STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Fiscal Review Committee

Performance Audit Report

March 2013

Justin P. Wilson
Comptroller of the Treasury

TENNESSEE COMPTROLLER OF THE TREASURY

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March 7, 2013

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
Mr. Lucian Geise, Executive Director
Fiscal Review Committee
320 Sixth Avenue North, 8th Floor
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have conducted a performance audit of selected programs and activities of the Fiscal Review Committee for the period July 1, 2010, through June 30, 2012.

Our audit disclosed certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. Management of the Fiscal Review Committee 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 internal control and instances of noncompliance to the Fiscal Review Committee's management in a separate letter.

Sincerely,

Deborah V. Loveless

Deborah V. Loveless, CPA
Director

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13/027

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Performance Audit
Fiscal Review Committee
March 2013

AUDIT SCOPE

We have audited the Fiscal Review Committee for the period July 1, 2010, through June 30, 2012. 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 expenditures, payroll and human resources, risk assessments, and access to computer applications.

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 Fiscal Review Committee is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

AUDIT FINDINGS

For the Past Two Years, Management of the Fiscal Review Committee Has Not Fulfilled Its Responsibility to Formally Assess the Committee's Operational and Fiscal Risks of Noncompliance, Errors, Fraud, Waste, and Abuse
As of December 6, 2012, committee management had not performed formal risk assessment procedures since July 2010, in violation of both state statutes and the committee's own written procedures. The committee has experienced significant personnel and operating environment changes during the past two years, which necessitate the reassessment of risks (page 6).

The Committee Did Not Follow Information Systems' Industry Best Practices Regarding Computer Access, Resulting in the Increased Risk of Fraudulent Activity or Loss of Data
Based on our computer access testwork, the committee did not follow information systems' industry best practices regarding user access (page 9).

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INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the audit of the Fiscal Review Committee. 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

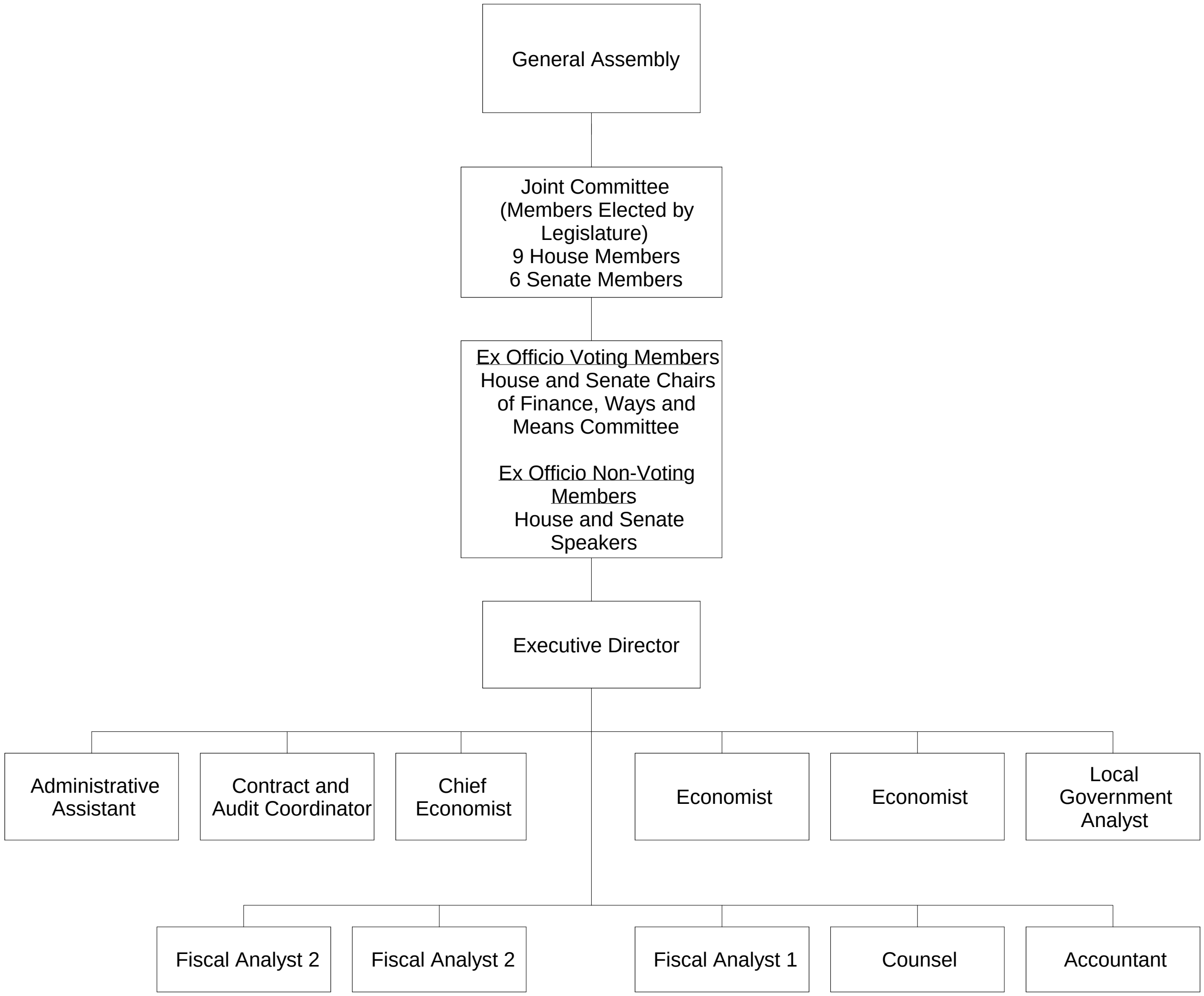
The 85th General Assembly established the Fiscal Review Committee in 1967 as a special, continuing committee to keep the members of the legislature informed of the fiscal matters of the State of Tennessee. The committee is composed of six senators and nine representatives, elected by members of the Senate and House of Representatives, respectively. Additionally, the chairs of the Finance, Ways and Means Committee of each house serve as ex officio voting members, while the speakers of each house serve as ex officio non-voting members.

The Fiscal Review Committee conducts a continuing review of the fiscal operations of state government. The committee is responsible for preparing and distributing the fiscal notes required by Section 3-2-107, *Tennessee Code Annotated*. With the Comptroller and the Commissioner of Finance and Administration, the committee is responsible for reviewing, at least annually, the organization and operation of state government to determine if changes are needed.

The Fiscal Review Committee is accounted for in business unit code 301.50. An organization chart of the Fiscal Review Committee is on the following page.

Fiscal Review Committee
Organization Chart

January 2013



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PRIOR AUDIT FINDINGS

There were no audit findings in the prior audit report dated March 2011.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

EXPENDITURES

Fiscal Review Committee operations are funded solely by state appropriations. For fiscal years 2011 and 2012, the committee's annual budget totaled approximately $2 million. The committee expended approximately $1.3 million during each fiscal year on items such as payroll, supplies and materials, third-party and state agency professional services, data processing, travel, equipment, and training.

Our objectives in reviewing expenditures were to determine whether

- the committee experienced significant or unusual fluctuations in budgeted or actual expenditures which required management explanations;

- the committee had any unusual or suspicious expenditures and if so, based on further investigation, the expenditures were reasonable considering the committee's operations;

- expenditure transactions were adequately supported, mathematically accurate, correctly recorded in the accounting system, properly approved, accompanied by a verification of receipt of goods or services, reasonable and necessary, and not a duplicate of other payments made to the vendor; and

- travel expenditures incurred by the Executive Director (both former and current) complied with applicable travel regulations, were reviewed by appropriate personnel, and were reasonable and necessary.

To evaluate whether the committee experienced significant or unusual fluctuations in budgeted and actual expenditures, we obtained listings of actual expenditures for fiscal years 2010 through 2012 and budgeted expenditures for fiscal years 2011 and 2012. For each account category, we calculated dollar and percentage variances between fiscal year 2010 and 2011 actual expenditures, fiscal year 2011 and 2012 actual expenditures, fiscal year 2011 actual and budgeted expenditures, and fiscal year 2012 actual and budgeted expenditures. We discussed with management any significant or unusual fluctuations that were identified, and we inspected documentation corroborating management's explanations.

To determine whether the committee had any unusual or suspicious expenditures, we scanned fiscal year 2011 and 2012 expenditure listings. We also identified and reviewed all transactions with amounts comprising more than 10% of total expenditures for each fiscal year. For unusual or suspicious expenditures identified, we conferred with key personnel and evaluated related supporting documentation.

We selected and tested a random sample of 25 non-payroll expenditure transactions from both fiscal year 2011 and fiscal year 2012. We examined source documents for those transactions and reviewed other payments made to that vendor and associated source documents. For the former Executive Director and the current Executive Director, we obtained a list of all their travel claims submitted and approved for payment during our audit period. To determine whether those travel expenditures complied with relevant travel regulations, were approved by appropriate personnel, and were reasonable and necessary, we interviewed applicable personnel, inspected documentation supporting each travel claim, and reviewed travel regulations promulgated by both the Department of Finance and Administration and the Fiscal Review Committee.

Based on the procedures performed, we determined that

- the significant or unusual fluctuations in budgeted and actual expenditures we noted were adequately explained by management, with minor exceptions;

- based on further investigation, the unusual or suspicious expenditures identified were reasonable considering the committee's operations, with immaterial differences;

- expenditure transactions were adequately supported, mathematically accurate, correctly recorded in the accounting system, properly approved, accompanied by a verification of receipt of goods or services, reasonable and necessary, and not a duplicate of other payments made to the vendor; and

- travel expenditures incurred by the Executive Director (both former and current) complied with applicable travel regulations, were reviewed by appropriate personnel, and were reasonable and necessary, with minor exceptions involving the former Executive Director's travel.

PAYROLL AND HUMAN RESOURCES

The Fiscal Review Committee has 12 employees, including an Executive Director. All committee employees are paid on a monthly basis. The committee performed its payroll and human resources functions internally until January 1, 2012, when the functions were transferred to the Office of Legislative Administration, as recommended by the current Executive Director.

Our objectives in reviewing payroll and human resources were to determine whether

- the committee experienced significant or unusual fluctuations in budgeted or actual aggregate payroll amounts which required management explanations;

- increases in gross salary amounts were properly authorized; and

- administrative leave-with-pay packages awarded to terminated employees were properly approved.

To assess whether the committee experienced significant or unusual fluctuations in budgeted or actual aggregate payroll amounts, we obtained a summary of budgeted and actual expenditures by account category. We analyzed the changes in payroll expenditures from 2010 through 2012 and the differences between budgeted and actual amounts for 2011 and 2012. We discussed with key personnel the significant and unusual fluctuations noted and inspected documentation supporting their explanations. To determine whether increases in gross salary amounts were properly authorized, we obtained a schedule of all paychecks each committee employee received during our audit period. We conducted interviews with key personnel, reviewed payroll documentation, and read the Department of Finance and Administration's and the committee's payroll policies and procedures. We obtained a list of terminated employees and inquired with management to identify which of those employees received administrative leave-with-pay packages. We gathered details of the administrative leave-with-pay package awarded (including the time frame the package covered, the dollar amount involved, and the approvals obtained) by holding discussions with key personnel and inspecting supporting documentation.

Based on the procedures performed, we determined that

- the significant or unusual fluctuations in budgeted or actual aggregate payroll amounts we identified were adequately explained by management;

- increases in gross salary amounts were properly authorized, with a minor exception; and

- in one instance, documentation showing the required approvals for an administrative leave-with-pay package awarded to a terminated employee was not maintained.

RISK ASSESSMENTS

Organizational managers share three basic objectives: effective and efficient operations; reliable financial reporting; and compliance with laws, regulations, and policies. To meet their objectives, managers must develop a comprehensive internal control framework consisting of five components, one of which is risk assessment. Risk assessment involves identifying and analyzing risks to achieving organizational objectives. Risks may arise from sources both within and outside the organization. The objective of our review was to determine whether management had fulfilled its responsibilities to formally assess the committee's risks of errors, fraud, waste, and abuse.

To gain an understanding of risk assessment requirements, we reviewed applicable provisions in *Tennessee Code Annotated*, the committee's *Staff Operations and Procedures Manual*, and the 2012 edition of *Governmental Accounting, Auditing, and Financial Reporting* issued by the Government Finance Officers Association. We also interviewed key personnel involved in the risk assessment process and inspected the committee's risk assessment documentation for the years 2008 through 2010.

Based on the procedures performed, we determined that management did not fulfill its responsibilities to formally assess the committee's risks of errors, fraud, waste, and abuse, as discussed in finding 1.

1. <u>For the past two years, management of the Fiscal Review Committee has not fulfilled its responsibility to formally assess the committee's operational and fiscal risks of noncompliance, errors, fraud, waste, and abuse</u>

Finding

The Fiscal Review Committee is responsible for conducting a continuing review of such items as revenue collections, budget requests, the recommended executive budget, appropriations, work programs, allotments, reserves, impoundments, the state debt, and the condition of the various state funds. To carry out the committee's responsibilities, the Executive Director and management team must establish an adequate internal control structure to provide reasonable assurance that the committee can achieve basic objectives related to its operations, financial reporting, and compliance with laws, regulations, and policies.

The Financial Integrity Act of 1983, Section 9-18-102, *Tennessee Code Annotated*, requires the following:

> (a) Each agency of state government and institution of higher education shall establish and maintain internal controls, which shall provide reasonable assurance that:
>
> (1) Obligations and costs are in compliance with applicable law;
> (2) Funds, property and other assets are safeguarded against waste, loss, unauthorized use or misappropriation; and
> (3) Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accurate and reliable financial and statistical reports and to maintain accountability over the assets.
>
> (b) To document compliance with the requirements set forth in subsection (a), each agency of state government and institution of higher education shall annually perform a management assessment of risk. The internal controls discussed in subsection (a) should be incorporated into this assessment. The objectives of the annual risk assessment are to provide reasonable assurance of the following:
>
> (1) Accountability for meeting program objectives;
> (2) Promoting operational efficiency and effectiveness;
> (3) Improving reliability of financial statements;
> (4) Strengthening compliance with laws, regulations, rules, and contracts and grant agreements; and
> (5) Reducing the risk of financial or other asset losses due to fraud, waste and abuse.

Furthermore, the Fiscal Review Committee's *Staff Operations and Procedures Manual*, effective October 1, 2008, states, "The risk assessment will be updated annually."

As of December 6, 2012, committee management had not performed formal risk assessment procedures since July 2010, in violation of both state statutes and the committee's own written procedures. An ongoing risk assessment process is a basic tenet of internal control. The ultimate purpose of a periodic risk assessment is to allow management to take effective action to eliminate or mitigate each of the risks identified.

The committee's former Executive Director resigned in September 2011, causing a series of personnel and organizational changes that culminated with the transfer of the committee's payroll and accounting functions to the Office of Legislative Administration on January 1, 2012. The current Executive Director, who was hired in November 2011, recommended this transfer. Personnel changes can increase an entity's risk exposure (through inexperience or loss of organizational memory), and operating environment changes may place special strains on an entity and its employees as they strive to adjust to the changes. Thus, it is imperative that the committee conduct a risk assessment, evaluate the continued effectiveness of internal controls instituted prior to the personnel and organizational changes enacted, and make any necessary adjustments to controls found to be inadequate. According to the current Executive Director, since he assumed his position near the end of our audit period, he was unaware of the requirement to perform an annual risk assessment. He asserted that the committee would comply with this requirement in future years.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. It is management's responsibility, in addition to performing and documenting a risk assessment, to design, implement, and monitor effective controls in the entity, as an ongoing process.

Recommendation

The Executive Director should take steps to ensure that annual risk assessments are conducted as he indicated to us during the audit. Each assessment should be well documented, complete, and clear. The risk assessment process should involve the active participation of staff; however, management is ultimately responsible for the results of the assessment. The Executive Director should assign specific responsibility to certain staff to see that the assessments are properly conducted and should hold staff accountable for performing this critical function.

The risk assessment should include consideration of the risks of errors, fraud, waste, and abuse related to the Fiscal Review Committee and should address financial reporting, operational, and compliance risks. Management should consider the relative materiality of the risks with regard to qualitative as well as quantitative materiality. The results of the risk assessment should be used by management to design appropriate internal controls to mitigate identified risks. As such, the risks should be prioritized, so that management can focus its initial attention on the greatest risks. Risks and related controls should be clearly linked.

Management's Comment

We concur that it appears that committee management has not conducted a formal risk assessment since July 2010. We will address this finding by working to evaluate risk and the effectiveness of internal controls with the Office of Legislative Administration as part of the FRC's annual review of our operations.

ACCESS TO COMPUTER APPLICATIONS

Fiscal Review Committee employees use Edison, the state's enterprise resource planning system, and internal applications that are non-financial in nature to perform their job duties. Prior to January 1, 2012, the Fiscal Review Committee's Office and Human Resources Manager managed employee access to Edison. On that date, the committee transferred this and other administrative functions to the Office of Legislative Administration. The Office of Legislative Information Systems is responsible for assigning and removing employee access for Fiscal Review Committee applications.

The objective of our review was to determine whether management followed information systems' industry best practices regarding computer access. To determine whether management followed information systems' industry best practices, we compared management's internal control activities to the industry's best practices. Based on the procedures performed, we determined that management did not follow information systems' industry best practices regarding computer access (see finding 2).

2. <u>The committee did not follow information systems' industry best practices regarding computer access, resulting in the increased risk of fraudulent activity or loss of data</u>

Finding

Based on our computer access testwork, the Fiscal Review Committee did not follow information systems' industry best practices, resulting in increased risk of fraudulent activity or loss of data. The wording of this finding does not identify specific vulnerabilities that could allow someone to exploit the committee's systems. Disclosing those vulnerabilities could present a potential security risk by providing readers with information that might be confidential pursuant to Section 10-7-504(i), *Tennessee Code Annotated*. We provided committee management with detailed information regarding the specific vulnerabilities we identified as well as our recommendations for improvement.

Recommendation

The Fiscal Review Committee Executive Director should work with the Director of Legislative Administration and the Director of Legislative Information Systems to ensure that these conditions identified to management are remedied through procedures that encompass all aspects of effective access controls. Management should reassess controls to include the risks noted in this finding in management's documented risk assessment. The risk assessment and the mitigating controls should be adequately documented and approved by the Executive Director. The Executive Director should implement effective controls to ensure compliance with applicable requirements, assign staff to be responsible for ongoing monitoring of the risks and mitigating controls, and take action if deficiencies occur.

Management's Comment

The FRC is a joint legislative committee, and as a part of the legislative branch, we rely on other legislative divisions for certain responsibilities. This finding has brought this issue, and the need to address it within the legislative branch, to our attention. Based on the finding, we will seek to develop a process with the assistance of the Office of Legislative Administration and Legislative Information Systems to better manage computer access for all FRC employees.