PERFORMANCE AUDIT

Office of Legislative Administration

May 2011

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

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May 19, 2011

The Honorable Ron Ramsey
Speaker of the Senate
and
The Honorable Beth Harwell
Speaker of the House of Representatives
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Ms. Connie Ridley, Director of Administration
Office of Legislative Administration
7th Floor, Rachel Jackson Building
320 6th Avenue North
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have conducted a performance audit of selected programs and activities of the Office of Legislative Administration for the period September 1, 2008, through June 30, 2010.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Management of the Office of Legislative Administration is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

Our audit disclosed certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. The office's management has responded to the audit findings; we have included the responses following each finding. We will follow up the audit to examine the application of the procedures instituted because of the audit findings.

We have reported one less significant matter involving an instance of noncompliance to the office's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/KBT/sah

11/029

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Performance Audit

Office of Legislative Administration

May 2011

AUDIT SCOPE

We have audited the Office of Legislative Administration for the period September 1, 2008, through June 30, 2010. Our audit scope included a review of internal control and compliance with laws and regulations in the areas of expenditures and revenues. The audit was conducted in accordance with generally accepted government auditing standards.

AUDIT FINDINGS

As Noted in the Prior Three Audits, the Office of Legislative Administration Has Not Established Adequate Controls Over the Supplies Inventory, Increasing the Likelihood That Theft of Inventory Could Occur and Not Be Detected Timely by Management

Our testwork revealed that the Supply Technician did not properly update the Edison inventory system to account for inventory on hand. In addition, the Director of Administration did not ensure that the physical inventory count was performed by someone independent of the supply room operation (page 5).

After the Office of Legislative Administration Dismissed the Former Director of the Office of Legal Services, It Awarded Her a Severance Package, Which Totaled More Than $121,000, and Also Allowed Her to Accrue Annual Leave During Her Terminal Leave Period, Which Totaled Close to $5,400, Without Any Policy Authorizing Such Packages

Based on instructions she received from the Chairs of the Joint Legislative Services Committee, the Director of Administration dismissed the former Director of the Office of Legal Services and awarded her a severance package for the period January 28 through September 30, 2009, without an established policy and without an apparent justifiable business reason, resulting in unnecessary costs to the state. The employee was also allowed to accrue annual leave during her terminal leave period (page 7).

Performance Audit
Office of Legislative Administration

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INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the audit of the Office of Legislative Administration. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated,* which requires the Department of Audit to "perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller."

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

BACKGROUND

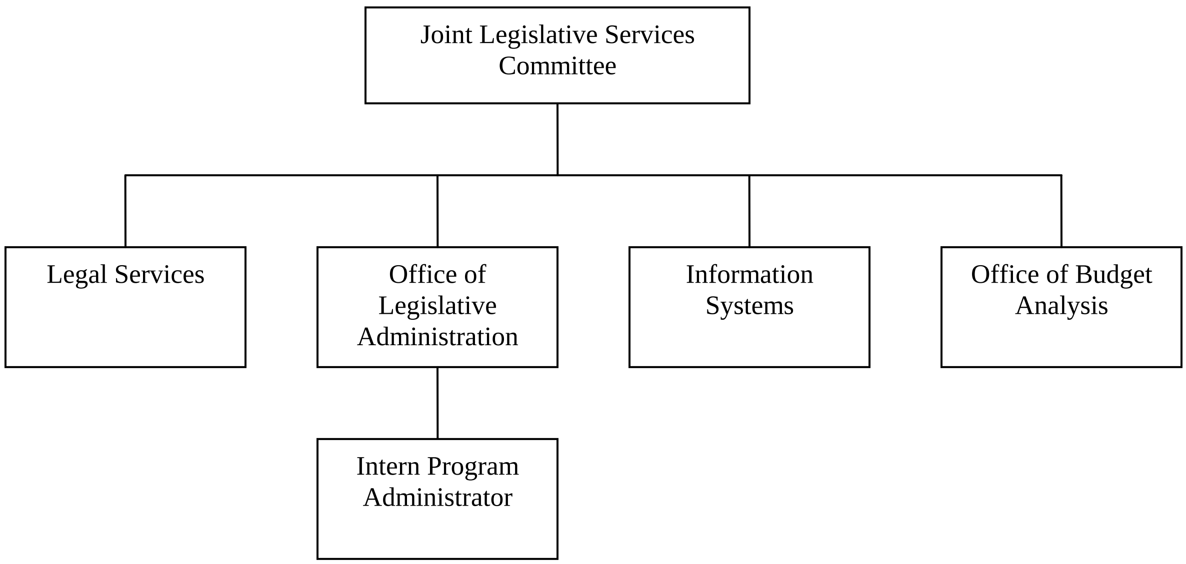
The Office of Legislative Administration processes the expenditures and revenues of the General Assembly and its committees, commissions, and support agencies, except for the Fiscal Review Committee. Legislative Administration is also responsible for human resources issues and staff administration including the Legislative Intern Program.

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

AUDIT SCOPE

We have audited the Office of Legislative Administration for the period September 1, 2008, through June 30, 2010. Our audit scope included a review of internal control and compliance with laws and regulations in the areas of expenditures and revenues. The audit was conducted in accordance with generally accepted government auditing standards.

Office of Legislative Administration
Organization Chart



PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Office of Legislative Administration filed its report with the Department of Audit on July 2, 2009. A follow-up of the prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDING

The current audit disclosed that the Office of Legislative Administration has corrected the previous audit finding concerning an employee that was placed on administrative leave with pay for six months without adequate justification and without proper documentation of the request and approval of such leave.

REPEATED AUDIT FINDING

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

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

EXPENDITURES

The objectives of our review of expenditures were to determine whether

- corrective actions, as described by management, were taken in regard to the supplies inventory;
- access to Edison was properly restricted;
- expenditure transactions were adequately supported, properly approved, and correctly recorded in the accounting system;
- payments for goods and services were made in a timely manner;

- expenditures for travel were in accordance with the Comprehensive Travel Regulations and, as applicable, Section 3-1-106, *Tennessee Code Annotated;*

- voucher registers were properly approved; and

- circumstances surrounding the awarding of an employee severance package indicated improper activity.

We reviewed applicable laws and regulations, interviewed key personnel, and reviewed supporting documentation to gain an understanding of the office's controls over expenditures necessary to achieving the audit objectives. We reviewed the supplies inventory procedures to determine whether corrective actions, as described by management, had been taken. We also performed test counts of sample items on the inventory listing noting any differences between the inventory records and the quantity that we counted. We reviewed the Edison security files to determine which employees were recognized users and to determine whether these employees' levels of access properly related to their job duties. We selected a nonstatistical sample of expenditures for the period September 1, 2008, through June 30, 2010, and examined supporting documentation to determine whether expenditure transactions were adequately supported, properly approved, and correctly recorded in the accounting system and that payments were made in a timely manner. We tested the sample items related to travel for compliance with the Comprehensive Travel Regulations and, as applicable, Section 3-1-106, *Tennessee Code Annotated*. We reviewed voucher registers for the period September 1, 2008, through June 30, 2010, to determine if the registers were properly approved. We obtained the name of one employee who was awarded a severance package and discussed the circumstances with the Director of Administration.

Based on our reviews, interviews, observations, and testwork, we determined that

- corrective actions in regard to the supplies inventory had not been implemented, as discussed in finding 1;

- access to Edison was properly restricted;

- expenditure transactions were adequately supported, properly approved, and correctly recorded in the accounting system;

- payments for goods and services were made in a timely manner;

- expenditures for travel were in accordance with the Comprehensive Travel Regulations and, as applicable, Section 3-1-106, *Tennessee Code Annotated;*

- voucher registers were properly approved; and

- the propriety of the severance package awarded to one employee was questionable, as discussed in finding 2.

1. <u>As noted in the prior three audits, the Office of Legislative Administration has not established adequate controls over the supplies inventory, increasing the likelihood that theft of inventory could occur and not be detected timely by management</u>

Finding

As noted in the prior three audits, the Office of Legislative Administration has not established adequate controls over the supplies inventory, which the office maintains for members of the legislature and their staffs. Based on our review and discussions with management, the supply room inventory consists of office supplies, picture frames, and United States and Tennessee flags, with an estimated value of $75,000 to $100,000.

Our testwork revealed that the Supply Technician did not properly update the Edison inventory system to account for inventory on hand. In addition, the Director of Administration did not ensure that the physical inventory count was performed by someone independent of the supply room operation.

In response to the prior finding, management concurred and stated:

> . . . we were already aware that the newly installed inventory system was not working to meet our inventory needs and that the Supply Room Technician was not properly utilizing the system. The decision had already been made and preparations begun to utilize the Edison inventory system. When the Edison financials component goes live for the Legislature, which will be April of 2009, we will convert the supply room inventory system. The Supply Room Technician will be advised that future failure to properly utilize the system may lead to disciplinary action or a transfer from the position.
>
> Further, physical inventory of the supply room will be assigned and completed by staff in the Office of Legislative Administration independent of the supply room operation.

Management's responses to this finding from the earlier audits are exhibited in the appendix titled "Management's Comments From Prior Audits."

During the current audit period, the office began using the Edison inventory system; however, we found that the Supply Technician did not consistently update the system to ensure proper accountability for inventory on hand. We performed test counts to compare the quantity of inventory items on hand with the quantity shown on the inventory listing, which was obtained from the system. For 18 of 25 inventory items we counted (72%), the quantity on hand based on our count did not agree with the quantity on the inventory system. For 8 of the 18 items, our count of items on hand was greater than the quantity shown in the system. The variances ranged from 3 to 140 items. For 10 of the 18 items, our count of items was less than the quantity shown in the system. The variances ranged from 2 to 49 items.

According to the Director of Administration, she specifically instructed the Supply Technician to personally maintain a log in the supply room to record all issuances of supply inventory so that he could update the Edison records periodically. However, we observed that the information documented on the supply log was often generic and did not include specific item numbers, making it difficult for the Supply Technician to properly update the system. When we discussed the maintenance of the log, we found that apparently the Supply Technician allowed individuals who needed supplies to record the items they received on the log and those individuals did not consistently provide enough information about the items obtained from inventory to clearly identify the items dispensed.

The prior audits also cited the fact that the Office of Legislative Administration did not perform regular physical inventories of its supplies. Although management previously responded that the physical inventory of the supply room would be assigned and completed by staff independent of the supply room operation, based on our discussion with the Supply Technician, he performed the two physical inventories that were completed during 2010. Although the Mailroom Technician (an employee independent of the inventory process) assisted him in performing the counts, management did not provide an independent review of the original counts or perform independent test counts to test the accuracy of the original counts.

If the Director of Administration does not provide appropriate staff so that controls over the supply inventory can work effectively, which would include consistent updating of the system as supplies are received and given out and performing independent physical inventory counts for comparison with the perpetual inventory records, theft of inventory could occur and not be detected timely by management, which increases the risk of fraud, waste, and abuse.

Recommendation

The Director of Administration should ensure that only the Supply Technician records inventory issuances on the supply inventory log so that the Edison system can be accurately updated. In addition, the Director of Administration should ensure that periodic physical inventory counts are performed by or in the presence of an employee who is independent of the supply inventory.

Management's Comment

We concur that the Supply Technician has failed to perform assigned tasks to ensure accurate recording of disbursements and tracking of existing inventory.

We concur that an independent review of the annual inventory included the services of the Supply Technician, which is found by this audit to be insufficient separation of duties.

Management will provide appropriate staff to perform tasks required to accurately manage the legislative supply room. Management will also ensure complete independence in the assignment of the task of annual inventory without the services of the Supply Technician.

2. <u>After the Office of Legislative Administration dismissed the former Director of the Office of Legal Services, it awarded her a severance package, which totaled more than $121,000, and also allowed her to accrue annual leave during her terminal leave period, which totaled close to $5,400, without any policy authorizing such packages</u>

Finding

According to written comments provided by the Director of Administration, the Lieutenant Governor (Speaker of the Senate) and the House Speaker notified the former Director of the Office of Legal Services that her services were no longer required and that her appointment had expired, effective January 27, 2009. Although the employee was eligible to retire at that time, the speakers provided a severance package to her, which totaled more than $121,000 for the period January 28 through September 30, 2009, and at the end of the severance period, the employee was placed on terminal leave until January 12, 2010.

The Office of Legislative Administration is created under *Tennessee Code Annotated*, Section 3-13-101, to support the day-to-day operations of the General Assembly. The Director of the Office of Legislative Administration is appointed by the Joint Legislative Services Committee. Among numerous other duties, the office's responsibilities include processing all forms and records on members and employees of the General Assembly, maintaining personnel records in accordance with accepted personnel practices, and preparing the payroll for all members and employees of the General Assembly. Although the office's responsibilities include personnel and payroll, we found that the office has not established a policy to govern employee severance packages.

The Director of Administration stated that during a meeting that she attended with the two speakers, who serve as the chairs of the Joint Legislative Services Committee, the speakers instructed her to create a document detailing the severance package and to obtain a decision from the employee as to whether she wanted to receive a lump sum payment for her accrued annual leave or to have the office pay out her leave beginning on October 1, 2009. We asked if the speakers had documented their approval of the severance package by signing any official documents, and the Director of Administration stated they had not. We also asked the Director of Administration if there was an employee contract that provided for a severance package and about the justification for the severance package provided to the employee. She stated that Legislative Directors do not have written contracts and there was no discussion with the Director of Administration about the justification for the package.

During the eight-month and three-day severance period, the office continued to pay the employee her normal compensation, which was $13,344 per month. In addition, since the severance period extended the employee on the payroll through September 30, 2009, the office also paid the employee $3,000 for her longevity bonus. The severance package also included the accrual of annual leave during the severance period at the rate of two days (15 hours) per month. Based on our review of the employee's Daily Attendance Card in her personnel file, at December 31, 2008, she had 315 hours of accrued annual leave. According to the severance package document, at October 1, 2009, she would have 450 hours of annual leave, which we were able to recalculate as the December 31, 2008, balance of 315 hours plus 135 hours (15 hours for each of the nine months from January through September 2009). See the table below for the calculation of the total severance package. The calculation does not include the state's expense for other benefits received by the employee such as retirement, social security, and insurance.

Severance Period January 28 Through September 30, 2009
Salary Payments, Longevity Payment, and Annual Leave Accrual

January 2009 compensation - 3 days x $606.55 *	$ 1,819.65
February through September 2009 - 8 months x $13,344	106,752.00
Longevity payment on September 30, 2009	3,000.00
Annual leave accrued during severance period - 16 days x $615.90 #	9,854.40
Total severance package not including retirement, social security, and Insurance	$121,426.05

***** Daily rate calculated as $13,344/22 working days in January

Daily rate calculated as $13,344 x 12 = $160,128/1950 hours = $82.12 hourly rate x 7.5 hours

The payment of the severance package to an employee without an established policy and without an apparent justifiable business reason resulted in unnecessary costs to the state.

As part of the severance package, the employee also accrued sick leave during the severance period at the rate of one day (7.5 hours) per month. According to the severance package document, at October 1, 2009, she would have 2,828 hours of sick leave, which would be credited toward retirement benefits. However, our calculations showed that this total was overstated by 22.5 hours. Our calculations were based on our review of the employee's Daily Attendance Card in her personnel file, which showed she had 2,738 hours of accrued sick leave at December 31, 2008. Based on her earning 7.5 hours for each of the nine months from January through September 2009, her balance at September 30, 2009, should have been 2,805.5 hours rather than the 2,828 hours shown in the severance package document.

We also noted that while the employee was on terminal leave, the period which began on October 1, 2009, she was allowed to accrue annual leave although the severance package document only provided for the accrual of annual leave during the severance leave period. Without the accrual of annual leave during the terminal leave period, we determined that her termination date would have been December 30, 2009; however, since the employee was allowed to accumulate annual leave during her terminal leave period, her actual termination date was January 12, 2010. The value of the additional accrued annual leave was $5,367.06.

Recommendation

If the chairs of the Joint Legislative Services Committee believe it is in the state's best interest to have a mechanism to provide for any post-employment benefits to which an employee is not entitled as part of regular employment, the Director of Administration should ensure that a written policy is established to govern the basic aspects of these types of payouts. The policy should ensure that any decisions to grant such payouts are made with the utmost transparency. The policy should provide that there is no entitlement to severance, but if utilized, only reasonable and necessary compensation will be granted to former employees and that the justification and approval of any severance package is fully and properly documented. This documentation should include all calculations of total benefits, including the impact on the employee's retirement, social security, and insurance and whether the way the package is set up provides longevity pay to which the employee is not otherwise entitled. The Director should also ensure that employees placed on terminal leave are not allowed to accrue annual leave during the terminal leave period if the accrual is not specifically provided in the severance package document.

Management's Comment

We do not concur that a severance package was awarded without any policy authorizing such package. The Legislative Operating Policies and Procedures, adopted and approved by the Joint Legislative Services Committee, which is chaired by the Speakers, states that administrative leave with pay may be approved by the Speakers at such times that the Speakers remove an employee from her normal duties for the good of the service.

Concurrence has been received by the Attorney General that the authority granted in this policy is sufficient.

Management will revise the operating policies and procedures to clarify the terms of awarding future leave in this category.

REVENUES

The objectives of our review of revenues were to determine whether

- revenue transactions were adequately supported, properly approved, and correctly recorded in the accounting system;

- funds collected were deposited timely and intact; and

- revenue records were reconciled with the revenue reports received from the Department of Finance and Administration.

We interviewed key personnel and reviewed supporting documentation to gain an understanding of the office's controls over revenues necessary to achieving the audit objectives. We selected a nonstatistical sample of revenue transactions for the period September 1, 2008, through June 30, 2010, and examined supporting documentation to determine whether revenue transactions were adequately supported, properly approved, and correctly recorded in the accounting system and whether funds were deposited timely and intact. We also interviewed key personnel to determine whether the office periodically reconciled its revenue records with the reports received from the Department of Finance and Administration.

Based on our interviews, reviews, and testwork, we determined that

- revenue transactions were adequately supported, properly approved, and correctly recorded in the accounting system;

- funds collected were deposited timely and intact; and

- revenue records were reconciled with the revenue reports received from the Department of Finance and Administration.

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. Management's responsibility is 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 entity 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.

APPENDICES

ALLOTMENT CODES

Office of Legislative Administration allotment codes:

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

MANAGEMENT'S COMMENTS FROM PRIOR AUDITS

Current Finding

As noted in the prior three audits, the Office of Legislative Administration has not established adequate controls over the supplies inventory, increasing the likelihood that theft of inventory could occur and not be detected timely by management

Management's Comment - For the Period April 1, 2004, Through October 31, 2006

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

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

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

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

Auditor's Comment - For the Period April 1, 2004, Through October 31, 2006

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

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

Management's Comment - For the Period July 1, 2001, Through March 31, 2004

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