were coded with the proper grant codes;

- appropriate payroll costs were reallocated to federal programs within 30 days of each month-end using an authorized redistribution method;

- the department made drawdowns at least weekly using the applicable STARS reports;

- an indirect cost recovery plan was negotiated, and indirect costs were included in the drawdowns; and

- the department used the appropriate STARS reports as bases for preparing the Schedule of Federal Financial Assistance and reports submitted to the federal government.

We interviewed key personnel to gain an understanding of the department's procedures and controls concerning Policy 20. We reviewed supporting documentation and tested nonstatistical samples of grant awards, revenue and expenditure transactions, drawdowns, and reports submitted to the federal government. We also reviewed payroll cost reallocations and the Schedule of Federal Financial Assistance. We determined that the department has not fully implemented the procedures established by Policy 20. These problems are discussed in finding 5.

5. <u>The department did not fully utilize the STARS grant module</u>

Finding

As noted in the prior two audits, the Military Department of Tennessee did not comply with the Department of Finance and Administration's Policy, "Recording of Federal Grant Expenditures and Revenues." The Department of Finance and Administration issued Policy 20 in response to the Cash Management Improvement Act of 1990. The policy is designed to establish uniform procedures to "track the exchange of funds between the State and Federal government." Management concurred with the prior finding and indicated it would work with the Cash Management Division of the Department of Finance and Administration to comply with the policy and would then monitor compliance efforts. However, the Military Department has still not fully implemented the procedures established by the policy. The following weaknesses were noted:

a. Of the 179 grants shown on the STARS Grant Status Report (report 829), 169 (94%) did not indicate the amount of the grant award. According to Section 20-02-202, "All grant awards must be recorded at the time that a grant award notification is received from the Federal government."

b. Federal drawdowns were not made utilizing the STARS grant module (report 832).

c. For the Emergency Management–State and Local Assistance program, the department made only five drawdowns of funds during the period October 1, 1995, through June 30, 1996. According to Section 20-02- 204, "All drawdowns must be performed at least weekly."

d. Funds to cover the indirect costs related to the Emergency Management–State and Local Assistance program were not drawn down. The department used all available funds for direct program expenditures. According to Section 20-02-205, "Allowable indirect costs must be recovered through the drawdown process on a timely basis."

e. The STARS Grant Activity Report (report 830) was used as the basis for preparing the Schedule of Federal Financial Assistance for all grants, but 18 of 32 grants tested (56.3%) had either no grant number shown on the STARS 830 report or an erroneous grant number. For four of 32 grants tested (12.5%), the grant number shown on the Schedule of Federal Financial Assistance did not agree with the grant agreement.

Recommendation

The fiscal director should instruct staff to begin utilizing STARS report 832 to calculate federal drawdowns and to enter the grant awards into STARS when the award is received. He should establish procedures to ensure drawdowns are made at least weekly and include the allowable amount of indirect costs. He should then regularly monitor staff performance to ensure the procedures are followed.

Management's Comment

We concur. The department will utilize STARS report 832 or will ask for exception from state procedure.

SPECIAL INVESTIGATIONS

MISAPPROPRIATION OF EQUIPMENT

Our review of the submission of falsified invoices and misappropriation of equipment by the Military Department's official photographer was initiated after an employee of the department's fiscal office discovered an invoice that appeared to have been altered. The purchase related to this invoice was initiated by the photographer. Because of his improper actions, the photographer's employment was terminated on November 4, 1996. Upon further review, the department's fiscal office identified four other invoices apparently altered by the former photogra-

pher. Department staff subsequently notified the Division of State Audit of the apparent falsification of invoices.

Our objectives were to examine photography equipment and supply purchases initiated by the former photographer during the period July 1, 1992, to November 4, 1996; to determine if invoices related to these purchases had been falsified; to determine through interviews and physical examination if photography equipment and supply items had been misappropriated by the former photographer; to identify other state property to which the former photographer had access and to determine whether any additional property items had been misappropriated by him; to refer our findings to the Military Department of Tennessee; and to refer the results of our review to the Office of the State Attorney General; the Office of the District Attorney General, Twentieth Judicial District; and the Federal Bureau of Investigation, Nashville Field Office.

We reviewed preliminary work completed by Department of Finance and Administration's internal auditors and incorporated their findings into our review. We then expanded the scope of our review to include all photography equipment and supplies purchases made during the period July 1, 1992, to November 4, 1996. We interviewed the former photographer and Military Department staff. We reviewed relevant department documentation of purchases and vendor documentation of sales. We also compared the department's inventory records with the results of a physical inventory conducted by Department of Finance and Administration's internal auditors.

6. Falsified invoices were submitted and equipment was misappropriated

Finding

The former photographer of the department admitted manipulating the state's purchasing system by creating bogus bid abstracts and falsifying invoices to obtain photography equipment which he sold or pawned. He stated that when submitting bid abstracts (forms which initiate the purchasing process and which document that purchases were approved and that bids were obtained), he would falsely record photography supply items. He admitted that he actually purchased camera equipment, not the supply items listed on the bid abstract. The former photographer stated that when he received the invoice from the vendor for the camera equipment, he would copy the original invoice, alter the copy to match the bid abstract (indicating that photography supplies were being purchased), and submit the altered invoice for payment. The former photographer stated that he would then sell or pawn the camera equipment in order to pay personal expenses.

The total amount attributed to the former photographer's misappropriation of state equipment through falsified invoices was $2,190.54. After his first interview with us, the former photographer returned three items totaling $1,308.74. As of April 30, 1997, he had not returned the remaining items totaling $881.80.

The former photographer further admitted misappropriating a total of $3,286.25 in state camera equipment from inventory.

When the cost of items misappropriated from inventory was added to the $2,190.54 misappropriated through the falsification of invoices, the documented amount of state equipment apparently misappropriated by the former photographer totaled $5,476.79. After deducting the cost of the items returned, the state's net loss was $4,168.05.

The former photographer also admitted manipulating federal purchasing and inventory systems, in a manner similar to the way he abused the state's purchasing and inventory system, to obtain camera equipment which he sold or pawned to pay personal expenses. A review by the Criminal Investigation Division of the US Department of the Army, Fort Campbell, Kentucky, determined that the former photographer falsified one invoice to obtain Canon camera equipment totaling $2,051.20 and misappropriated five cameras listed on federal inventory records totaling $4,327.10.

The total amount associated with his misappropriation of federal equipment was $6,378.30.

Thus, the combined state and federal documented amount associated with the former photographer's misappropriation of camera equipment and accessories was $11,855.09. After deducting the cost of the items returned, the combined net loss was $10,546.35. His actions violate *Tennessee Code Annotated*, Section 39-14-103, "Theft of Property."

The misappropriation of $11,855.09 is attributable, in part, to weak internal controls. Specifically, the department's procurement office did not require original invoices to be independently submitted by vendors, and the fiscal office processed copied invoices for payment without any justification as to why the original invoice was not obtained. Further, the procurement office did not require the receipt of items purchased to be independently verified by receiving personnel. In addition, the procurement office allowed the deletion of property from property listings without explanations and without signatures from the individuals assigned responsibility for the property items.

The former photographer's employment with the department was terminated effective November 4, 1996, pursuant to Tennessee Department of Personnel Rule 1120-10-.06 (10), "Willful Abuse or Misappropriation of State Funds, Property, or Equipment." As an Executive Service employee, he had no right of appeal. On February 6, 1997, we submitted our findings pertaining to the former photographer's actions to the Office of the State Attorney General; the Office of the District Attorney General, Twentieth Judicial District; and the Federal Bureau of Investigation, Nashville Field Office. As of the date of this report, there was no disposition of any possible actions by those offices.

In a January 31, 1997, memorandum to the Division of State Audit, the department detailed corrective action taken to address four weaknesses in the department's internal control

structure identified by Department of Finance and Administration internal auditors in a November 27, 1996, summary of their review.

According to the memorandum, the department currently (1) prohibits paying from copied invoices; (2) requires vendors to submit invoices to the procurement office; (3) prohibits the deletion of property without signatures from individuals assigned the property; and (4) segregates purchasing duties. These actions appear appropriate, but management must continue to monitor if the controls are being utilized and to determine if later modifications to the controls are needed due to changing circumstances.

Recommendation

Department management should monitor the implementation of corrective actions to ensure that the planned changes in procedures are formally documented, promptly disseminated to staff responsible for the purchasing and equipment inventory functions, and fully complied with. Such monitoring should include periodic examination of bid abstracts, purchase orders, invoices, receiving reports, and equipment inventory. Any indicators of fraud, abuse, or illegal acts, such as document alteration, should be promptly reported by staff to management.

Management's Comment

We concur. Procedures are in place to monitor the implementation of corrective actions.

IMPROPER PURCHASES

Our review of the department's purchases of water stabilizers and an emission control device from Emissions and Stabilizers, Inc., was prompted by an allegation of purchasing improprieties regarding another agency's purchase of the devices from the same vendor.

Our objectives were to determine whether proper purchasing procedures were followed in the testing and procurement of the devices; to examine the department's internal controls over purchases made under Delegated Purchase Authority from Bid (DPA), #4013687, dated September 29, 1995, issued by the Department of General Services; and to report our findings to the Military Department of Tennessee and the Department of General Services and recommend appropriate actions to correct any deficiencies.

We interviewed relevant Military Department and Department of General Services staff. We also interviewed Mr. Steve Dake, President of Emissions and Stabilizers, Inc.

We reviewed Department of General Services purchasing policies and procedures and examined invoices from Emissions and Stabilizers, Inc.; department bid abstract forms; informa-

tion/sales packets from the manufacturer, Emissions Panther, Inc.; and the Delegated Purchase Authority from Bid under which the emission control and water stabilizer devices were purchased. We also reviewed the On-Line purchasing screens on the Tennessee On-Line Purchasing System (TOPS) related to the department's purchase of any of these devices at any department location.

7. The department made inappropriate purchases

Finding

a. The department allowed Emissions and Stabilizers, Inc., to install devices on department equipment without proper authorization and without a written agreement about the test period.

b. The department's Chief of Procurement authorized payment for the devices through a Delegated Purchase Authority (DPA) reserved for emergency repairs when, in fact, the devices were accessory items.

c. The department's Chief of Procurement, with the cooperation of the vendor, split the original $13,080 invoice submitted by the vendor into five separate invoices, each below $5,000, to avoid other purchasing requirements and possible scrutiny of the transaction.

Department of General Services Policies and Procedures Manual, Section 6.8, "Product Testing and Demonstration," states that "in order to ensure proper testing and valid evaluation of test results, vendors are required to obtain prior approval for such test/demonstrations from the Purchasing Division."

Although the vendor had no written authorization from the Department of General Services to perform tests or demonstrations, Military Department employees agreed to the installation because they mistakenly believed that they had authorization to test vendor products. They stated that they were unaware of the Department of General Services policy cited above.

DPA #4013687 is an authority issued by the Department of General Services that allows the Military Department to directly purchase emergency repair items during the period October 1, 1995, through September 30, 1996. The department's Chief of Procurement stated that she understood the vendor's invoice for the devices to pertain to emergency repairs, not equipment accessories. When informed by the auditors that the devices were equipment accessories, not emergency repairs, she stated that if she had known the proper classification of the devices, she would not have approved their purchase under the DPA.

However, the vendor's invoice was submitted to the Chief of Procurement by one of the department's facility managers along with a November 21, 1995, memorandum. This memorandum clearly stated that three devices had already been installed on a test basis. This memorandum

did not indicate in any manner that the devices were emergency repair items. Consequently, the department's Chief of Procurement should have inquired further as to the proper classification of the purchase, and not assumed that the devices were emergency repair items. If she had inquired about the proposed purchase at that point, she would have determined that the devices were additions, not replacement parts, and presumably would not have authorized payment.

On July 23, 1996, the auditors discussed with Mr. George Street , Director of Purchasing, Department of General Services, potential problems with the Military Department's purchase of the water stabilizers and emission control device. Shortly thereafter, at Mr. Street's direction, Purchasing Division staff initiated a review of those purchases. In a memorandum dated August 6, 1996, the General Services reviewer stated that "none of the referenced purchase orders were properly handled by [the] agency or in compliance with purchasing procedures." According to Mr. Street, since these purchases were initiated under a DPA, his department had assigned the responsibility for "emergency repair" purchases to the Military Department and thus would not have reviewed such purchases prior to their payment. Mr. Street stated that such purchases are subject to examination by his staff through special review.

According to Mr. Street, the devices should have been submitted to his division for testing, not to the Military Department, and the purchase of the devices should have been effected through the competitive bid process, not a DPA for emergency repairs. Furthermore, Mr. Street stated that such invoice splitting directly violated Department of General Services purchasing policies and procedures.

Staff of the Division of State Audit contacted management of the Military Department on May 10, 1996, to obtain an explanation for the weaknesses in the internal controls which failed to prevent these purchases. After department staff reviewed the matter, they concurred that appropriate procurement procedures had not been followed and that the internal controls needed to be strengthened. On June 4, 1996, the department requested that Emissions and Stabilizers, Inc., refund the $13,080 and remove its equipment. As of June 30, 1997, no refund has been made, and the equipment has not been removed.

On July 26, 1996, the Adjutant General issued a memorandum to department management outlining the appropriate internal control procedures for non-routine purchases and the testing of new equipment. These corrective procedures, if properly followed, should help to ensure that similar transactions are approved by top management in the future and that department personnel comply with policies and procedures. Also, on May 20, 1997, a verbal reprimand was issued to the department's Chief of Procurement.

Recommendation

Upper management should ensure that all individuals involved in the purchasing function receive adequate training on purchasing procedures and ensure compliance with these procedures. Questions regarding purchasing policies and procedures should be directed to the Department of General Services, Purchasing Division, for clarification.

Upper management should also consider appropriate disciplinary actions against the individuals who purchased, approved, or allowed the installation of the water stabilizers and the emission control device contrary to purchasing policies and procedures.

The department should pursue appropriate legal action regarding refunds requested but not received from Emission and Stabilizers, Inc., for the water stabilizers and emission control device installed on a trial basis.

The department should review the feasibility of removing the devices from its equipment and returning the devices to the vendor.

Management's Comment

We concur.

a. Upper management has required that all personnel dealing with purchasing go through a review course.

b. Appropriate action has been taken against individuals involved.

c. Appropriate legal action will be pursued by the department.

d. Department has reviewed the feasibility of removing the devices.

PRIOR AUDIT FINDINGS

Section 8-4-109, Tennessee Code Annotated, requires that each department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Military Department of Tennessee filed its report with the Department of Audit on February 2, 1996. A follow-up of all prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDING

The current audit disclosed that the department has corrected the previous audit finding concerning failure to prepare required reconciliations.

REPEATED AUDIT FINDINGS

The prior audit report also contained findings concerning inadequate segregation of duties, the inadequate active state duty payroll system, weak controls over the Station Commanders' Upkeep and Maintenance Funds, and noncompliance with Policy 20. These findings have not been resolved and are repeated in the applicable sections of this report.

OBSERVATIONS AND COMMENTS

TITLE VI OF THE CIVIL RIGHTS ACT OF 1964

Tennessee Code Annotated, Section 4-21-901, 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, 1994, and each June 30 thereafter. For the year ended June 30, 1996, the Military Department filed its compliance report and implementation plan on June 27, 1996, and for the year ended June 30, 1995, on June 30, 1995.

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 State Planning Office in the Executive Department was assigned the responsibility of serving as the monitoring agency for Title VI compliance, and copies of the required reports were filed with the State Planning Office for evaluation and comment. However, the State Planning Office has been abolished. The Office of the Governor is currently evaluating which office in the Executive Branch will be the new monitoring agency.

A summary of the dates state agencies filed their annual Title VI compliance reports and implementation plans is presented in the special report, *Submission of Title VI Implementation Plans*, issued annually by the Comptroller of the Treasury.

APPENDIX

DIVISIONS AND ALLOTMENT CODES

Military Department divisions and allotment codes:

341.01	Division of Administration
341.02	Division of Tennessee Army National Guard
341.03	Division of Tennessee Air National Guard
341.04	Tennessee Emergency Management Agency
341.07	Armories Maintenance
341.09	Civil Defense - Disaster Relief
341.10	Armories Utilities