



# STATE OF TENNESSEE COMPTROLLER OF THE TREASURY

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**Department of General Services**

**Performance Audit Report**

November 2013

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**Justin P. Wilson**  
**Comptroller of the Treasury**



**Department of Audit**  
**Division of State Audit**  
**Risk-Based Performance Audit Group**

**DEBORAH V. LOVELESS, CPA, CGFM**  
Director

**KANDI B. THOMAS, CPA, CFE, CGFM**  
Assistant Director

**SHIRLEY A. HENRY, CPA, CGFM**  
**JENNIFER WHITSEL, CPA, CFE**  
Audit Managers

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**Sheila Raymer, CFE**  
**Heather Roe**  
Staff Auditors

**Amy Brack**  
Editor

**Amanda Adams**  
Assistant Editor

---

**Comptroller of the Treasury, Division of State Audit**  
1500 James K. Polk Building  
Nashville, TN 37243-1402  
(615) 401-7897

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STATE OF TENNESSEE  
**COMPTROLLER OF THE TREASURY**  
DEPARTMENT OF AUDIT  
DIVISION OF STATE AUDIT  
SUITE 1500  
JAMES K. POLK STATE OFFICE BUILDING  
NASHVILLE, TENNESSEE 37243-1402  
PHONE (615) 401-7897  
FAX (615) 532-2765

November 6, 2013

The Honorable Bill Haslam, Governor  
and  
Members of the General Assembly  
State Capitol  
Nashville, Tennessee 37243

and  
The Honorable Bob Oglesby, AIA, LEED AP, Commissioner  
Department of General Services  
312 Rosa L. Parks Avenue  
William R. Snodgrass Tennessee Tower, 22<sup>nd</sup> Floor  
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have conducted a performance audit of selected programs and activities of the Department of General Services for the period July 1, 2011, through July 31, 2013.

Our audit disclosed certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. Management of the Department of General Services 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.

Sincerely,

A handwritten signature in black ink that reads "Deborah V. Loveless".

Deborah V. Loveless, CPA  
Director

DVL/jw  
13/044

State of Tennessee

# A u d i t   H i g h l i g h t s

Comptroller of the Treasury  
Division of State Audit

Performance Audit  
**Department of General Services**  
November 2013

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## AUDIT SCOPE

We have audited the Department of General Services for the period July 1, 2011, through July 31, 2013. Our audit scope included a review of internal controls and compliance with laws, regulations, and provisions of contracts or grant agreements in the areas of the Central Procurement Office; the State of Tennessee Real Estate Asset Management Division; Motor Vehicle Management Division, the Office of Financial Management, the Office of Information Technology Services, and the Division of Warehousing and Distribution within the Office of the Chief Financial Officer; the Postal Services Division within the Office of the Chief Operating Officer; and the State Protest Committee. Management of the Department of General Services is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

For our sample design, we used nonstatistical audit sampling, which was the most appropriate and cost-effective method for concluding on our audit objectives. Based on our professional judgment, review of authoritative sampling guidance, and careful consideration of underlying statistical concepts, we believe that nonstatistical sampling provides sufficient appropriate audit evidence to support the conclusions in our report. We present more detailed information about our methodologies in the individual report sections.

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.

## CONCLUSIONS

### FINDINGS

**The Central Procurement Office's Payment Card Program Staff Did Not Ensure That State Agencies Submitted Payment Card Documentation in Accordance With Payment Card Policies and Procedures, nor Did Management Include Any Risks Associated With Statewide Payment Card Documentation in the Department's Annual Risk Assessment**

In our review, the Payment Card Program staff in the Central Procurement Office did not ensure that state agencies submitted payment card documentation in accordance with the office's payment card policies and procedures (page 14).

**The Department Did Not Properly Document the Issuance of Payment Cards to Its Employees, and, as a Result, We Could Not Determine If the Cards Were Issued in Accordance With State Payment Card Program Policies and Procedures; the Department also Failed to Address the Risks Related to Issuance of Payment Cards in Its Annual Risk Assessment**

We found that the Department of General Services' Agency Coordinator did not maintain all completed payment card applications, cardholder agreements, or approver agreements (page 20).

**The State of Tennessee Real Estate Asset Management Division Entered Into a Contract That Was Overly Broad in Scope and Then Pursued Multiple Contract Amendments to Refine the Contract Scope; Furthermore, Management Created an Organizational Conflict of Interest With Its Contract Amendments**

Based on our review of the Statewide Facility Assessment, Master Planning, and Facility Management Services Contract, as well as its Request for Proposals, State of Tennessee Real Estate Asset Management (STREAM) Division entered into a contract that was too broad in scope. To ultimately accomplish the apparent specific goals that STREAM intended, STREAM used amendments to refine its intentions in its contract with Jones Lang LaSalle. Ultimately, some of these amendments created an organizational conflict of interest whereby Jones Lang LaSalle can profit from its own planning recommendations (page 24).

**The State of Tennessee Real Estate Asset Management Division and the Central Procurement Office Did Not Adequately Document the Decision to Exclude a Vendor From the Negotiation of the Facilities Management Services Contract**

Based on our audit, STREAM and the Central Procurement Office did not thoroughly document their decision to exclude a third eligible vendor from the Facility Management Services Request for Qualifications (page 35).

**The Department Did Not Follow Information Systems Procedures and Did Not Maintain Proper Information Systems Security Controls, Increasing the Risk of Fraudulent Activity and Data Loss**

Based on our testwork, Department of General Services' staff did not follow the state's information system procedures in two specific areas, resulting in an increased risk of fraudulent activity or loss of data (page 57).

## **OBSERVATIONS**

The following topics did not warrant findings but are included in this report because of their effect on the operations of the Department of General Services and on the citizens of Tennessee: STREAM relied on temporary holdover agreements instead of procuring new leases (page 38); STREAM failed to assess the Facilities Revolving Fund rates annually (page 41); the department entered into a cooperative purchasing agreement with the University of Tennessee and Enterprise Holdings, Inc., instead of conducting its own competitive bid process (page 48); the department paid \$150,391.01 for unrented CarShare vehicles from March 2012 to March 2013 (page 50); the Motor Vehicle Management Division did not have effective internal controls for recording third-party collections for damaged property (page 52); the Motor Vehicle Management Division lacked an adequate process to ensure state vehicle misuse was properly investigated (page 54); and the Contract station lacked proper internal controls for assets and cash receipts (page 60).

# Performance Audit Department of General Services

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# Performance Audit Department of General Services

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## INTRODUCTION

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### POST-AUDIT AUTHORITY

This is the report on the performance audit of the Department of General Services. 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.

Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury, or his designee. Those responsibilities include serving as a member of the Advisory Council on State Procurement, Procurement Commission, and the State Building Commission. We do not believe that the Comptroller’s service in this capacity affected our ability to conduct an independent audit of the Department of General Services.

### BACKGROUND

The Department of General Services was created by the General Assembly in 1972 under Section 4-3-1101, *Tennessee Code Annotated*. As stated in Section 4-3-1103, *Tennessee Code Annotated*, the Department of General Services is responsible for coordinating and administering “the state’s purchases, personal properties, printing and motor vehicle facilities, surplus property, postal services and general public works services, and will provide for state agencies all additional support services that are not assigned by law to specific departments.” The divisions of the Department of General Services are described below.

#### Central Procurement Office

The Central Procurement Office was created by Public Chapter 1098 (enacted in 2010) and Public Chapter 295 (enacted in 2011). The goal of the legislation was to streamline and centralize procurement functions in an effort to create cost savings and efficiencies while ensuring transparency and accountability in the procurement and contracting process. The Central Procurement Office approves all contracts on behalf of the Chief Procurement Officer.

The Central Procurement Office also houses the Governor's Office of Diversity Business Enterprise, which facilitates greater opportunity for small, minority, woman-owned, and service-disabled veteran-owned business enterprises in the State of Tennessee's procurement and contracting activities.

### **Procurement Commission**

The Central Procurement Office operates under the oversight of the Procurement Commission, as created by Section 4-56-102, *Tennessee Code Annotated*. The Procurement Commission is composed of the Commissioners of General Services and Finance and Administration and the Comptroller of the Treasury. The Procurement Commission is responsible for review and approval of all proposed policies, procedures, rules, and statutes related to procurement.

### **Advisory Council on State Procurement**

Created by Section 4-56-106, *Tennessee Code Annotated*, the Advisory Council on State Procurement is responsible for reviewing and issuing a formal comment on all procurement policies, standards, guidelines, and procedures established by the Chief Procurement Officer. Additionally, when requested by the Chief Procurement Officer, the Council may conduct studies, research, and analyses, and make reports and recommendations with respect to subjects or matters within the authority and duties of the Chief Procurement Officer.

The 12-person council is made up of five voting members and seven non-voting members. The voting members include the Chief Procurement Officer, two members appointed by the Commissioner of the Department of General Services, one member appointed by the Commissioner of the Department of Finance and Administration, and one member appointed by the Comptroller of the Treasury. The non-voting members include two members appointed by the Governor, two members appointed by the Lieutenant Governor, two members appointed by the Speaker of the House, and one member appointed by the Fiscal Review Committee Chairman.

### **State of Tennessee Real Estate Asset Management**

On September 30, 2011, Governor Haslam signed Executive Order No. 7, effectively transferring the management and operation of the Division of Real Property Administration from the Department of Finance and Administration to the Department of General Services. The merger of the Division of Real Property Administration with the Department of General Services' Property Services Management Division resulted in the creation of the State of Tennessee Real Estate Management Division (STREAM).

STREAM is the capital and real estate procurement arm of state government (except for higher education), handling all issues of land, lease, and construction on behalf of the State of Tennessee. Additionally, STREAM manages state office and warehouse space. STREAM works under the authority and policies of the State Building Commission to carry out its mission to serve all state agencies with their capital and real estate needs.

STREAM's functions include asset management, capital improvements, operational administration, legal review, maintenance, landscaping, and fire and life safety programs. In addition, STREAM manages the implementation of Project T3, Transforming Tennessee for Tomorrow, which is an initiative to better use existing state-owned office space and reduce leased space by consolidating and moving agencies into state-owned buildings.

## **Office of the Chief Financial Officer**

### Motor Vehicle Management Division

Motor Vehicle Management Division is responsible for establishing and implementing rules and regulations for the acquisition, utilization, assignment, and maintenance of vehicles and equipment. Motor Vehicle Management Division also manages the Enterprise and CarShare (formerly known as WeCar) program, the State Vehicle Misuse program, the State Employee Shuttle Service, the State Employee Vanpool program, the Executive Motor Pool program, and the Fuelman and Voyager fuel card programs.

### Office of Financial Management for the Department of General Services<sup>1</sup>

The Office of Financial Management is responsible for coordinating budget activities for the Department of General Services and for providing accurate, clear, and concise information through sound budgetary analysis and fiscal reporting. The goal is to facilitate management's decision-making by providing relevant, appropriate, and timely information to the department's leadership team. Furthermore, this office is responsible for oversight of attendance and leave transactions and employee payroll processing for the Department of General Services.

### Office of Information Technology Services

The Office of Information Technology Services is responsible for providing information technology direction and support to departmental users and programs. This information technology support includes deploying and maintaining hardware and software, developing and maintaining information technology systems, and assisting departmental business units in defining their information technology needs based on their business requirements.

### Division of Warehousing and Distribution

Warehousing and Distribution is a centralized supply distribution and warehousing operation that purchases, warehouses, and distributes forms, envelopes, and other printed materials essential to the operation of agencies across the state. Additionally, the Division of Warehousing and Distribution manages the Surplus Property Program, which redistributes personal property declared to be surplus by the state or federal government.

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<sup>1</sup> A portion of the Department of General Services' Office of Financial Management's accounting staff and related functions transferred to the Department of Finance and Administration, effective July 1, 2012, in accordance with Executive Order No. 13. These functions included recording accounting transactions, review and approval of state employee State Payment Card purchases, maintaining accounts receivable, monitoring collection efforts, and determining monthly agency cost allocation and labor distribution.

### Parking Division

The Parking Division is the centralized resource for managing the state's parking lots and the swipe-n-ride program for state employees.

### **Office of the Chief Operations Officer**

#### Postal Services Division

The Postal Services Division provides centralized mail services for state agencies in Davidson County. The division contains the following sections: Incoming Mail Service, the Contract Post Office, and Outgoing Mail Services. Incoming Mail Services is responsible for the sorting, delivery, and pick-up of U.S. mail and interoffice messenger mail for all state departments, institutions, and agencies located in Davidson County. The Contract Station Post Office is operated under written agreement with the United States Postal Service (USPS) and operates in accordance with all applicable USPS rules and regulations. Outgoing Mail Services provides centralized postage metering, inserting, and pre-sorting mail for all departments, institutions, and agencies located in Davidson County.

#### Printing and Media Services Division

Printing and Media Services is responsible for the in-house printing and media needs of state government. The primary function is to provide for the printing of forms, manuals, brochures, newsletters, annual reports, letterhead stationery, envelopes, mailers, training materials, posters, graphic design, and photography on a timely basis and at competitive rates. Other services that support the printing function include design and layout of such material, technical consultation, development of specifications, cost estimation, and service to state agencies in matters pertaining to forms and publication approvals.

#### Office of Human Resources

The Office of Human Resources is responsible for the planning and implementing of a broad range of programs including employee relations, compensation and employee transactions, organizational design/change, performance management, recognition programs, workforce planning, talent management, and learning and development.

### **Office of General Counsel**

The Office of General Counsel provides legal advice to the Commissioner and all divisions of the department on a variety of legal matters, such as representing the department in matters with outside parties and other governmental agencies and officials; ensuring the department is in compliance with state statutes, rules, regulations, and policies; providing guidance and support to all of the department's attorneys; assisting in the formulation of Requests for Proposals and defending contract protests; and pursuing and collecting monetary damages from claims involving state personal and real property.

## **Office of Internal Audit**

The Office of Internal Audit is the independent appraisal function established within the Department of General Services to examine and evaluate departmental activities. The Office of Internal Audit conducts limited reviews, performs contract compliance audits, evaluates the department's Enterprise Risk Management activities to ensure risks are managed appropriately and internal controls are operating effectively, conducts special investigations, provides advisory services, and serves as a liaison to the Office of the Comptroller of the Treasury.

## **Communications**

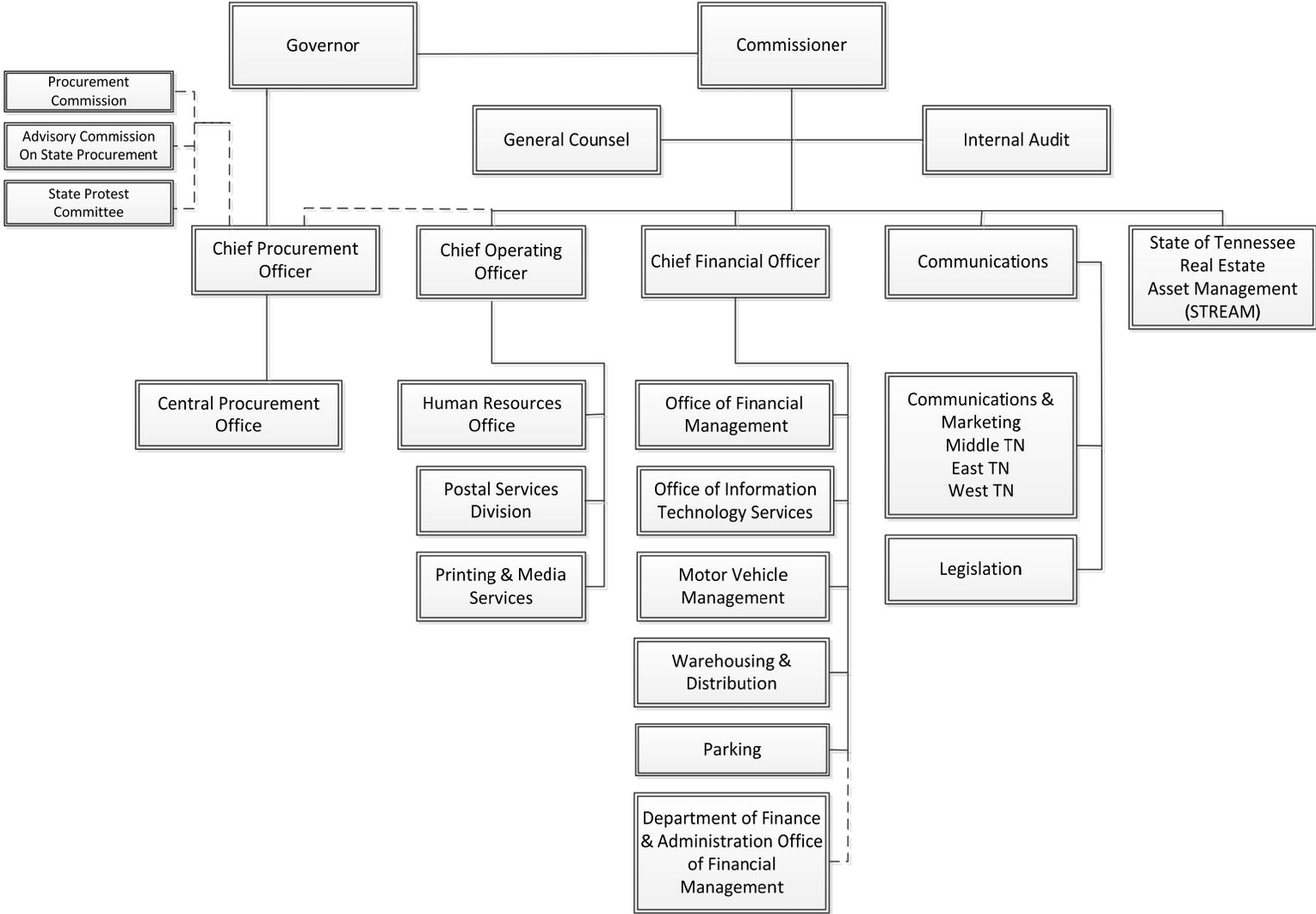
The Office of Communications is responsible for handling all media requests for information on anything pertaining to the department. The Assistant Commissioner serves as the Legislative Liaison and Public Information Officer for the department and handles any legislative issues as they arise.

## **State Protest Committee**

Created by Title 4, Chapter 56, *Tennessee Code Annotated*, the State Protest Committee is a three-member committee that is responsible for hearing appeals from vendors who disagree with determinations made by the Chief Procurement Officer relative to protests of a procurement process or intended award of a contract. The State Protest Committee consists of the Commissioners of General Services and Finance and Administration and the State Treasurer.

An organization chart of the Department of General Services is on the following page.

Department of General Services  
 Organizational Chart  
 June 2013



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## AUDIT SCOPE

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We have audited the Department of General Services for the period July 1, 2011, through July 31, 2013. Our audit scope included a review of internal controls and compliance with laws, regulations, and provisions of contracts in the areas of the Central Procurement Office; the State of Tennessee Real Estate Asset Management Division; Motor Vehicle Management, the Office of Financial Management, the Office of Information Technology Services, and the Division of Warehousing and Distribution within the Office of the Chief Financial Officer; the Postal Services Division within the Office of the Chief Operating Officer; and the State Protest Committee. Management of the Department of General Services is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

For our sample design, we used nonstatistical audit sampling, which was the most appropriate and cost effective method for concluding on our audit objectives. Based on our professional judgment, review of authoritative sampling guidance, and careful consideration of underlying statistical concepts, we believe that nonstatistical sampling provides sufficient appropriate audit evidence to support the conclusions in our report. We present more detailed information about our methodologies in the individual report sections.

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.

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## PRIOR AUDIT FINDINGS

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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 performance audit report of the Department of General Services, dated October 2011, contained three findings. The Department of General Services filed its report with the Division of State Audit on May 10, 2012. A follow-up of all prior audit findings was conducted as part of the current audit.

## RESOLVED AUDIT FINDINGS

The current audit disclosed that the department corrected all of the previous audit findings concerning attestation requirements, conflict-of-interest statements, and postponement of maintenance needs involving state facilities.

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## OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

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### CENTRAL PROCUREMENT OFFICE

#### Statewide Procurement Responsibilities

The Central Procurement Office (CPO) in the Department of General Services (DGS) is the central purchasing authority for goods, non-professional services, and professional services for state government. CPO has the authority to enter into contracts on behalf of other state executive agencies and manages all solicitation<sup>2</sup> types. CPO also manages the delegated purchase authority<sup>3</sup> of procurements valued at \$50,000 and below. Procurement personnel responsible for procuring the state's goods and services include the Chief Procurement Officer and all persons acting on behalf of the Chief Procurement Officer, whether such persons are located in the CPO, within a state agency, or under a delegated authority.

The objectives of our review of CPO were to

- determine whether the office's creation and its revision of prior procurement policies, procedures, and rules affected the new staff's ability to carry out newly established or revised procurement policies and procedures;
- verify that office staff were following the current policies and procedures for competitive negotiations;
- ascertain whether procurements made by executive branch agencies, including DGS, were in compliance with current CPO policies and procedures and if procurements were made through the proper procurement processes;

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<sup>2</sup> "Solicitation" means a written document that facilitates the award of a contract to contracting parties for goods or services. Examples of solicitations include, but are not limited to, an Invitation to Bid, a Request for Information, a Request for Proposals, and a Request for Qualifications from potential qualified vendors.

<sup>3</sup> Delegated purchase authority means the approval given by the Central Procurement Office in accordance with CPO policy to a state agency to purchase goods or services for an individual program, within specified limits and guidelines.

- identify whether CPO properly endorsed Comptroller-approved language in contracts or requests for proposals or if CPO revised the language without approval;
- determine whether CPO complied with Sections 12-4-110 and 4-56-105(5), *Tennessee Code Annotated*, and Chapter 473, Public Acts 2011, Section 10, Item 2 (Appropriations Bill), and obtained the required approval from the Office of the Comptroller of the Treasury for applicable contracts;
- ascertain whether CPO accurately and properly maintained and tracked savings related to its Strategic Sourcing Program to identify spending categories of goods and services procured statewide and examine the potential to save the state more money; and
- review the department's 2012 Financial Integrity Act Risk Assessment as it related to the CPO to determine that management identified and addressed related procurement and contract risks.

We interviewed CPO staff and reviewed procurement and contracting policies, procedures, rules, and related statutes to gain an understanding of the contract process. We selected a nonstatistical random sample of 60 procurements from a population of 272 procurements with contracts beginning July 1, 2012, through May 31, 2013, to determine CPO's compliance with policies and procedures in place at the time of the awards. Additionally, we tested the procurements to ensure that CPO obtained the Comptroller of the Treasury's approval, if required. We also tested the procurements in which negotiation techniques were utilized to determine compliance with CPO competitive negotiations policy. Additionally, to determine whether state entities, including the Department of General Services, followed established policies, and procedures and processes, we conducted an online survey with Service Contracting Coordinators at each state entity, and we shared the results with CPO management. For a list of state entities surveyed, see Appendix 2.

We interviewed CPO's strategic sourcing vendor responsible for calculating procurement savings and the consultant responsible for verifying the savings calculated by the strategic sourcing vendor. Through its Strategic Sourcing Program, CPO identified 15 spending categories of goods or services, from road salt to janitorial services, where the opportunity exists to save the state money. We reviewed the savings calculation spreadsheets for 3 of 15 spending categories: clinical lab services, road salt, and fuel.

We reviewed the department's 2012 Financial Integrity Act Risk Assessment as it related to CPO.

Based on our audit procedures, we determined that

- CPO staff facilitated the state's procurements and contracts in accordance with policies and procedures;
- CPO staff ensured competitive negotiations were used in accordance with policies and procedures; however as noted in finding 4 on page 35, STREAM and the Central

Procurement Office did not adequately document the decision to exclude a vendor from the negotiation of the Facilities Management Services Contract;

- CPO staff utilized required Comptroller-approved language in the applicable state contracts and Requests for Proposals;
- CPO staff obtained Comptroller approval of applicable contracts, when required;
- CPO's strategic sourcing vendor and consultant accurately calculated and properly maintained and tracked savings relating to the office's Strategic Sourcing Program;
- the department's 2012 Financial Integrity Act Risk Assessment related to CPO adequately identified and addressed risks related to procurement and contracts.

### **Statewide Payment Card Administration**

To ensure state agencies used payment cards appropriately, the Department of Finance and Administration (F&A) promulgated rules for the Payment Card program. The state established the Payment Card Program in 2002 to provide the state with an efficient way to conduct business and assigned statewide administrative responsibility to F&A. In December 2011, statewide administrative responsibility transferred to the Department of General Services' Central Procurement Office.

The Payment Card Administrator and a Payment Card Program Assistant within CPO administrate the Payment Card Program statewide. They are responsible for ensuring that state agencies comply with the state's payment card policies and procedures. CPO and state agencies that use payment cards must follow CPO's *State of Tennessee State Payment Card Cardholder/Approver Manual* (Payment Card Manual), and the memo dated September 29, 2006, from the Department of Finance and Administration to the State Agency Fiscal Officers and State Payment Card Agency Coordinators, entitled "Revised State Payment Card Documentation Guidelines for Citibank Contract" (Payment Card Guidelines). As of June 2013, 2,083 state employees had payment cards.

### **Central Procurement Office's Responsibilities**

The State Payment Card Program Administrator and State Payment Card Program Assistant oversee the statewide program by

- enforcing payment card policies and procedures;
- reviewing card applications and ordering new payment cards;
- providing payment card training;
- handling exception requests to the payment card program policies and procedures;
- working with Citibank to resolve fraudulent items charged to payment cards; and

- handling the accounting for payment card purchases for all cardholders across the state.

### Department of Finance and Administration's Agency Payment Card Responsibilities

The Fiscal Officer and Agency Coordinator, who by executive order are employed by the Department of Finance and Administration (F&A), manage various aspects of DGS's payment card program and are specifically responsible for requesting payment cards, canceling payment cards, and ensuring that cardholders appropriately use their payment cards.

The objectives of our review of CPO and F&A's responsibilities under the program were to

#### *Statewide Objectives*

- gain an understanding of CPO Payment Card Program staff's duties and responsibilities and determine if DGS's Office of Internal Audit's assistance in the payment card area created a conflict of interest;
- verify that new payment cards were secured and accounted for before issuance to state departments and agencies;
- gain an understanding of the policies and procedures the State Payment Card Program Administrator developed to guide agencies in managing the program;
- determine whether the program's rebates were calculated and deposited correctly and recorded in Edison, the state's accounting system;
- determine whether CPO's Payment Card Program Assistant ensured state agencies submitted transaction logs and other documentation timely and whether the Payment Card Assistant properly reviewed the documentation; and
- review the department's 2012 Financial Integrity Act Risk Assessment as it related to CPO's statewide responsibilities to determine that management identified and addressed risks.

#### *Departmental Objectives*

- determine whether F&A's Agency Coordinator and Fiscal Officer were properly issuing payment cards to Department of General Services' cardholders, documenting training, and justifying increases in purchase and cycle limits;
- ascertain whether the DGS's payment cardholders purchased goods or services in accordance with current policies and procedures; and
- establish whether F&A's Agency Coordinator and Fiscal Officer promptly canceled the payment card accounts of DGS's employees who left DGS employment.

We discussed DGS's Internal Audit staff responsibilities related to the state payment card program with CPO's State Payment Card staff and the staff of the Office of Internal Audit to gain an understanding of those responsibilities.

We interviewed the CPO Administrative Assistant responsible for securing the payment cards before issuance and performed a walkthrough of the payment card distribution process to state agencies.

We obtained and reviewed the most current State Payment Card policies and procedures manual governing the executive branch cardholders. We also reviewed the payment card rebates from Citibank from April 16, 2012, through April 15, 2013, and verified whether rebates were accurate, were deposited, and were recorded in Edison.

To gain an understanding of all requirements, we obtained and reviewed: CPO's *State of Tennessee State Payment Card Cardholder/Approver Manual*, one manual specifically for the executive branch and one manual for both the legislative and judicial branches; and the memo dated September 29, 2006, from F&A to the State Agency Fiscal Officers and State Payment Card Agency Coordinators, entitled "Revised State Payment Card Documentation Guidelines for Citibank Contract."

We conducted a walkthrough of the Payment Card Program Assistant's procedures regarding review and receipt of required payment card documentation submitted by state agencies to CPO. By obtaining the tracking spreadsheet from the Payment Card Program Assistant, we gained an understanding of the process the Payment Card staff utilizes to ensure state agencies submit payment card documentation completely and timely. We also conducted a walkthrough to determine how the Payment Card Program Assistant reviews payment card documentation.

We reviewed DGS's 2012 Financial Integrity Act Risk Assessment as it related to the Payment Card Program to determine that CPO management identified and addressed statewide program risks. We interviewed the F&A Agency Coordinator, Fiscal Officer, and Accounting Manager to determine how F&A manages the Payment Card Program for the department at an agency level.

We performed testwork on all 35 DGS payment card cardholders who received a new payment card during the audit period to determine whether the cardholders complied with State Payment Card Program policies and procedures and whether the cardholder's approver justified the card and single-purchase limits for the DGS cardholders.

To determine whether CPO ensured cardholders' transactions were properly supported, approved, and reconciled to the monthly payment card statement and to determine whether the agency cardholders' complied with State Payment Card Program and the Department of General Services' purchasing policies and procedures, we selected a nonstatistical random sample of 80 payment card transactions, totaling \$23,171.95, from a population of 14,944 transactions, totaling \$5,336,277.70, for the period July 1, 2011, through May 15, 2013. From this sample, we

also determined if cardholders' transaction logs and supporting documentation met requirements outlined in the Payment Card Guidelines.

Additionally, we tested all 21 DGS cardholders whose employment was terminated to determine if the Payment Card Administrator canceled the payment cards promptly.

Based on procedures performed, we determined that

- the DGS Internal Audit staff provided assistance to CPO's State Payment Card Program staff by testing statewide transactions to ensure appropriate documentation had been uploaded into Edison and we concluded that this assistance did not represent a conflict of interest for the department;
- payment cards were secured prior to issuance and staff properly issued new payment cards to the state's agencies;
- the State Payment Card Program Administrator did not have written policies and procedures for the consistent, efficient, and effective management of the payment card program from a statewide perspective (see finding 1);
- the State Payment Card Program's rebates were correctly calculated and deposited and recorded in Edison;
- CPO's State Payment Card Program Assistant did not ensure all state agencies submitted payment card documentation (see finding 1);
- the review of submitted payment card documentation was adequate;
- CPO management did not include all statewide risks associated with the Payment Card Program in the department's 2012 Financial Integrity Act Risk Assessment (see finding 1);
- the F&A Agency Coordinator and Fiscal Officer for DGS did not adequately document payment card issuance and training (see finding 2);
- F&A Agency Coordinator and Fiscal Officer responsible for DGS ensured cardholder purchase and cycle limits were reasonable, and maintained documentation for justification of exceptions to these limits;
- DGS cardholder transactions, transaction logs, and supporting documentation in the majority of instances were in compliance with the current purchasing policies and procedures. We noted minor discrepancies for transactions involving the Motor Vehicle Management Division (MVM) cardholders. The Agency Coordinator delegated responsibility to collect and review transaction logs and cycle statements to F&A's Accounting Manager; however, the Accounting Manager was unaware that the Payment Card Manual required MVM cardholders to submit signed transaction logs or signed cycle statements; and
- the F&A Agency Coordinator promptly canceled payment card accounts when cardholders left DGS employment.

**Finding 1 – The Central Procurement Office’s Payment Card Program staff did not ensure that state agencies submitted payment card documentation in accordance with payment card policies and procedures, nor did management include the risks associated with statewide payment card documentation in the department’s annual risk assessment**

Payment Card Program staff in the Department of General Services’ (DGS) Central Procurement Office (CPO) did not ensure that state agencies submitted payment card documentation in accordance with CPO’s payment card policies and procedures. As a result, the Payment Card Program staff did not ensure state agency cardholders used payment cards appropriately or that each state agency’s management had effectively monitored payment card purchases, increasing the risk of payment card fraud, waste, and abuse. In addition, CPO did not include risks of not fulfilling its responsibility for statewide payment card controls in its annual risk assessment.

**Current CPO Roles and Responsibilities**

To fulfill its responsibilities to ensure state agencies have followed established controls for payment card purchases, CPO’s Payment Card Program Assistant reviews the payment card documentation submitted by each state agency every month (cycle period). CPO requires each state agency to submit the following payment card documentation:

- approved cardholder transactions logs documenting all purchases charged to the card (logs are prepared by each cardholder and approved by a designated approver);
- each cardholder’s individual payment card statement provided by Citibank for the month;
- the state agency’s billing statement, also provided by Citibank, which shows the total balance owed by the state agency for all its cardholders for the month;
- the cycle certification memo signed by the state agency’s Fiscal Officer certifying that the payment card documentation is complete and that transactions charged by the state agency’s cardholders complied with the Payment Card Manual, unless properly noted in the cycle exception listing; and
- if applicable, a cycle exception listing of transactions identified as not permissible by the Payment Card Manual and the agency’s corrective action to resolve the improper purchases.

The Payment Card Guidelines establish that payment card cycle periods end on the 15<sup>th</sup> day of each month. In addition, the Payment Card Guidelines allow state agencies eight weeks from the end of each cycle period to submit payment card documentation to CPO. The Payment Card Program Assistant tracks the date CPO receives payment card documentation from each state agency on an Excel spreadsheet called the “tracking document.” He also reviews the billing statements, cycle certification memo, and cycle exception listing, if applicable, to ensure that these documents contain the appropriate signatures. Due to the large quantity of transaction logs submitted to CPO, the Payment Card Program Assistant only reviews some transaction logs to

ensure they contain appropriate signatures and to verify that the individual payment card statement is attached.

### State Agencies Failed to Submit Payment Card Documentation

During our review of the tracking document for cycle period July 15, 2011, through April 15, 2013, we discovered that multiple state agencies failed to submit any payment card documentation to CPO or submitted the documentation late. We found 20 state agencies with a total of 1,404 cardholders (representing 78% of all cardholders) that did not submit any payment card documentation for a total of 140 random cycle periods. These agencies are listed in Table 1.

**Table 1**

<b>State Agencies That Failed to Submit Payment Card Documentation</b>				
<b>State Agency</b>	<b>First Month Agency Failed To Submit Documentation</b>	<b>Total Missing Cycle Periods</b>	<b>Number of Cardholders</b>	
Department of Agriculture	7/15/2011	22	175	
Tennessee Wildlife Resources Agency	7/15/2011	20	563	
Department of Military	10/15/2011	18	37	
Department of Correction	10/15/2011	18	33	
Department of Finance and Administration (Shared Services)	2/15/2012	15	5	
Tennessee Rehabilitative Initiative in Correction (TRICOR)	5/15/2012	12	14	
Fiscal Review Committee	9/15/2011	6	1	
Department of Tourist Development	11/15/2012	6	19	
Office of Legislative Administration	8/15/2011	4	2	
Department of Commerce and Insurance	1/15/2013	4	6	
Department of Transportation	2/15/2013	3	169	
Department of Children's Services	9/15/2011	2	131	
Department of Education	1/15/2012	2	13	
Alcoholic Beverage Commission	3/15/2013	2	2	
Department of Intellectual and Developmental Disabilities	8/15/2011	1	64	
District Public Defenders Conference	1/15/2013	1	4	
Department of Veterans Affairs	4/15/2013	1	8	
Department of Environment and Conservation	4/15/2013	1	296	
Board of Probation and Parole	4/15/2013	1	1	
Department of Human Services	4/15/2013	1	36	
		140	1,404	

Table 2 shows 20 state agencies representing 1,012 cardholders (50% of all cardholders) that submitted the payment card documentation late for 97 cycle periods.

**Table 2**

<b>State Agencies That Submitted Payment Card Documentation Late</b>			
<b>State Agency</b>	<b>Number of Cardholders</b>	<b>First Month Late</b>	<b>Number of Late Cycle Periods</b>
Department of General Services (Vendor Payment Cards)	98	7/15/2012	9
Department of Children's Services	131	7/15/2012	9
Department of Environment and Conservation	296	7/15/2012	8
Attorney General and Reporter	12	7/15/2012	8
Department of Education	13	7/15/2012	8
Department of Human Services	36	7/15/2012	7
Department of Transportation	169	7/15/2012	6
Department of Commerce and Insurance	6	7/15/2012	5
Department of Mental Health and Substance Abuse Services	17	7/15/2012	5
Department of Veterans Affairs	8	7/15/2012	5
Department of Labor and Workforce Development	5	8/15/2012	5
Department of Safety and Homeland Security	83	7/15/2012	4
Department of Tourist Development	19	7/15/2012	4
Department of Intellectual and Developmental Disabilities	64	9/15/2012	3
Department of General Services (Motor Vehicle Management)	3	7/15/2012	3
Office of the Governor	2	7/15/2012	2
Department of State	3	8/15/2012	2
Tennessee Bureau of Investigation	43	8/15/2012	2
Tennessee Regulatory Authority	3	8/15/2012	1
Fiscal Review Committee	1	4/15/2013	1
	<b>1,012</b>		<b>97</b>

### **CPO's Responsibility for Payment Card Documentation**

According to the Payment Card Administrator, the Payment Card Program Assistant is responsible for ensuring that agencies submit payment card documentation by the established deadlines. She and her assistant notify agencies via telephone when they have not received the documentation. According to the Payment Card Guidelines,

[state] agencies whose submissions are more than two weeks late are subject to having their new account request suspended until the late cycle submission is received. If an [state] agency has submissions more than four weeks late, the agency's Chief Fiscal Officer must contact the [Central Procurement Office] to discuss the reasons and to determine a timeframe for the late submission to be delivered. If an [state] agency is unable to meet the determined timeframe, the issue will be escalated to the agency head.

According to the Payment Card Administrator, she notified delinquent state agencies that their rights to new account requests could be suspended. The Payment Card Administrator added that her process is to communicate with delinquent agencies through individual or conference calls but she does not create or retain documentation of these communications. The Payment Card Administrator indicated that she has never suspended a state agency's right to new cardholder accounts.

## Two Agencies Permitted to Keep Documentation On-site

After reviewing the tracking document, we also noted that the Tennessee Wildlife Resource Agency (TWRA) and the Department of Agriculture did not submit the payment card documentation for months. As a result, we inquired with the Payment Card Administrator about why TWRA and the Department of Agriculture did not submit this documentation. According to the Payment Card Administrator:

- She permitted TWRA to retain its documentation because of an ongoing audit by the Comptroller's Office. As noted in Table 1, TWRA did not submit any payment card documentation for 20 cycle periods beginning July 15, 2011; however, we did not begin our audit of TWRA until March 2012. The Payment Card Administrator's explanation does not fully explain why TWRA did not submit the required documentation. The Comptroller's Office did not request that document submissions be halted or delayed, the audit did not start until 9 months after the failure to submit documentation, and an ongoing audit would not be a substitute for the department's review of payment card documentation. Our performance audit of the Tennessee Wildlife Resources Agency, released in October 2013, reported significant internal control deficiencies related to payment card policies and procedures.
- In April 2010, she allowed the Department of Agriculture to retain its documentation because F&A, who had statewide administrative responsibility over the Payment Card Program at the time, wanted to explore ways for state entities to submit payment card documentation electronically. However, according to the CPO, it has not pursued electronic submission of payment card documentation to date.

## Lack of Clear Communication from CPO to Agency Fiscal Officers and Agency Coordinators

In Finding 2, we disclosed that the Department of Finance and Administration staff, who serve as the Fiscal Officer and Agency Coordinator over DGS's payment cardholders, did not properly document the issuance of payment cards to DGS employees. During our review, we found that CPO has written policies and procedures governing cardholders and their purchases, but has not developed written guidance to ensure that all state agencies consistently and uniformly manage the state payment card program.

To illustrate our point, our performance audit of the Tennessee Wildlife Resources Agency (TWRA) referenced above, reported that TWRA payment cardholders purchased computer-related items, in apparent violation of Section 4.1 of the State Payment Card Manual, which states, "Items that require commodity code approval **shall not** be paid for with the card (i.e., communications, printing, computer-related items)." As part of that audit, we contacted the CPO State Payment Card Administrator to request a listing of items classified as computer-related; however, instead of providing a list or criteria for determining which items are classified as computer-related items, the State Payment Card Administrator referred us to the Department of Finance and Administration's Office for Information Resources (OIR). In response to our inquiry regarding the types of items that represent prohibited computer-related items, the

Information Technology (IT) Planning Manager at OIR provided us with the following definition for computer-related purchases:

IT Procurement Definition: Acquisition of information system or information technology related hardware, software, licenses, or services

When we asked for additional guidance to assist us in the specific purchases, we also provided the IT Planning Manager with the purchases TWRA staff had made. The IT Planning Manager confirmed that the following items represent prohibited computer-related items:

- computer hard drives, motherboards, video cards, or other hardware;
- RAM memory;
- ROM Drives;
- monitors;
- keyboards, cables, or mice;
- printers;
- flash drives, SD cards, or other data storage devices (excluding DVDs, CDs, Zip Disks, etc.);
- audio recording devices; and
- docking media ports (SD readers, etc.) or equivalent devices.

In addition, discussion with the IT Planning Manager disclosed that digital cameras may be prohibited and that he believed that video cameras would be prohibited if they were attached to the network.

In our follow-up with TWRA staff, the TWRA Agency Coordinator stated that confusion between OIR and TWRA regarding prohibited and allowable computer-related purchases remains.

Failing to provide clear, consistent written guidance on acceptable items allowed for purchases using payment cards increases the risk that payment cardholders may make inappropriate purchases with the cards.

### **Payment Card Documentation Not Included in Risk Assessment**

Given the problems identified during our fieldwork, we also reviewed the department's risk assessment. CPO management failed to include the risks associated with statewide payment card documentation, and specifically, the impact of failing to fulfill its responsibility for statewide payment card controls in the department's annual risk assessment.

## **Recommendation**

As the entity responsible for statewide payment card administration, the Chief Procurement Officer should ensure that all state agencies that use payment cards follow all payment card policies and procedures, including proper submission of the state agency payment card documentation to CPO. If any state agency fails to submit this documentation or submit it timely, the Chief Procurement Officer should immediately suspend new accounts until corrective action is achieved. If the state agency still does not comply with the payment card guidelines, the Chief Procurement Officer should consider additional consequences. When these corrective actions are warranted, the Chief Procurement Officer should ensure the decision-making process is adequately documented.

If the Chief Procurement Officer wishes to allow exceptions to any payment card guidelines for a particular state agency, he should ensure all exceptions are adequately documented and retained.

The Chief Procurement Officer should also consider revising existing policies to include guidance to Fiscal Officers and Agency Coordinators so that the Payment Card Program is managed consistently and uniformly statewide. To resolve confusion between OIR and other state agencies related to prohibited and allowable computer-related purchases, the State Payment Card Administrator should define and communicate the specific criteria for computer-related purchases. The Payment Card Administrator should also appropriately amend the State Payment Card Manual to include the clarification of computer-related purchases.

Management should also assess all significant risks, including 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 Commissioner. The Commissioner 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**

We concur.

The 2012 risk assessment for the Central Procurement Office included the risks related to inappropriate transactions made with the payment cards (P-Card), but did not specifically address documentation submission by agencies.

We concur that during the period of July 15, 2011, through April 15, 2013, multiple state agencies failed to submit timely any payment card documentation to the Central Procurement Office. The Department of General Services has taken the following steps to correct the problem:

- Adhering to and tightly managing a payment card timeline matrix relative to communication and document submission;

- AP-Card Training Certification is under construction to alleviate confusion and streamline the process for approvers and cardholders;
- Documentation will not be allowed to be housed in any agency without the special permission of the Central Procurement Office. All permission, if warranted, will be effectively documented;
- Via the newly constructed P-Card Training Certification program, all streamlined rules of excluded payment card purchases will be addressed to ensure knowledge transfer.

**Finding 2 – The department did not properly document the issuance of payment cards to its employees, and as a result, we could not determine if the cards were issued in accordance with State Payment Card Program policies and procedures; the department also failed to address the risks related to issuance of payment cards in its annual risk assessment**

Each department or agency is responsible for administering its own payment card function. Typically, Fiscal Officers and Agency Coordinators at each department or agency are also required to manage various aspects of the card program, such as issuing and canceling payment cards and ensuring that cardholders properly and appropriately use their payment cards. We found that the DGS Agency Coordinator did not properly document the issuance of payment cards to employees within the Department of General Services, and as a result, we could not determine if he issued the cards in accordance with State Payment Card policies and procedures.

**State Payment Card Requirements**

The *State of Tennessee State Payment Card Cardholder/Approver Manual* (Payment Card Manual) outlines the application process agencies must follow to issue new payment cards. The application process begins by the cardholder completing the State Payment Card New Account Application and Maintenance Form, which “must be signed by the employee, the employee’s supervisor and the Cardholder’s division authority.” The form is forwarded to the Agency Coordinator for approval as evidenced by signature. Prior to receiving the payment card, the cardholder is also required to take and pass the cardholder/approver training class, read the Payment Card Manual, and sign the State Payment Card Cardholder Agreement. Additionally, prior to the cardholder receiving a card, the cardholder’s approver must take and pass the Cardholder/Approver training class before assuming approver responsibilities and sign the State Payment Card Approver Agreement for each new cardholder. When the cardholder and approver complete the training class, which includes a test, they receive a printout of a certificate that shows they passed the training class.

**New Cardholders Testwork**

We reviewed the cardholder files for 35 DGS cardholders who were issued cards by the Agency Coordinator from July 1, 2011, through April 26, 2013. Based on our review of the

cardholder files, we determined that the Agency Coordinator and staff did not maintain all completed State Payment Card New Account Application and Maintenance Forms, State of Tennessee State Payment Card Cardholder Agreements, and State of Tennessee State Payment Card Approver Agreements. For the 35 cardholders tested, we found the following:

- For 9 cardholders tested (26%), the Agency Coordinator had not signed the State Payment Card New Account Application and Maintenance Form for these cardholders.
- For 28 cardholders tested (80%), the required parties did not sign the State of Tennessee State Payment Card Cardholder Agreement.
- For 29 cardholders tested (83%), we found that all required parties did not sign the State of Tennessee State Payment Card Approver Agreement or we could not determine if the parties signed the agreements because they were not on file.

We also reviewed the cardholder files to determine if the cardholder and approver passed their training course prior to the cardholders receiving their payments cards. We found that, for the 35 cardholders tested, the cardholder file for 11 cardholders (31%) did not contain the test results for the training course. We also could not find any evidence that the 35 cardholders' approvers took the training course.

As evidenced by the deficiencies noted, the DGS Agency Coordinator did not issue payment cards in accordance with the Payment Card Manual, increasing the risk of unauthorized purchases by unauthorized employees.

### **Issuance of Payment Cards Not Included in Risk Assessment**

Given the problems identified during our fieldwork, we also reviewed the department's risk assessment. The only risk relating to payment cards included in the risk assessment concerned fraudulent charges. Management failed to include any risks noted above associated with the issuance of payment cards in the department's annual risk assessment.

### **Recommendation**

The Department of General Services' Payment Card Fiscal Officer and Agency Coordinator should follow existing State Payment Card policies and procedures to ensure that they obtain all required documents with all required signatures for all new cardholders. The Fiscal Officer and Agency Coordinator should also ensure they retain test results from the training classes for all new cardholders and approvers.

Management should also assess all significant risks, including the risks noted in this finding, in its documented risk assessment. In addition to documenting and approving the risk assessment and the mitigating controls, the Commissioner 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

We concur.

The 2012 risk assessment for the Payment Card Program included the risks related to inappropriate transactions made with the cards, but did not address documentation risk associated with the initial issuance of the cards. While card holder files are not an area of significant risk, they do contain relevant acknowledgements and proof of training.

Based on this audit's preliminary suggestion, the Department of General Services performed a detailed documentation review of the remaining active cardholder population. By doing so, we obtained a complete list of all exceptions in this area. This list was provided to the Agency Coordinator for resolution on August 15, 2013. Subsequent to the review, many of the documents initially thought missing, were found. All remaining documentation exceptions were resolved prior to this report date.

The Department of General Services adheres to the Department of Finance and Administration's guidance regarding risk assessment and has included this documentation risk in the worksheets for the 2013 assessment.

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## STATE OF TENNESSEE REAL ESTATE ASSET MANAGEMENT

The State of Tennessee Real Estate Management Division (STREAM) manages, procures, and disposes of all land, leases, and capital projects on behalf of the State of Tennessee, except for higher education. STREAM is composed of the following groups:

- Real Estate Compliance Group, which provides legal, environmental, and procurement services to the other STREAM groups and acquisition and disposition services to other state agencies and institutions;
- the Facilities Administration Group, which supervises the operation, security, and maintenance of state-owned buildings;
- the Real Estate Leasing Group, which procures and disposes of all state leases and manages leases funded by the Facilities Revolving Fund (FRF);
- the FRF Capital Projects Group, which works with contractors to provide project management to construction projects funded by the FRF; and
- the Non-FRF Capital Projects Group, which provides project management of Non-FRF capital projects, which are funded by each applicable state agency, until completion and release of the facility to the managing agency.

The objectives of our review of STREAM were to

- determine whether STREAM followed the proper procurement and amendment processes for the division's contracts for the state's real estate and facilities maintenance needs;
- determine whether STREAM took appropriate action to prepare for the Facilities Management Group's Reduction in Force (RIF) and whether management complied with the Department of Human Resources' policies and procedures and the Tennessee Excellence Accountability and Management (TEAM) Act requirements;
- determine whether STREAM effectively managed negotiating new leases on behalf of the state;
- determine whether STREAM routinely assessed and updated the FRF rates charged to state agencies; and
- review the department's 2012 Financial Integrity Act Risk Assessment as it related to STREAM to determine whether management identified and addressed risks.

We conducted interviews with STREAM personnel and management of the Office of the Comptroller of the Treasury to gain an understanding of procurement processes and contract execution for the state's real estate and facilities maintenance needs. As a result of discussions with STREAM management during our audit planning phase, we reviewed eight contracts with a total maximum liability of \$372,936,100 and one contract with no maximum liability, as well as the related procurement documents to determine STREAM's compliance with applicable policies and procedures from the Central Procurement Office, the State Building Commission, and best practices.

We interviewed STREAM's Human Resources Director to determine what steps the division took to announce, implement, and prepare Facilities Management staff for a RIF. We reviewed the related sections of the TEAM Act, as well as the Department of Human Resources' RIF policies and its evaluation of STREAM's RIF plan.

We interviewed the Real Property Agent for STREAM to gain an understanding of the Leasing Group's responsibilities and the status of the STREAM's efforts to procure long-term leases when necessary. We reviewed the Leasing Group's processes for renewing leases, as well as a listing of the leased properties STREAM relied on for temporary leasing agreements.

We reviewed *Tennessee Code Annotated* and the *By-Laws, Policy and Procedure of the State Building Commission of Tennessee* to determine the requirements for updating the FRF rates. We interviewed STREAM personnel to gain an understanding of its role in managing the FRF rates and the impact the FRF rates have on state agencies.

We reviewed the department's 2012 Financial Integrity Act Risk Assessment as it related to STREAM.

Based on procedures performed, we determined that

- STREAM management followed the proper procurement and amendment processes for the division's contracts, except in the contract awarded to Jones Lang LaSalle (JLL). We found that because STREAM's original contract with JLL was broad in scope it used contract amendments to refine the scope and maximum liability of the original "Statewide Facility Assessment, Master Planning, and Facility Management Services" contract, and STREAM management did not provide adequate support for a Rule Exception Request related to the second contract for facilities management (see findings 3 and 4);
- division management took appropriate action to prepare for the Facilities Management Group's RIF and complied with the Department of Human Resources' RIF policies and the requirements of the TEAM Act;
- STREAM's Real Estate Leasing Group continued to utilize temporary leasing agreements rather than effectively negotiating new leases (see observation 1);
- STREAM management failed to assess the FRF rate annually in accordance with the *By-Laws, Policy and Procedure of the State Building Commission of Tennessee* (see observation 2); and
- STREAM management did not include the risks related to its contracts, the reliance on temporary leasing agreements, and annual assessment of the FRF rates (as noted in the related findings and observations) in management's annual risk assessment.

**Finding 3 – The State of Tennessee Real Estate Asset Management Division entered into a contract that was overly broad in scope and then pursued multiple contract amendments to refine the contract scope; furthermore, management created an organizational conflict of interest with its contract amendments**

The State of Tennessee Real Estate Asset Management Division (STREAM) of the Department of General Services (DGS) is the capital and real estate procurement arm of the state working under the authority of the State Building Commission (SBC). In October 2011, STREAM issued a Request for Proposal (RFP) to the vendor community seeking vendors to provide services to the state. On January 23, 2012, the SBC approved a \$1,000,000 Statewide Facility Assessment, Master Planning, and Facility Management Services Contract (the Master Planning Contract) to Jones Lang LaSalle (JLL). According to the SBC's minutes, the contract vendor was to provide the following services:

assess the condition and management of current State properties, including capital maintenance and renovation, the need for additional or expanded facilities to accommodate State programs and service delivery, efficiencies that may be achieved by consolidation of spaces and the potential disposition of any property surplus.

## **State Building Commission's Role (including the Executive Subcommittee)**

According to the *By-laws, Policy and Procedure of the State Building Commission of Tennessee* (SBC Policy), the commission's approval is required for

1. projects involving improvement to real property in which the state has an interest;
2. acquisition and disposal of interest in real property;
3. proposed leases and other contracts which may involve the use of private funds for construction and which relate to improvements in real property; and
4. any demolition of real property.

According to Item V-2A of the SBC Policy, "the Executive Sub-Committee is authorized to act for the full Commission in any matter which has been delegated to the Executive Sub-Committee by the Commission."

Even though the State Building Commission's Executive Subcommittee (ESC) approved the original contract to procure facility assessments, master planning services, and facilities management services, in June 2012, the ESC decided the facilities management services portion of the contract should be removed from the original scope and procured through independent competitive negotiations. The ESC approved Master Planning Contract amendment 1 with the request that STREAM formally amend the contract to remove the facilities management portion. STREAM formally removed the facilities management section of the original contract in the fourth amendment. Based on our review of the Central Procurement Office and STREAM's process to obtain a new vendor for the Facilities Management Services Contract, we found inadequate documentation involving the competitive procurement process. See finding 4 on page 35.

A timeline of events involving both the original Master Planning Contract and Facilities Management Services Contract is exhibited below.

### **Results of Our Review**

Based on our review of the RFP and the Master Planning Contract, we found that STREAM's original contract with JLL described a broad scope of services, making it difficult to know what services JLL would be providing for the \$1,000,000. As of July 31, 2013, STREAM management amended the original scope and contract dollar maximum with five amendments which increased the maximum contract liability to \$7,650,000.

We discussed the contract amendments with STREAM management to determine the basis for the amendments and why the original contract did not specifically include the services procured through the amendments. According to the Director of Real Estate Compliance, STREAM intended from the beginning of the contract period to obtain all the services it ultimately secured through the contract amendment process. Based on our review and our discussion with the Office of the Comptroller of the Treasury's Office of Management Services, we could not determine that some of the amendments were within the scope of services of the

original contract. In two cases, the amendments created organizational conflicts of interest whereby JLL could profit from its own planning and leasing recommendations.

**Table 3**

<b>Statewide Facility Assessment, Master Planning, and Facility Management Contract and Facilities Management Services Contract Timeline</b>	
Information related to Statewide Facility Assessment, Master Planning, and Facility Management Contract in black.	
Information related to Facilities Management Services Contract in red.	
<b>Date:</b>	<b>Action:</b>
October 19, 2011	The State of Tennessee Real Estate Asset Management Division (STREAM) issued a Request for Proposals (RFP) for the Statewide Facility Assessment, Master Planning, and Facility Management Contract (the Master Planning Contract).
December 6, 2011	STREAM announced the results of the RFP.
January 23, 2012	The Executive Subcommittee (ESC) approved the award of the contract to Jones Lang LaSalle (JLL).
March 1, 2012	Master Planning Contract begins.
June 14, 2012	ESC approved the 1st amendment including Project T3, pre-planning, and requested to remove facilities management services from original contract.
November 15, 2012	The State Building Commission (SBC) delegated the 2nd Amendment, which allowed JLL to receive commissions from leases, to ESC for action.
November 19, 2012	ESC approved the 2nd amendment.
December 13, 2012	SBC delegated the 3rd amendment, which increased funding for pre-planning services, to ESC for action.
December 17, 2012	ESC approved the 3rd amendment and the 4th amendment, which increased funding for facility assessments and master planning. Facility Management formally deleted from contract.
January 22, 2013	The Central Procurement Office (CPO) issued Request for Qualifications (RFQ) for Facilities Management Services Contract.
March 14, 2013	SBC delegated the 5th amendment, which increased the funding of Project T3 leadership, to ESC for action.
March 25, 2013	ESC approved the 5th amendment.
March 27, 2013	CPO announced the results of the RFQ for the Facilities Management Services Contract.
April 1, 2013	Facilities Management Services Contract begins.

***The Role of the Office of Management Services***

The Office of the Comptroller of the Treasury’s Office of Management Services (OMS) reviews various contracts including those that require the Comptroller of the Treasury’s approval. Section 4-56-107, *Tennessee Code Annotated*, states

without limitation of the audit authority of the comptroller of the treasury, the comptroller is authorized to examine any procurement contract, grant or other documents...the comptroller of the treasury is authorized to approve procurements, contracts, grants and other documents that serve to incur financial obligations against state government.

The Director of OMS stated that its office did advise DGS that the scope of services for the original Master Planning Contract was too broad; OMS, however, could not force DGS to clarify the language because the scope of a contract is a management decision and a broad scope is not necessarily a violation of procurement statutes and SBC Policy. The Director of OMS stated that OMS did its “due diligence and fulfilled the requirements of its [OMS’s] role” in its review of the contract and at the “end of the day nothing approved was out of compliance with SBC Policy and Procedures.” OMS ultimately recommended that the SBC approve the original contract and all five amendments, including the removal of both the facilities management services and the additional services scope in amendment 4 to the contract.

We also discussed this contract award and related amendments with the Comptroller of the Treasury. The Comptroller stated “he met personally with the former commissioner and advised him that the proposed RFP seemed broad and that the department could avoid potential future problems if it defined more specifically what services were requested. The former commissioner replied that he did not want to slow the process down.”

### **STREAM’s Broad Scope**

According to the Director of OMS, STREAM developed the Master Planning Contract’s scope of services in broad or vague terms. Then, to procure specific services, division management had to amend the contract to clarify its intentions, which could appear as new services not within the contract’s original scope. Based on our review, we could not determine whether the first, second, third, and fifth amendments were within the original contract’s scope of services because the Master Planning Contract was so vague and management’s intention was not clear. For example, with the first amendment to Master Planning Contract, STREAM management introduced Project T3, Transforming Tennessee for Tomorrow, a project which was not clearly defined in the original scope. The goal of Project T3 is to reduce the state’s real estate portfolio, while updating space to increase efficiency and productivity. Projects associated with Project T3 address deferred building maintenance issues, which were identified by JLL’s facility assessments, and provides a plan to update state workspaces to enhance state agencies’ efficiency, flexibility, and adaptability through needed renovations.

**Contract Scope –  
T3 Management and  
Pre-Planning**

The Rules of the Department of Finance and Administration (F&A), Chapter 0620-3-3.07(1)(b), which establish the requirements for procuring and contracting for personal service contracts, state that a “contract amendment should be...within the original scope of work and within the intent and purpose of the original contract; or a logical extension to the original scope of work.” Even though this contract was governed by SBC Policy and not F&A rules, this should be used as best practice guidance in STREAM’s development of contract scope.

As noted above, the original contract only authorized facility assessments and master planning services and did not include project management and pre-planning services that were added in the first amendment<sup>4</sup>. STREAM’s Director for Real Estate Compliance stated that Section G.11 of the Scope of Services and Work Plan for Facility Management Services lists project management services in the original scope of the contract. However, the SBC did not authorize the Scope of Services and Work Plan for Facilities Management Services in the original contract. Because the services outlined in the Scope of Services and Work Plan for Facility Management Services were not authorized by the SBC, we do not consider project management or pre-planning services to have been included in the scope of the Master Planning Contract.

The second amendment added contract language allowing JLL to collect a commission for negotiating state leases. Based on our review, we could not determine whether the second amendment was within the scope of the original contract because the original scope language does not address commissions for JLL’s work in negotiating leases. The Master Planning Contract states that JLL will “renegotiate lease terms in remaining properties to [the] extent possible and prioritize for the greatest savings to the State/Client[,] and negotiate lease terms to meet future space needs of the State to obtain the best lease terms possible for the State,” but does not address commissions for JLL.

Contract Scope –  
Lease  
Commissions

STREAM’s Director of Real Estate Compliance told us that she had discussed with OMS staff STREAM’s intentions to allow JLL commissions as payment for negotiating state leases. The Director of OMS within the Office of the Comptroller of the Treasury stated that allowing a contractor to collect a commission was a policy change as this was not the state’s standard business practice and was not described in the original contract. Ultimately, the ESC approved this amendment.

### **STREAM Created an Organizational Conflict of Interest**

We believe the first and second amendments also placed JLL in a position to offer the state advice and then reap the benefits of its own recommendations, creating an organizational conflict of interest. Although Tennessee law, rules, and regulations are silent on the matter, it is presumed that a vendor who offers the state advice should not be permitted to bid and be awarded a contract which would allow the vendor to act on the advice it originally provided. In our review of other governmental procurement processes we found that, to avoid conflicts of interest in procurement situations, the federal government took steps to address organizational conflicts of interest such as these in federal regulations. Specifically, subpart 2.101, *Federal Acquisition Regulation*, defines “organizational conflict of interest” as when

a[n entity] is unable or potentially unable to render impartial assistance or advice to the Government, or the [entity]’s objectivity in performing the contract work is

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<sup>4</sup> The third and fifth amendments are extensions of the first amendment and increase funding for pre-planning and Project T3 leadership, respectively.

or might be otherwise impaired, or a[n entity] has an unfair competitive advantage.

Furthermore, subpart 9.505, *Federal Acquisition Regulation*, states that the two principles of resolving an organizational conflict of interest are

preventing the existence of conflicting roles that might bias a contractor's judgment; and preventing unfair competitive advantage...[which] exists where a contractor competing for award of any Federal contract possesses proprietary information that was obtained from a Government official without proper authorization; or source selection information that is relevant to the contract but is not available to all competitors, and such information would assist that contractor in obtaining the contract.

As stated previously, STREAM initially contracted with JLL to assess the condition of state facilities and provide recommendations to improve facility management. STREAM's Executive Director of Building Commission Relations stated in the June 14, 2012, SBC meeting that JLL developed the master plan the state would use to implement Project T3, and STREAM did not believe it was necessary to consider other vendors who might provide oversight and management of Project T3 because the project would be delayed, causing additional costs to the state. The first amendment states that JLL's responsibility to develop the Project T3 plan under the Master Planning Contract gave JLL a unique understanding of the conditions of facilities and needs of the state. In our opinion, its work on the original contract gave JLL an unfair advantage to be paid for both recommending the Project T3 plan and then ultimately supervising/administering the plan. Also, because JLL can benefit financially from the advice it renders to the state, we believe that it cannot offer unbiased, impartial advice in the state's best interest.

**Conflict of Interest – Project T3 Management**

Similarly, STREAM allowed JLL to advise management on leasing arrangements while also allowing JLL to charge lessors leasing commissions and keep a portion of those commissions. JLL's lease commission agreement states it can earn up to 4 percent of a lease's gross rentals, which is the annual commission multiplied by the term in years of the lease. The lessor agrees to pay half of the total gross rentals when the lease is signed and to pay the remainder the day the tenant moves into the space or on the commencement date of the lease regardless of whether the state remains in the space for the entire term of the lease. The second amendment to the Master Planning Contract states that "a percentage [based on a sliding scale] of any lease commission collected by Contractor [JLL] pursuant to this Contract shall be remitted to the State..." with JLL keeping the remainder. The authority given under this amendment increases the risk that JLL may recommend unnecessary leases so that it can profit from them.

**Conflict of Interest – Lease Commissions**

Table 4

<b>Contract and Amendment Services Explained</b>			
Outside the Scope of the Original Contract			
Organizational Conflict of Interest and Outside the Scope of the Original Contract			
Item	Approved Maximum Liability	Approved by SBC	Services Provided
Original Contract	\$1,000,000	January 23, 2012	a) <u>Facility Assessments</u> – assessing and identifying the cost of needed deferred maintenance and renovation of state facilities. b) <u>Master Planning Services</u> – providing the state with recommendations and actionable steps to improve management of state facilities.
Amendments			
First	\$3,500,000	June 14, 2012	a) <u>Project Management of Project T3</u> – coordinating the various stages of agencies’ moves, scheduling, budget, and construction management. b) <u>Pre-Planning Services</u> – justifying proposed capital projects by developing a business analysis and budget to determine if the project would benefit the state.
Second	\$0 <sup>5</sup>	November 19, 2012	<u>Lease Commissions</u> – adds that JLL can collect a 4% commission on the leases it procures.
Third	\$1,150,000	December 17, 2012	Increased funding for Pre-Planning Services introduced in 1st Amendment
Fourth	\$1,000,000	December 17, 2012	Increased funding for Facility Assessments and Master Planning Services as outlined in the original contract
Fifth	\$1,000,000	March 14, 2013	Increased Funding for Project T3 Leadership introduced in 1st Amendment
<b>Total:</b>	<b>\$7,650,000</b>		

<sup>5</sup> This amendment allowed JLL to collect a commission and did not add additional funding to the contract.

## Other Issues Noted

### State's Policy on Project Management Services

As noted above, we determined that leadership of Project T3 is a distinct and separate service which we could not determine was within the original scope of the Master Planning Contract. At the time the ESC approved the first amendment, STREAM already had a Statewide Management Assistance Contract in place through a different vendor. This existing vendor, whose contract began November 1, 2010, provided STREAM with project management services for SBC-approved capital projects. At the time STREAM proposed the first amendment to the Master Planning Contract, the Office of the Comptroller of the Treasury's Director of OMS stated that she questioned the proposed amendment in light of the existing Statewide Management Assistance Contract. She also raised concerns that existing contracts would be underutilized to favor JLL. The Office of General Counsel for the Department of General Services stated in a memo, addressed to the Governor's Chief of Staff and General Counsel, that JLL was the

Existing  
Vendor  
Contract

only vendor capable of providing Project T3 Leadership, the scope of which includes more than is contracted for under the [Statewide Management Assistance] contract.

The DGS attorneys stated that the Statewide Management Assistance Contract vendor knew that JLL would lead Project T3 and had no objection because the vendor did not have the ability to manage the project and could not offer pre-planning services to the state. When asked, however, the DGS attorneys could not provide written documentation from the Statewide Management Assistance Contract vendor verifying this information or verifying that DGS took necessary steps to avoid the appearance of underutilizing an established contract in favor of JLL.

### **Urgency of Project T3 Implementation to Justify JLL Contract Amendment**

STREAM management stressed the urgent need to implement Project T3 quickly to maximize savings for the state as justification for submitting contract amendments to the Master Planning Contract even though the project was not within the scope of the original contract. According to statements made by STREAM's Executive Director of Building Commission Relations in the June 14, 2012, SBC meeting, STREAM was facing a time constraint and needed to implement Project T3 quickly and the amendment to this contract was the exception to the normal process; not the new norm in that process.

Urgent  
Implementation  
= Savings?

The Executive Director of Building Commission Relations stated that the loss of time would be compounded by the loss of institutional knowledge JLL had already gained through its initial work on the contract and that the increased cost of procurement would be substantial. According to the former DGS Commissioner, the state would incur approximately \$1 million a month in third-party lease costs if the SBC delayed approval of the first amendment. The former

Commissioner estimated a six-month delay and \$6 million in avoidable costs for competitive procurement and implementation.

The State Treasurer stated that he would approve

the first amendment to the JLL contract with the understanding and being part of the motion... [that it] is an exception to the State Building Commission's competitive procurement policies for this first amendment only.

The Secretary of State also stated that

if we [the SBC] approve today's extraordinary item that doesn't construe that that's a new policy on our [the SBC's] part.

The ESC approved the amendment because of STREAM management's statement of urgency and emphasis on the potential savings. Ultimately, the first and fifth amendments adding Project T3 to the Master Planning Contract cost \$3,344,000.

### **Effect of Broad Scope Contract and Organizational Conflict of Interest**

As a result of the overly broad nature of the original contract scope, the services were not clearly defined within the original contract scope, and when the services were approved through contract amendments the newly defined services created organizational conflicts of interest for JLL. STREAM management either did not fully plan and prepare a comprehensive RFP to obtain all needed services or did not properly disclose its full intentions to the SBC. As a result, the Department of General Services effectively bypassed required competitive negotiations to procure services. In addition, STREAM and the department risked the misuse of taxpayer dollars by allowing a vendor to profit from its own planning and leasing recommendations.

### **Failure to Identify Risks in Annual Risk Assessment**

Given the problems identified during our fieldwork, we also reviewed the department's risk assessment. Management failed to include any risks associated with STREAM's contract procurement process and contract management in the department's annual risk assessment.

### **Recommendation**

Government officials are responsible for our tax dollars. Taxpayers rightly expect that state officials responsible for the procurement and oversight of public contracts will ensure that contract language is specific and appropriately sufficient in scope to ensure that all procurement is in the best interest of the state so that taxpayers' dollars are not misused or abused.

The Commissioner should take necessary steps to ensure that all contracts contain a specific scope of services to describe the contractor's responsibilities and that amendments are not used to expand or introduce new services. The Commissioner also should consider

reviewing the *Federal Acquisition Regulations* relating to organizational conflicts of interest and should implement best practices in the department's procurement and management of contracts.

Management should assess all significant risks, including the risks noted in this observation, in management's documented risk assessment. The Commissioner should document and approve the risk assessment and the mitigating controls. In addition, the Commissioner 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**

We do not concur.

This finding is not based on any alleged violation of statute, rule, or policy, but is instead a judgment of the Real Estate division's business decisions. We believe this finding is founded on a basic misunderstanding of the contract and its structure. It appears the audit report has confused the difference between services awarded to the selected vendor, which were intended to be provided over the life of the four (4) year contract, and those services which were authorized to commence with approval of the contract in a three (3) month period. Additionally, we find the audit report fails to recognize the procedures for approval of leases and contract amendments that would eliminate potential negative effects of any possible organizational conflict of interest.

#### Details Regarding the Scope of Services

We do not concur with the audit report's finding that the contract's scope of services was both overly broad and under-inclusive at the same time. There is no statute, rule, or policy that prohibits a contract from having a broad scope. As such, we will focus on the audit report's assertion that the scope of services was too narrow to include the services authorized by the amendments. Through a possible misunderstanding of the difference between services awarded and services authorized, we believe the audit report mischaracterizes the contract as covering only the few services authorized in the original contract and suggests that the services authorized through the amendment process were not within the original contract's scope. The original intent of the Facility Assessment, Master Planning, and Facility Management Services contract was to enter into a single contract with a single vendor that would provide comprehensive real estate services. The Real Estate division's business intent was to have one contract that would serve all real estate needs that could not be handled in house and that were not satisfied by the existing Statewide Management Assistance Contract. Therefore, the Request for Proposal and resulting contract were drafted to attempt to cover as broad a scope as possible.

The contract's structure was based on a comprehensive menu of services, some of which were authorized in the original contract and the rest which could be authorized via amendments over the life of the four (4) year contract as additional funding became available. This comprehensive menu of services is listed on Contract Attachment A, Scope of Services and Work Plan, while Contract Attachment B lists specific work items from Attachment A that were

authorized under the original contract. The audit report states it was “difficult to know what services JLL would be providing for the \$1,000,000.” However, Contract Attachment B clearly indicates the services that will be provided in return for the \$935,233.33 (maximum liability less anticipated reimbursable expenses). Furthermore, the fact that the contract term is four (4) years undermines the audit report’s conclusion that the only services intended by the original contract were the limited scope of services authorized in the original contract, which were to be performed in three (3) months. More so, the disparity between the contract’s maximum liability (\$1,000,000) and the amount of the winning bid in response to the RFP (over \$19 million) also evidences the clear intentions for the contract. Finally, Section E.15 and Section H of Contract Attachment A set forth the process by which additional work would be authorized under the contract. As reflected by comments of the Comptroller of the Treasury’s Office, we believe all parties understood the goal of creating a broad contract scope.

The audit report states, “we could not determine that some of the amendments were within the scope of services of the original contract” and that the amendments “could appear as new services not within the contract’s original scope.” With respect to the amendments addressing the addition of Project T3 Leadership Services and Pre-Planning Services, the contract’s approving body (the State Building Commission Executive Sub-committee) found that the work authorized in the amendments was a “logical extension” of the master planning scope of work in the original contract and that an amendment was the appropriate method to include these services. This determination was reflected in the recitals that are part of the 1<sup>st</sup> amendment. Therefore, the Finance and Administration rule cited on page 27 of the audit report was followed. If the report attempts to claim that the amendment to add Project T3 Leadership Services and Pre-Planning Services was not compliant with State Building Commission procurement policies, then such a claim must fail because approval of all amendments by the Executive Sub-Committee is evidence that the Office of the Comptroller of the Treasury itself deemed the amendments compliant with its policies.

As indicated on page 27 of the audit report, a contract’s scope is a management decision, and in this case, the scope was approved by the Executive Sub-committee on multiple occasions (approval of the issuance of the Request for Proposal for the contract, approval of the contract itself, and each amendment) and recommended by the Office of Management Services who found that “nothing approved was out of compliance with State Building Commission Policy and Procedures.” Further, while the Real Estate division acted as the procurement arm, ultimately, the referenced contract is a State Building Commission contract. The State Building Commission, acting through its Executive Sub-Committee, confirmed the Real Estate division’s compliance with its rules with respect to this procurement at every step of the way, by unanimously approving the original contract and all amendments.

#### Details Regarding a Potential Conflict of Interest

We do not concur with the report’s finding that a vendor’s participation in both facility assessments and leasing can create an organizational conflict of interest posing risk to the State. It should be noted that the potential conflict of interest identified in the audit report is not prohibited by any statute, rule or policy, as the report itself notes on page 28, “Tennessee law, rules and regulations are silent on the matter.” The Real Estate division does not believe there

was any “organizational conflict of interest” relative to the 1<sup>st</sup> or 2<sup>nd</sup> contract amendments, but even if such “organizational conflict of interest” existed, it was fully disclosed, reviewed, and ultimately waived by the Executive Sub-committee in its approval of said amendments.

The lease initiation, review, and approval process provides ample protection to the State from such a potential conflict. First, it is usually the agencies themselves that initiate lease procurements, not the Real Estate division, and certainly not the vendor. The vendor is simply not in a position to cause “unnecessary leases” to be procured in the overwhelming majority of instances. Second, even with respect to the decommissioning leases that were initiated by the Real Estate division as a result of the vendor’s recommendations regarding the condition of certain State office buildings, the business case justifications for these procurements and the leases themselves were extensively reviewed by the Real Estate division and Executive Sub-committee members and their staff, who ultimately agreed with and approved entering into these leases. Because of the nature of the approval process, with each lease being fully vetted in public meetings, any risk of a misuse of taxpayer dollars as a result of a perceived “organizational conflict of interest” was eliminated. The system of checks and balances on the Real Estate division’s contracting abilities protected the State against any risk that a vendor would steer the State toward unnecessary leases.

#### Conclusion

The Real Estate division followed all applicable statutes, rules and policies in the procurement of these services, and the contract was reviewed and fully vetted by the State Building Commission’s Executive Sub-committee staff and publicly approved by the members in public meetings. This procurement was fully transparent, and, therefore, Finding #3, as currently written, is unsupportable.

#### **Finding 4 – The State of Tennessee Real Estate Asset Management Division and the Central Procurement Office did not adequately document the decision to exclude a vendor from the negotiation of the Facilities Management Services contract**

To assess the condition of state facilities and develop a plan to address identified maintenance issues, the Department of General Services’ State of Tennessee Real Estate Asset Management Division (STREAM) procured the Statewide Facility Assessment, Master Planning, and Facility Management Contract (the Master Planning Contract). The scope of services under this contract originally included facility assessments, master planning services, and facility management services. As noted in Finding 3, when the State Building Commission (SBC) approved the award of the Master Planning Contract, the SBC and Executive Subcommittee of the SBC did not authorize the facilities management scope of services included in the contract. The Executive Subcommittee only approved amendment one of the Master Planning Contract with the understanding that the Facilities Management Services portion of the contract would be removed so that the Central Procurement Office (CPO) could competitively negotiate to procure facilities management services. Based on discussion with the Office of the Comptroller of the Treasury’s Director of the Office of Management Services, it was the SBC’s position that the scope of services in the original Master Planning Contract was too broad. STREAM formally

deleted the facilities management section from the Master Planning Contract in the fourth amendment (see finding 3).

In order to obtain the needed facilities management services, the department prepared a new Request for Qualifications (RFQ) based on its original Request for Proposals (RFP) for the Master Planning Contract. According to the CPO's Sourcing Analyst who served as the RFQ Coordinator for the new Facilities Management Services Contract, CPO used a combination of an RFQ and a competitive negotiation process to procure the new contract.

*Rules of the Department of Finance and Administration*, Chapter 0620-3-3.03(3)(a) states that "contracts representing the procurement of services shall be made on a competitive basis." In general, CPO asks vendors to submit a technical proposal for RFQ procurement. An evaluation team scores each vendor's proposal, and CPO asks the most technically qualified vendors to submit cost bids for the proposed work. CPO then awards the contract to the vendor with the lowest cost bid. In the case of the Facilities Management Services Contract, two evaluation teams worked concurrently but separately to evaluate the technical and cost proposals from Jones Lang LaSalle (JLL) and another vendor who had bid on the original Master Planning contract. The cost proposals evaluation team worked with the vendors to clarify the prices in the vendors' proposals, which according to the Sourcing Analyst made it a competitive negotiation.

Based on our review of the original Master Planning Contract and its RFP, we found that six vendors submitted proposals for the contract. Three of them were successful bidders for the Master Planning Contract and were considered for the Facilities Management Services Contract. However, when CPO initiated its RFQ process, CPO and STREAM only evaluated two of the three successful vendors. Based on our audit work, neither CPO nor STREAM thoroughly documented their decision to exclude the third eligible vendor from the RFQ process and ultimately awarded the new contract to JLL, the same vendor awarded the Master Planning Contract.

According to the Deputy Commissioner of STREAM, the Facilities Management Contract was competitively negotiated between the two most technically qualified vendors from the Master Planning Contract's RFP. According to the Rules of the Department of Finance and Administration Chapter 0620-3-3.03(3) (c)(1), however, "the procuring agency shall identify and contact at least three potential service providers for Competitive Negotiation."

### **Submission of Rule Exception Request**

Because STREAM did not evaluate all three vendors, the Deputy Commissioner of STREAM submitted a Rule Exception Request to CPO for approval stating that there were "only two vendors qualified to perform comprehensive facilities management services at the high level of services standards required by the State" and that only these two vendors "received technical evaluation scores within the competitive range of acceptability." The Sourcing Analyst/Facilities Management RFQ coordinator stated that the "competitive range" was determined based on CPO's review of the technical scores from the original Master Planning Contract's RFP. Also, according to the Sourcing Analyst, it was CPO's position that there was a 'clear break' between the two highest technically evaluated vendors and the third vendor who was determined to be the

lowest technically evaluated vendor. STREAM’s Deputy Commissioner stated that there were other considerations, including the limited services offered by the third vendor and the urgency of the state’s deferred maintenance needs that factored into the decision to exclude the third vendor from the RFQ. We asked for CPO’s documentation of all evidence and justification to seek the Rule Exception Request to eliminate the third vendor; however, these other considerations were not fully documented in the Rule Exception Request or elsewhere. After its submission, the former Chief Procurement Officer approved the request, and filed the approved rule exception request with the Office of the Comptroller of the Treasury’s Office of Management Services.

### Technical Evaluation Scores Explained

These three vendors were the only successful bidders on the original Master Planning Contract RFP. According to the RFP, to accomplish a successful bid, vendors were required to obtain a minimum normalized score of 53 in the technical evaluation of their proposal, as illustrated in Table 5.

<b>Table 5</b>	
<b>Technical Evaluation Minimum Normalized Score</b>	
<b>Vendor</b>	<b>Score</b>
<i>Vendor 1*</i>	<i>70.00</i>
<i>Jones Lang LaSalle*</i>	<i>69.05</i>
Vendor 2	61.06
* Vendors considered for RFQ.	

Based on the scores, all three vendors were eligible for inclusion in the RFQ since they all met the minimum score of 53. In addition, according to the Sourcing Analyst, the scope of services for the Facilities Management Services Contract changed slightly from the Master Planning Contract. As a result, the two vendors from the original RFP who were considered for the RFQ were asked to submit new technical proposals, which were evaluated independently from the vendors’ initial technical proposals in the RFP. JLL and Vendor 1 also submitted new cost proposals. JLL ultimately submitted the lowest cost proposal. Based on our review of the RFQ and the evaluations performed, we do not disagree that CPO evaluated the two vendors with the highest technical scores; however, we found that neither CPO nor STREAM properly documented with full transparency all decisions involved in eliminating the third vendor from consideration.

Without adequate documentation specifying the reason that the third vendor was not qualified to perform facilities management services, we could not determine whether this vendor should have been excluded from the RFQ process. In addition, we question whether urgency is a sufficient reason to deviate from the established procurement process and regulations.

## **Recommendation**

The Commissioner should ensure this department and all state departments and agencies follow established competitive procurement processes, when possible.

The Commissioner, STREAM Deputy Commissioner, and Chief Procurement Officer should also ensure that all Rule Exception Requests and other procurement decisions are fully and adequately documented.

## **Management's Comment**

We do not concur.

The Real Estate division and the Central Procurement Office believe they did in fact adequately document the above referenced decision. Prior to release of the Request for Qualifications, the Real Estate division acted in good faith by seeking a rule exception request to limit the competitive negotiations to the top two (2) vendors. The Central Procurement Office apprised the Office of the Comptroller of the Treasury concerning all aspects of the Request for Qualifications, including that the Central Procurement Office was limiting the competitive negotiations to two (2) vendors. The Central Procurement Office nonetheless sought and received relief from requirement, Tenn. Comp. R. & Regs. 0620-3-3-.03(3)(c)(1) ("Rule 0620-3-3.03(3)(c)(1)"), through the Rule Exception Request process. As indicated by the Rule Exception Request, the competitive negotiations were limited to two (2) vendors because the third vendor had a technical score deemed non-competitive by the Central Procurement Office. The entire Request for Qualifications package, including the Rule Exception Request, was reviewed and approved by the Comptroller's Office prior to release to the public. Furthermore, there is no policy, statute, rule or procedure that delineates a level of documentation beyond that included in the Rule Exception Request.

**Observation 1 – The State of Tennessee Real Estate Asset Management Division relied on temporary holdover agreements instead of effectively procuring new leases**

### **Background on Temporary Holdover Agreements**

The State of Tennessee Real Estate Asset Management Division (STREAM) is responsible for procuring all state agencies' leases. The Leasing Group within STREAM reviews agencies' space needs, requests proposals for leases, and procures new leases. The division enters into month-to-month "holdover" agreements with lessors for an agreed-upon period of time when state agencies remain in leased properties after the agencies' leases expire. In some cases, the Leasing Group has continued to lease the property through consecutive holdover agreements rather than procuring a new lease on behalf of the state agency. In addition, department management did not completely address the risks associated with maintaining holdover leases in its annual risk assessment.

## Department Responsibility

The Leasing Group is responsible for procuring leases that are funded by the state's Facilities Revolving Fund (FRF), as well as the non-FRF leases, which are funded directly by agencies. Section 12-2-114, *Tennessee Code Annotated*, states:

(a) when it becomes necessary for any agency of the state to lease space...the division of real property management [now STREAM], shall prepare a general statement of such agency's space needs, and shall advertise such needs in a newspaper of general circulation in the city and/or county where the space is needed...[and] (d) the director of the division of real property management [STREAM] may then negotiate with the prospective lessors for leasing of the needed space, taking into account not only the rent offered but the type of space, the location, its suitability for the purpose, services offered by the lessor, moving costs, and all other relevant factors.

## Failure to Effectively Procure New Leases

Based on a listing provided by the Leasing Group's Real Property Agent, STREAM had 83 FRF leases and 8 non-FRF leases in holdover status as of May 13, 2013. We determined that these 91 leases will be in holdover status an average of 528 days by the end of the current agreements, covering the period April 30, 2013, to December 31, 2013. The Leasing Group has continually relied on multiple holdover agreements for many of these leases; see Table 6 below.

**Table 6**

<b>Holdover Agreements (as of May 13, 2013)</b>			
	<b>Average:</b>	<b>Range</b>	
		<b>Minimum</b>	<b>Maximum</b>
Days in Holdover (at the end of current holdover agreement)	528	42	1,706
Consecutive Holdovers	4	1	13

We also found that the rental rates for five of these leases have increased while in a holdover arrangement, which will cost the state \$311,506.34 in excess rent by the end of the current holdover agreements. The lessor for one property occupied by the Tennessee Housing Development Agency increased its monthly rent by \$16,038.87, which will result in the state paying an additional \$272,660.79 by the end of the current holdover agreement on December 31, 2013.

To address this issue, STREAM contracted with Jones Lang LaSalle (JLL) to procure new FRF leases for those currently in holdover agreements and those expiring through the end of calendar year 2013. According to the Real Property Agent, the Leasing Group submitted 52 task orders to the contractor between February 2013 and April 2013, so JLL could initiate the search

for new leases by publishing the Requests for Proposals for the leases in newspapers of general circulation. As of April 29, 2013, however, JLL provided the Leasing Group with updates on only two of these leases and had not completed any new lease procurements to replace holdover leases. Based on subsequent discussion with the Assistant Commissioner of STREAM on June 27, 2013, JLL will only be responsible for the lease procurements that require State Building Commission approval, which included 35 of the 52 originally submitted task orders as of July 31, 2013. Of the 35 leases JLL is now responsible for, 15 of these leases have entered into holdovers. The Leasing Group is now responsible for procuring leases for the remaining task orders.

### **Inadequate Staffing, Communication, and Policies & Procedures**

According to the Real Property Agent, STREAM management has dedicated only four employees to the Leasing Group to physically review state-leased space for over 400 state leases and manage these leases to ensure that the lessors comply with the leasing agreements.

In addition to understaffing, STREAM management has also failed to adequately communicate to other agencies its role and responsibility to procure leases for the state. In our discussions, the Real Property Agent stated that there is confusion between state agencies, the Facilities Management Group in STREAM, and the Leasing Group in STREAM regarding who is responsible for the maintenance of leased space, enforcing the terms of agency leases, and working with landlords to resolve building issues.

Finally, according to the Real Property Agent, the only formal instructions available to the Leasing Group are the *By-Laws, Policy and Procedure of the State Building Commission of Tennessee* and a Lease Workflow flowchart prepared for JLL.

As a result of STREAM's failure to efficiently manage the lease portfolio, 91 leases, 15 of which JLL has been tasked to procure, have entered into holdover agreements. Holdovers expose the state to risk because landlords may increase rental rates or terminate the agreements with only 30 days' notice. Additionally, changes in state agencies' space needs may not be properly addressed while the department continues to rely on temporary holdover agreements rather than analyzing needs and procuring new leases which are in the state's best interest.

### **Failed to Identify Risks in Annual Risk Assessment**

Given the problems identified during our fieldwork, we also reviewed the department's risk assessment. The risk assessment fails to specifically address the risks associated with the use of holdover agreements.

Management should work to ensure that all new lease procurements are completed promptly and consider whether additional personnel are needed within STREAM's Leasing Group in order to manage the lease portfolio.

The Deputy Commissioner for STREAM should consider developing formal policies and procedures to assist the Leasing Group and the leasing consultant with the timely procurement of

leases. The Deputy Commissioner should also consider how to effectively communicate STREAM's authority and responsibility to procure and manage leases on the state's behalf to other state agencies. Management should assess all significant risks, including the risks noted in this observation, in management's documented risk assessment.

**Observation 2** – The State of Tennessee Real Estate Asset Management Division failed to assess the Facilities Revolving Fund rates annually in accordance with the *By-Laws, Policy and Procedure of the State Building Commission of Tennessee*

## **Background**

The State of Tennessee Real Estate Asset Management Division (STREAM) manages the daily operations of the Facilities Revolving Fund (FRF). Section 9-4-905, *Tennessee Code Annotated*, created the FRF to fund

operating expenses for office buildings and support facilities;...routine maintenance expenditures on office buildings and support facilities; major maintenance and renovation projects for office buildings and support facilities as approved by the state building commission; relocation expenses for state agencies; payments for leased space occupied by state agencies; and payments to build or acquire buildings or support facilities as approved by the state building commission.

STREAM is also responsible for the annual reassessment of the FRF rates, which are the fair market rates STREAM charges to state agencies to occupy state-owned and third-party leased space. The FRF rates are greater, in most cases, than the rental rates the state pays for third-party leased space, and it is this incremental increase in the rates that is used to fund the operations and purpose of the FRF.

Based on our audit work, STREAM has failed to assess the FRF rates annually as required by State Building Commission (SBC) policies and procedures.

## **Department Responsibility**

Section 9-4-907, *Tennessee Code Annotated*, states that

lease payments for space occupied by state agencies...shall be established by policy issued by the commissioner of finance and administration and approved by the state building commission.

Under Executive Order No. 7, Governor Haslam transferred the Division of Real Property Administration (RPA) within the Department of Finance and Administration to the Department of General Services. Effective October 1, 2011, the newly formed STREAM, which combined the former Division of Real Property Administration and the Division of Property Services Management within the Department of General Services, assumed responsibility for the

assessment and establishment of FRF rates. According to Item 14.01 of the *By-Laws, Policy and Procedure of the State Building Commission of Tennessee* (SBC Policy),

RPA [which has been reorganized as a part of STREAM] will assess all rate factors annually, then submit FRF rates for all of the various categories of space to the Commissioner of Finance and Administration for his review and recommendation to the State Building Commission.

Item 14.01 also states that RPA [STREAM] will

develop procedures to charge State agencies appropriate lease amounts based on rates established in accordance with this [SBC] policy... [and] to implement approved FRF policy... [that] will include guidelines for the review of all plans, costs and revenues related to the use, purchase, sale or construction of a FRF asset to insure consistent and equitable treatment for all State agencies and, further, to insure the efficient and effective use of all FRF assets.

Four different FRF rates exist for different types of leased space:

Type of Leased Space	Rate Per Square Foot
Urban Office	\$18.00
Rural Office	\$14.00
Statewide Office/Warehouse	\$7.50
Statewide Warehouse	\$6.50

### **Failure to Update FRF Rates**

The Assistant Commissioner of STREAM stated that the current FRF rates are based on an old Department of Finance and Administration market study report. The Facilities Planning Specialist in STREAM's Leasing Group also stated that the FRF rates have not been adjusted since June 11, 2007, and that an outdated market study, along with Internet inquiries, were used to adjust the FRF rates at that time. Since STREAM personnel were unable to provide the market study report or supporting documentation which was used for the rate adjustment, we were unable to confirm whether the FRF rates were adjusted or sufficiently adjusted in June 2007. Clearly, management is long overdue in its responsibility to assess and adjust the FRF rates based on current market conditions, increasing the risk of an insufficiently funded FRF and STREAM's inability to cover operating expenses identified in Section 9-4-905, *Tennessee Code Annotated*.

STREAM management stated that the FRF rates are recognized by the SBC in the annual budget, and management did not interpret that the SBC Policy required the division to conduct a full market study annually.

In addition, based on discussions with a Facilities Planning Specialist in STREAM's Leasing Group, STREAM has not established and submitted to the SBC FRF policies or

procedures designed to establish the guidelines to review all plans, costs and revenues related to the use, purchase, sale or construction of a FRF asset, as required by Item 14.01 of the SBC Policy.

Without an annual assessment of the FRF rates, state agencies may also be overcharged compared to local real estate markets, and the state's operating budgets may be negatively affected. According to STREAM's Assistant Commissioner, the failure to update the FRF rates would have resulted in overcharging state agencies during the real estate crisis and, as the market has recovered, would potentially have caused the FRF to be underfunded. The Assistant Commissioner also noted that when statewide FRF rates are greater than current market rates, there is a greater burden on agencies, especially agencies in recovering real estate markets and rural areas of the state.

The Deputy Commissioner for STREAM should develop and implement formal FRF policies and procedures governing the assessment and adjustments of the rates, including the frequency of full market studies, and submit those policies to the SBC for approval. The Deputy Commissioner should also ensure that market studies and other documentation in support of adjustments to the FRF rates are properly maintained. The Commissioner should consider whether FRF rates should differ by region in order to more accurately reflect the rent agencies pay throughout the state. Management should assess all significant risks, including the risks noted in this observation, in management's documented risk assessment.

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## **RESULTS OF OTHER AUDIT WORK**

### **Allegations Involving the Statewide Contract For Moving Services**

During our audit, our office received allegations of improprieties regarding the awarding and administration of the Statewide Contract for Moving Services. At the time of publication, there is ongoing litigation involving a vendor and the department involving those allegations. We will continue our review and publish a separate report on these issues at a later date.

### **RFP and Contract Deficiencies**

During our audit, we found additional, minor issues while reviewing public Request for Proposals (RFP) files for contracts approved by the State Building Commission (SBC). Based on our review, however, none of these issues would have changed the overall outcomes of the bidding processes.

#### *RFP Deficiencies*

1. Differences Between Scores on Score Sheets and Score Summary Matrix
  - Two evaluators' scores documented on their score sheets were different than the scores documented in the Score Summary Matrix (the Matrix) in the RFP file for the Statewide Management Assistance Contract.

- a) The first evaluator's score sheet for the first vendor indicated a score of 27 points; the Matrix stated that the score was 26 points.
  - b) The second evaluator's score sheets indicated a score of 31 points for the first vendor and 28 points for the second; the Matrix stated that the scores were 32 points and 30 points, respectively.
2. Error in Maximum Possible Score on Facility Assessment and Master Planning RFP Evaluation

While evaluating the Statewide Facility Assessment, Master Planning, and Facility Management Services Contract RFP, evaluators scored one section of the RFP by using the wrong maximum score when the actual total maximum score for the section was 38 points. Based on our review of the scoring sheets, one evaluator's maximum score was 37 points for three vendors who submitted proposals and 38 points for the other two vendors.
  3. Duplicate Scoring Sheets

We also found a discrepancy in one vendor's evaluation for the Statewide Facility Assessment, Master Planning, and Facility Management Services Contract; the vendor's file contained two copies of the first page of the scoring sheet. The score on one copy was 21 points. The score on the second copy was 17 points. The score on the second copy was used in the total score documented in the Score Summary Matrix.
  4. Evaluation Instructions Were Not Followed

In reviewing the Statewide Management Assistance RFP, the evaluators were provided with instructions stating that "all proposals are assumed to have full points" and that evaluators were to "deduct (down) from the maximum" as they reviewed the proposals. Three of the five evaluators did not follow these instructions on their score sheets. Two evaluators added points, rather than deducting from the maximum. We could not determine how the third evaluator awarded points; the evaluator only provided a total score.

### *Contract Related Deficiencies*

During our audit, we also noted several examples of delays in obtaining the necessary signatures and approvals for contracts, amendments, and Notices to Proceed, exposing the state to the risk of allowing vendors to provide services which have not been fully authorized and approved.

1. Contracts
  - Based on our review of STREAM contracts, we found that the Statewide Facility Assessment, Master Planning, and Facility Management Contract (Master Planning Contract) had a commencement date of March 1, 2012, but was not fully executed until March 9, 2012.

- The Statewide Management Assistance Services Contract had a commencement date of November 1, 2010, but the contract was not fully executed until November 19, 2010.

2. Amendments

We also found that two amendments to the Master Planning Contract were signed by the Commissioner and/or Jones Lang LaSalle (JLL) before the SBC approved them.

- JLL’s representative and the Commissioner signed Amendment One on May 18, 2012; the ESC approved the amendment at its June 14, 2012, meeting.
- JLL’s representative signed Amendment Two on November 14, 2012; the ESC approved the amendment at its November 19, 2012, meeting.

3. Notices to Proceed

Notices to Proceed, which are letters to contractors stating the dates which they can begin project work, should be issued to vendors after contracts are fully executed. Construction contracts are fully executed when they have been signed by the vendor, the State Architect, the Commissioner of the Department of General Services, the Comptroller of the Treasury, and the Attorney General. During our audit work, we found that for two construction contracts the Notices to Proceed were issued on February 15, 2013; however, the contracts were executed on April 24, 2013; and the vendor performed work and billed the state in the intervening period.

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**OFFICE OF THE CHIEF FINANCIAL OFFICER**

**Motor Vehicle Management Division**

Motor Vehicle Management Division (MVM) has the responsibility to provide the most efficient and economical ground transportation possible to the various departments and agencies of state government. In addition, the division is responsible for establishing and implementing rules and regulations for the acquisition, utilization, assignment, and maintenance of vehicles and equipment. The division manages the CarShare (formerly WeCar) and Enterprise Holdings, Inc. (Enterprise), rental programs, which allow employees who travel on state business to use Enterprise vehicles obtained from the downtown CarShare lot or from statewide Enterprise locations. MVM also manages the State Vehicle Misuse program, whereby complaints of vehicle misuse are reported to the proper agency and investigated. Additionally, the division is responsible for collecting monies owed from third parties who have damaged state vehicles.

The objectives of our review of MVM’s processes were to

- determine whether state agencies were properly billed for the CarShare and Enterprise rental programs, and payments were properly recorded in Edison, the state’s accounting system;
- assess whether state agencies could effectively review their employees’ CarShare and Enterprise reservations;

- review the department’s decision to outsource the state dispatch fleet to Enterprise;
- determine whether the size of the CarShare vehicle fleet met the state’s needs and was adjusted based on reviews of state employees’ short-term vehicle use;
- ensure that third-party collectables for damages to state vehicles were handled properly;
- ascertain whether all complaints of state vehicle misuse were properly reviewed and investigated; and
- review the department’s 2012 Financial Integrity Act Risk Assessment to assess whether management addressed all risks related to CarShare and Enterprise rentals, third-party collectables, and state vehicle misuse.

### *Enterprise and CarShare Rental Programs*

We conducted interviews with the MVM Director, the Director for the Office of Financial Management, and the Executive Administrative Assistant 2 who are responsible for reviews of the monthly Enterprise billings. Using the Planned Fee Invoices from Enterprise for the period February 2012 through March 2013, we reviewed these monthly invoices to ensure that payment for the department’s vehicle usage and for the state’s unused vehicles was appropriately documented and processed in Edison. We also reviewed a nonstatistical haphazard sample of ten rentals used by Office of the Comptroller of the Treasury employees to verify that the Office was properly billed based on rental period and to identify any issues with penalties for cars that were returned late, dirty, or not refueled.

We reviewed the information on the CarShare and Enterprise rental programs provided by department staff. To assess whether “Master Administrators” at other departments and agencies could effectively review their own employees’ CarShare reservations, we reviewed one of the Master Administrator’s log reports from the Enterprise system. In order to determine whether state agencies have the ability to review employees’ CarShare and Enterprise reservations, we also reviewed the presentation material from the program implementation and discussed DGS’s recommended process with the Executive Administrative Assistant 2.

We reviewed the department’s cooperative purchase agreement with the University of Tennessee and Enterprise, the contract which includes the CarShare program. We also reviewed the department’s utilization study comparing the costs of the state-managed vehicle fleet to the rental car services through the Enterprise contract. Finally, we reviewed the Chief Financial Officer’s presentation to the State Procurement Commission, and the Spend, Savings, and Usage Analysis prepared for the commission meeting on October 31, 2012, which recommended renewing the Enterprise contract for another year.

We discussed the CarShare fleet size with the Director for the Office of Financial Management and the MVM Director. We also reviewed the data that they used to determine the initial fleet size and fleet adjustments.

### *Third-Party Collectables*

We conducted interviews with department staff and reviewed policies and procedures to gain an understanding of the department's process for collecting money from third-parties for damages to state vehicles involved in accidents with these at-fault third-parties. We tested a nonstatistical random sample of 60 closed collectable accounts for damaged vehicles from a population of 126 accounts closed from July 1, 2012, to June 11, 2013, to determine whether all collections were properly documented. In order to ensure the reliability of the data, we observed how the Wreck Repair Coordinator pulled the closed accounts from the department's vehicle management system, and we obtained a written statement from him attesting to the completeness of the population tested.

### *State Vehicle Misuse*

To assess the department's process for reporting state vehicle misuse, we conducted interviews with MVM staff. We also reviewed the division's policies and procedures to gain an understanding of its process. We reviewed the complaint files for the state vehicle misuse allegations from July 1, 2011, through April 9, 2013, and tested them to determine whether the department forwarded the complaints to the appropriate entities and whether it ensured that the complaints were properly investigated.

Finally, we reviewed the department's 2012 Financial Integrity Act Risk Assessment as it related to the CarShare and Enterprise programs, state vehicle misuse, and third-party collectables to determine whether management identified and addressed the related risks.

Based on procedures performed, we determined that

- the billings for both the CarShare and Enterprise rental programs were accurate and was properly recorded in Edison;
- state agencies have the ability to effectively review their employees' CarShare and Enterprise reservations using data from the Enterprise reservation system and Edison travel authorizations;
- while the utilization study supported the decision to outsource the dispatch fleet, the department did not leverage the state's purchasing power by rebidding the contract for rental car services (see observation 3);
- department management initially overestimated the number of vehicles needed for the CarShare fleet and did not effectively manage the fleet size to reduce the number of unused vehicles paid for by the state until one year after the program implementation (see observation 4);
- MVM did not properly track the collections and balances owed for damages to state vehicles (see observation 5);
- MVM did not have a centralized reporting system or specific instructions in its operations manual to ensure that all instances of state vehicle misuse were properly investigated (see observation 6); and

- management addressed the risks related to the CarShare and Enterprise contract but failed to include the risks related to third-party collectables and state vehicle misuse in its risk assessment (as noted in the related observations).

**Observation 3 – The department entered into a cooperative purchasing agreement with the University of Tennessee and Enterprise Holdings, Inc., instead of conducting its own competitive bid process**

Prior to January 2012, the Motor Vehicle Management Division (MVM) within the Department of General Services managed the dispatch vehicle fleet for state employees' business transportation needs. According to management, MVM managed a fleet of 279 vehicles. In April 2011, the department faced the dilemma of maintaining or replacing an aging fleet and increasing maintenance costs, and, due to budget constraints, the department lacked the funds to replace the fleet vehicles at the end of their useful lives. At that time, department management began researching more cost-effective alternatives to replacing the dispatch fleet and identified various fleet contracts:

- University of Tennessee's (UT) contract with Enterprise Holdings, Inc. (Enterprise);
- Western State's Contracting Alliance car rental contract; and
- the car rental contract used by the State of Indiana.

Although there was an urgent need to replace its fleet quickly and even though outsourcing the fleet was a sound business decision, we believe the department may have benefited from conducting its own competitive bid process rather than joining the existing University of Tennessee contract with Enterprise.

**Utilization Study Performed**

Management conducted a utilization study to analyze the cost and usage level of the dispatch fleet as of June 30, 2011, to determine the potential cost savings from outsourcing the state's dispatch fleet. We reviewed the utilization study provided by the Chief Financial Officer, which recommended that the state establish a pilot fleet program with Enterprise and sell its existing fleet. For the study, the department's staff obtained vehicle data from FleetFocus/M5, the state's fleet management software, and Edison, the state's accounting system. To assist management's decision-making process, the study included data on

- vehicle depreciation;
- daily vehicle usage cost;
- the number of rentals for each vehicle class from July 2010 through January 2011;
- MVM staffing allocations;
- the breakdown of the cost of CarShare technology;
- Global Positioning System (GPS) technology installed by Enterprise; and

- the list of vehicles in the state's fleet.

Based on our review of the utilization study, we found that the analysis of the costs to operate the fleet in-house was reasonable; however, the study only presented two options: outsource fleet operations to Enterprise, or replace the vehicles and continue to run the fleet in-house. The study did not consider other potential vendors.

### **University of Tennessee's Contract With Enterprise**

At the time of the utilization study, UT had two contracts with Enterprise: discounted rental car services for the university's alumni association and discounted rental car services for university employees.

UT procured both contracts through the Request for Proposals (RFP) process and received bids from Avis, Dollar-Thrifty, and Enterprise. Based on our review of the RFP documents, Enterprise won both contracts because the vendor offered a better rebate to the university's alumni and better rates for university employees.

According to Section 12-3-216, *Tennessee Code Annotated*, effective through July 1, 2013,

The chief procurement officer is authorized to enter into cooperative purchasing agreements with other states, local governments and higher education institutions; provided, that each contract is established through the use of competitive sealed bids and each procurement has the prior approval of the procurement commission.

Because the above statute granted it the authority, the Department of General Services entered into a cooperative purchasing agreement with Enterprise on January 4, 2012, which technically extended UT's Enterprise contract terms for university employees to include state employees. The state also negotiated with Enterprise and added a Participating Addendum to establish the CarShare program.

### **Spend, Savings and Usage Analysis**

The Board of Standards (now the Procurement Commission) approved the Participating Addendum (contract) on November 16, 2011, and asked the department to update the board after the first contract year of the cost savings achieved through the contract and determine whether the Enterprise program was still the best choice for the state's transportation needs. The department provided its update to the Procurement Commission on October 31, 2012.

In anticipation of the October 31, 2012, commission meeting, the department created the Spend, Savings and Usage Analysis summarizing the data on the CarShare program accumulated from the program's stated date, February 2012, through August 31, 2012, and comparing the cost savings to the estimated cost of replacing the state's fleet. The study did not, however, present other alternatives including potential savings by outsourcing to other vendors. While speaking at the commission meeting, the Deputy Commissioner/Chief Financial Officer stated he would like

to keep the Enterprise contract for another year to obtain enough data to determine whether to continue it or procure car rental services directly.

In the future, the department should conduct a complete competitive bidding process to identify all vehicle fleet operation alternatives to determine the best options for the state before continuing its cooperative agreement with UT and Enterprise.

**Observation 4 – The department paid \$150,391.01 for unrented CarShare vehicles from March 2012 to March 2013**

In January 2012, the Department of General Services (DGS) replaced the State of Tennessee's motor vehicle fleet with fleet services, called CarShare, through a cooperative purchasing agreement with Enterprise Holdings, Inc. (Enterprise). Beginning in February 2012, the CarShare program fleet offered state employees who travel on state business the opportunity to rent Enterprise vehicles kept on lots near state office buildings. The fleets are located in Nashville and Knoxville. In cases where a CarShare fleet vehicle is not available to rent, state employees can rent a vehicle directly from Enterprise at one of its rental locations.

When a state employee rents a CarShare fleet vehicle, Enterprise bills the applicable state agency directly. When vehicles go unrented, DGS pays Enterprise for the cost to maintain the fleet. The department reduces its cost for unrented vehicles through quarterly rebates offered by Enterprise, calculated based on the total Enterprise and CarShare rentals for the period multiplied by a rebate percentage established in the cooperative purchasing agreement.

During our audit, we analyzed the state's CarShare vehicle usage to determine the total costs that were paid by state agencies for vehicle rentals and the costs DGS paid for unrented vehicles.

**Fleet Size Changes**

The Chief Financial Officer, Director of the Office of Financial Management, Director of the Motor Vehicle Management Division (MVM), and the Internal Audit Director originally established a CarShare fleet with 80 vehicles in February 2012. In April 2012, management reduced the fleet to 77 vehicles due to a lack of space in the parking lot. In both August and December 2012, three vehicles were removed from the CarShare fleet and reassigned for use by entities that were moved due to Project T3. MVM billed the costs for these vehicles to Project T3. In January 2013, DGS's Director of the Office of Financial Management reviewed CarShare usage and recommended an additional reduction of 18 vehicles. However, due to concern over vehicle availability, the MVM Director requested that Enterprise remove only 10 vehicles from the CarShare fleet. The changes in fleet size are illustrated in Table 7.

**Table 7**  
**Fleet Size Changes from February 2012 through February 2013**

<b>Month</b>	<b>Fleet Quantity</b>
February 2012	80
April 2012	77
August 2012	74
December 2012	71
February 2013	61

**Rate Reductions**

Since the program's inception, management negotiated two rate reductions to decrease the state's costs for unrented vehicles. The first reduction took effect in July 2012 and the second in February 2013. The effect of the change in fleet size and the rate reductions on DGS's cost of unrented vehicles is illustrated in Table 8:

**Table 8**  
**Effect of Fleet Size Changes & Rate Reductions on DGS's Cost of Unrented Vehicles**

	Quarter Ended					Total
	March 2012	June 2012	September 2012*	December 2012	March 2013	
<b>Total Program Cost</b>	\$ 128,804.70	\$ 188,714.31	\$ 176,842.94	\$ 174,917.94	\$ 164,092.17	\$ 833,372.06
<b>Less: Paid by State Agencies</b>	50,358.32	126,524.18	121,216.30	122,807.73	114,866.20	535,772.73
<b>Unrented Vehicle Costs</b>	78,446.38	62,190.13	55,626.64	52,110.21	49,225.97	297,599.33
<b>% Cost of Unrented Vehicles</b>	61%	33%	31%	30%	30%	36%
<b>Less: Rebates Received</b>	13,778.87	32,085.45	33,618.72	35,505.21	32,220.07	147,208.32
<b>Net Total Unrented Vehicle Costs</b>	\$ 64,667.51	\$ 30,104.68	\$ 22,007.92	\$ 16,605.00	\$ 17,005.90	\$ 150,391.01
<b>% Cost of Unrented Vehicles After Rebate</b>	50%	16%	12%	9%	10%	18%
*Rate reductions in July 2012 and August 2012.						

As shown in Table 8, DGS paid a significant portion of total CarShare costs for the quarter ended March 2012. Changes to the fleet size, billings for cars assigned to Project T3, and rate reductions negotiated by DGS's Office of Financial Management and the MVM Director reduced the costs from April 2012 through March 2013, when DGS's costs for unrented vehicles remained steady and were further reduced through quarterly rebates.

The Director of DGS's Office of Financial Management and the MVM Director should continue to evaluate the CarShare program and make the necessary adjustments to offer state employees a beneficial product while minimizing the costs to the state.

**Observation 5 –The Motor Vehicle Management Division staff did not record collections for damaged property collectables in accordance with Motor Vehicle Management Division’s policies and procedures and prematurely closed work orders relating to collectables; internal control over the cash receipt process was not effective; and the Department of Finance and Administration did not record accounts receivable for outstanding collectables at year-end**

When an accident causing damage to a state building or vehicle occurs, the Motor Vehicle Management Division (MVM) and the Office of General Counsel within the Department of General Services (DGS) are responsible for pursuing, receiving, and monitoring reimbursement for repair expenses, called collectables, from the at-fault party. We found that MVM did not have effective internal controls relating to the receipt of checks received for collectables. In addition, we found that the Wreck Repair Coordinator within MVM did not record payments received for collectables in accordance with the division’s written policies and procedures and prematurely closed work orders relating to collectables prior to receiving the full reimbursement. Finally, we found that the Department of Finance and Administration’s (F&A) Office of Financial Management staff did not create an account receivable for any outstanding balances at the end of the state’s fiscal year.

## **Background**

When MVM receives a report of a vehicle accident, the Wreck Repair Coordinator opens a work request within the FleetFocus/M5 system, MVM’s vehicle management system. He opens the work request while waiting to receive a statement from the state employee explaining what occurred, pictures of the damage, a repair estimate, and a law enforcement report, if applicable. Once the Wreck Repair Coordinator receives all required documentation, he places it in an Accident Folder and creates a purchase order in Edison, the state’s accounting system, for repair work on the vehicle. He then uses the work request to create a work order in FleetFocus/M5 to track the vehicle repair work.

Damages are either paid by the at-fault party’s insurance company or the at-fault party directly. If the at-fault party cannot pay the damages in full, MVM and the at-fault party establish a mutually agreed-upon payment plan.

## **Failed to Properly Record Collectables Received for Vehicle Damage**

We reviewed a sample of 60 work orders involving vehicles damaged by a third-party from July 1, 2012, through June 11, 2013, and matched them against the corresponding Accident Folders to determine whether third party collectables were handled properly. Based on our review of the Accident Folders sampled, we found that the Wreck Repair Coordinator did not follow procedures prescribed in the division’s operations manual relating to the recording of collectables. Specifically, we found the following:

- For 7 Accident Folders tested (12%), the collectables amount recorded in the FleetFocus/M5 system and in the Accident Folder did not agree. Based on review of the *Motor Vehicle Management Operations Manual*, the system and Accident Folders should agree.

- For 3 Accident Folders tested (5%), the Wreck Repair Coordinator did not place the completed pre-numbered receipt for each collectable in the Accident Folders. Instead, the receipts were found elsewhere on his desk. According to the *Motor Vehicle Management Operations Manual*, when a check is received, a copy of the receipt is placed in the Accident Folder.
- For 10 Accident Folders tested (33%), the Wreck Repair Coordinator did not complete the pre-numbered receipts on the date the collectable was received; he wrote the receipts from one to 19 days after he received the collectable. According to the *Motor Vehicle Management Operations Manual*, when a check is received, the Wreck Repair Coordinator “will prepare a receipt from the Receipt Book.”

Since the state pays for all repairs and then seeks recovery of the collectables from the at-fault parties, it is important that staff properly establish the outstanding collectable balances and promptly record the receipt of those collectables. Failing to adequately and promptly record collectables received from at-fault parties increases the risk that the recorded outstanding balances due to the state from at-risk parties are inaccurate.

### **Premature Closure of Work Orders**

The Wreck Repair Coordinator stated that he closes the work order in FleetFocus/M5 when an insurance company informs him it is sending him payment for damages instead of waiting until the department actually receives the payment. Additionally, he stated that when he receives the first payment against a payment plan he will close out the work order in the system to reflect a zero balance even though a remaining balance is still outstanding. According to the Wreck Repair Coordinator, he relies on this process to track the accounts by following up on closed accounts with outstanding balances. According to the *Motor Vehicle Management Operations Manual*, the work order should not be closed out until MVM has received payment.

### **Ineffective Controls Over the Custody of Collectables Received**

When the at-fault party sends the state payment for damages, whether directly or via the insurance company, the collectables are first delivered to MVM where an Administrative Secretary opens the payment envelope and date stamps it. While testing the work orders, we found that the Administrative Secretary does not make a list of checks received, which is a critical cash receipting control. The Administrative Secretary then delivers the collected amounts to the Wreck Repair Coordinator, who prepares a pre-numbered receipt. The Wreck Repair Coordinator then records each individual collectable on a sheet of paper in the Accident Folder for each incident. He forwards the amounts received to the Accounting Technician 2 in F&A’s Office of Financial Management, who records the collectables in a log and keys the amounts into Edison. In an effective internal control environment, receipts are recorded or logged at the initial receipting point before custody of the check changes from one person to another. Once the check collections pass to another individual, that individual must independently verify the checks in his possession. Failing to adequately log amounts and track collectables during the cash receipting process increases the risk that the checks may be misplaced or stolen.

## **No Accounts Receivable for Outstanding Collectables Balances at Year-End**

Based on our discussion with F&A's Office of Financial Management staff and our review of Accident Folders, we found that staff had not recorded the outstanding collectables in Edison. Based on information provided by the MVM Director, for the period from September 1, 2011, through April 11, 2013, there were 90 open collectable vehicle accounts. According to applicable accounting standards for collectables, accounts receivable should be recognized when the obligor acknowledged the debt is owed. Based on collectable data as of May 8, 2013, there was \$58,854.43 in outstanding collectables where an uninsured at-fault party agreed to a payment plan. For all applicable work orders with an outstanding balance, the division should record accounts receivable in Edison.

F&A's failure to recognize the remaining balances on collectables at year-end creates misstatements in DGS's accounting records. Additionally, as a result of this recognition error, the department is also unable to follow write-off procedures established by F&A Policy 23 when write-offs become necessary.

### **Risk Assessment**

Given the issues identified during fieldwork, we also reviewed the department's 2012 Financial Integrity Act Risk Assessment. Management failed to include any risks associated with collectables in the annual risk assessment.

The MVM Director should ensure current written procedures relating to receipting and recording are consistently followed by the Wreck Repair Coordinator so that both the Accident File and FleetFocus/M5 system are complete, accurate, and agree. The director should also establish appropriate, effective internal controls relating to the receipt of collectables.

Management should assess all significant risks, including 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 Commissioner. The Commissioner 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.

F&A's Office of Financial Management staff should ensure that collectables are treated in accordance with applicable accounting standards.

**Observation 6 – The Division of Motor Vehicle Management lacked an adequate process to ensure that all instances of state vehicle misuse were properly investigated**

Section 4-3-1105, *Tennessee Code Annotated*, states that it is the responsibility of the Department of General Services (DGS) to

study the use of state-owned automobiles by the state departments, offices and agencies, and establish rules and regulations for the housing, repair and operation of such automobiles.

As a part of this responsibility, the department's Motor Vehicle Management Division (MVM) investigates the alleged misuse of state-owned vehicles. Based on our review, however, MVM did not have an adequate process in place to ensure that all instances of state vehicle misuse were properly investigated.

MVM has to rely on other entities to send notice of allegations of potential misuse or abuse they have received. Without the department's own centralized vehicle misuse reporting system, such as a hotline, the division received many of the allegations through the Office of the Comptroller of the Treasury's fraud hotline, from other state entities, and local police departments. In fact, some complaints were submitted to the Governor's Office, which forwarded the complaints to MVM.

### **MVM's Responsibility for Reported Misuse**

When MVM receives complaints, the Administrative Services Assistant 4 researches the vehicles associated with these complaints to determine which entity owns the vehicle, creates a case file, and assigns a unique case number to track the investigation. MVM then notifies the owner entities so they can properly investigate. According to the MVM Director, MVM is only responsible for forwarding these complaints to the appropriate entities and obtaining confirmation from the entity that it investigated them. The owner entities are responsible for investigating and resolving the complaints, which includes determining the appropriate disciplinary action.

### **MVM Manual Does Not Effectively Address Complaint Handling**

Based on our review of the *Motor Vehicle Management Operations Manual*, we found that the manual does not address

- a specific deadline when MVM staff must forward complaints to owner entities; or
- when MVM staff should follow up with owner entities.

### **No Deadline to Forward Complaints**

For 4 of 49 cases tested (8%), MVM staff did not send initial letters to the responsible owner entities to start an investigation until over a month after receiving the complaints.

### **No Regular Follow-Up Process**

For 36 cases which had been open for longer than one month, MVM staff sent follow-up letters sporadically to remind the responsible owner entities to report complaint resolution to them. With follow-up letters sent anywhere from 6 to 283 days after previous letters, MVM did not encourage prompt resolution and corrective action for vehicle abuse or misuse. We also

found that 11 of 49 cases (22%) were unresolved for longer than six months. At the time of our review, we found one complaint that was still open after 560 days. In this case, MVM informed the agency of the complaint within three days but did not send its first follow-up letter until 283 days later.

### **The Impact of Not Having a Centralized State Vehicle Misuse Reporting System Has Not Been Included in Management’s Risk Assessment**

In our review of the department’s annual risk assessment, we found that management lists potential misuse or abuse of vehicles on official state business as a risk, but management has not evaluated the risks associated with its inconsistent process of forwarding complaints to other entities. Without a central mechanism for the public to report vehicle misuse, the department’s risk of not facilitating proper investigations of vehicle misuse is increased.

To ensure that instances of vehicle misuse are properly reported, the Commissioner should consider establishing a system, such as an advertised complaint hotline, to allow the public to report alleged vehicle misuse. The MVM Director should ensure that the division’s *Motor Vehicle Management Operations Manual* is updated to address specific instructions for how complaints against drivers from DGS and other state entities should be investigated and resolved. The Director should also take the necessary steps to ensure that all complaints are forwarded to the proper entity, followed up on, and closed in a reasonable time frame. Although the risks associated with the misuse and abuse of state vehicles were partially identified in the department’s risk assessment, management should revise the risk assessment so that it specifically includes the department’s responsibility to ensure that complaints of the misuse of state vehicles are properly investigated.

### **Office of Financial Management**

In accordance with Executive Order No. 13, effective July 1, 2012, a portion of the Office of Financial Management (OFM) accounting staff transferred to the Department of Finance and Administration (F&A). This Executive Order states that “the management and operations of financial accounting and reporting for the Department of General Services ... shall be transferred to the Department of Finance and Administration...The Department of Finance and Administration shall have exclusive jurisdiction and control over the Departments’ financial accounting and reporting functions.” OFM at F&A uses the state’s accounting system to record revenue from other state agencies and external customers for services provided by the Department of General Services’ program areas.

OFM staff at the Department of General Services (DGS) manages payroll, fiscal reporting, and budget activities for DGS. Prior to the Executive Order, OFM at DGS was responsible for calculating overhead administrative costs for vehicles, equipment (e.g., dozers and tractors), and attachments (e.g., spreaders and sprayers) for use in billing state agencies.

The objectives of our review of the Office of Financial Management at DGS were to determine whether the allocation percentage for overhead costs for vehicles, equipment, and attachments was properly calculated, reasonable, and updated regularly.

We interviewed key personnel responsible for fiscal and accounting processes within the Office of Financial Management at DGS. In addition, we reviewed and relied upon work performed on the Single Audit for fiscal year ended June 30, 2012, such as memos and emails exchanged between key personnel and the Division of State Audit and a recalculation of administrative overhead expenses and cost allocation percentages.

Based on procedures performed, we determined that the percentages used to allocate administrative overhead costs were properly calculated and reasonable with minor exceptions. Because the Motor Vehicle Management Division experienced significant operational changes since February 2012, management for OFM within the Department of Finance and Administration should consider reassessing the allocation of these administrative costs between vehicles, equipment, and attachments.

### Office of Information Technology Services

The objective of our review was to determine whether management followed the state's information systems procedures regarding computer access and disaster recovery. To determine whether management followed the state's information system procedures, we compared management's internal control activities to the state's information system procedures. Based on the procedures performed, we determined that management did not follow the state's information systems procedures regarding computer access and disaster recovery (see finding 5).

#### **Finding 5 – The department did not follow information systems procedures and did not maintain proper information systems security controls, increasing the risk of fraudulent activity and data loss**

Based on our testwork, Department of General Services' staff did not follow the state's information system procedures in two specific areas, resulting in an 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 department'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 department management with detailed information regarding the specific vulnerabilities we identified as well as our recommendation for improvement.

#### **Recommendation**

The Commissioner should ensure that these conditions are remedied through procedures that encompass all aspects of effective information systems controls. Management should evaluate and identify all significant risks, including 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 Commissioner. The Commissioner 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**

We concur.

We concur with this finding, and management has already taken corrective action to resolve these issues.

### **Division of Warehousing and Distribution**

The Division of Warehousing and Distribution (DWD) provides storage and distribution for a variety of forms, publications, and other printed materials that belong to other state agencies and departments. DWD also operates the surplus property program that redistributes personal property that is declared surplus by a state agency or the federal government. To assist with its surplus program, DWD also has the Law Enforcement Support Office (LESO), which manages the 1033 program for the state. Local Law Enforcement Agencies (LEAs) also participate in this program. The 1033 program allows for the transfer of surplus personal property from the United States Department of Defense to participating LEAs which in most cases allows LEAs to pay only shipping costs for the inventory. The 1122 program allows LEAs to purchase law enforcement equipment at a discount from civilian retail prices.

The objectives of our review of the Division of Warehousing and Distribution and its processes were to determine whether

- DWD sufficiently administered the LESO program;
- the LESO program met federal program requirements regarding accountability, utilization and transferability of surplus federal government property; and
- security policies and procedures over the warehouse were adequate.

We obtained and reviewed a copy of the department's policies and procedures, the LESO memorandum of agreement, and the state plan of operation, which is filed with the federal government.

We obtained a population of all LEAs approved to acquire federal inventory from DWD through the LESO program. We selected a nonstatistical random sample of 30 LEAs from a population of 294 to determine if the LEAs were approved to participate in the program. In addition, we obtained the LESO inventory for federal fiscal year 2012 that the department submitted to the Department of Defense, and we selected a nonstatistical random sample of 60 inventory items from a population of 932 items acquired by the LEAs through the LESO

program for the period July 1, 2011, through September 30, 2012, to determine if the State LESO Coordinator maintained the proper transfer documentation.

We conducted interviews and performed walkthroughs with management to assess DWD's adherence to policies and procedures and their physical security of inventory items maintained at the warehouse.

Based on procedures performed, we determined that

- the LESO program met federal program requirements;
- based on our review of the LEAs and LESO inventory documentation, the division is sufficiently administering the LESO program; and
- the division adequately secured DWD facilities, although some security improvements could be made.

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## OFFICE OF THE CHIEF OPERATING OFFICER

### Postal Services Division

The Postal Services Division is responsible for operating a United States Postal Service (USPS) contract station staffed by state employees located on the third floor of the William R. Snodgrass Tennessee Tower. The contract station sells USPS goods and services such as stamps, money orders, envelopes, flat-rate mail, and priority mail with average monthly sales of approximately \$8,200. The inventory sold at the contract station is the property of the USPS; therefore, all monies received from sales are the property of the USPS. The contract station is a requirement in order for the state to operate the mail processing center, which is located on the first floor of the building and managed by the Postal Services Division.

The objectives of our review of controls of the contract station were to

- gain an understanding of the cash receipting, recording, and reconciliation process for the contract station;
- determine if an adequate reconciliation process is used by the division to ensure the contract station's cash receipts are recorded;
- determine whether the contract station maintained proper internal controls in order to detect money order theft, fraud, waste, or abuse in a timely manner;
- determine that the safeguards over the contract station are in compliance with the *USPS Operations Manual*;
- obtain the reason for the unexplained variance in inventory in the division's monthly overage and shortage report; and
- review the department's 2012 Financial Integrity Act Risk Assessment as it related to the contract station to determine that management identified and addressed risks.

We conducted interviews and performed walkthroughs with key personnel to obtain an understanding of the cash receipting, recording, and reconciliation processes to account for the goods and services offered by the contract station. In addition, we obtained the most current *USPS Operations Manual* to determine the prescribed procedures to safeguard the cash and inventory located in the contract station.

In order to determine if the contract station complied with the *USPS Operations Manual*, we performed an inventory count at the contract station. During our inventory count, we obtained a range of money orders and verified whether the contract station maintained proper internal controls to promptly detect theft, fraud, waste, and abuse of money orders. We also reviewed the *USPS Operations Manual* relative to securing money orders.

We then obtained and reviewed the contract station's daily cash receipts reconciliation file. We obtained and reviewed the Postal Services Division policies and procedures for preparing the monthly overage and shortage report. Also, we examined the contract station's monthly overage and shortage reports, from April 2012 through February 2013, for any reported variances and sought explanations for these variances from the Mail Services Manager.

Finally, we reviewed the Department of General Services' 2012 Financial Integrity Act Risk Assessment as it related to the contract station to determine that management identified and addressed risks.

Based on procedures performed, we determined that

- some physical safeguards at the contract station did not comply with the *USPS Operation Manual*, nor were proper controls followed at all times to mitigate the risk of theft, fraud, waste, and abuse of cash and inventory (see observation 7);
- the contract station does have a reconciliation process for cash receipts, but improvements are needed (see observation 7);
- although we did not find any missing money orders for the period we reviewed, we did find that the contract station did not always maintain proper internal controls over money orders to detect theft, fraud, waste, or abuse in a timely manner (see observation 7);
- unexplained variances in the division's monthly overage and shortage reports were caused by a minor clerical error; and
- management did not include any risks associated with the contract station in the department's 2012 Financial Integrity Act Risk Assessment (see observation 7).

**Observation 7 – Contract station staff did not properly safeguard federal postal assets and did not establish an adequate cash receipting process**

The Department of General Services contracts with the federal government to operate a United States Postal Service (USPS) contract station located on the third floor of the William R. Snodgrass Tennessee Tower. The station provides for the sale of USPS goods and services to

the public, and the daily operations are the responsibility of the department's Postal Services Division staff.

According to Section 1-3.1 of the USPS' *Publication 116: Postal Contract Unit Operations Guide*, provided to us by the USPS Retail Specialist for Tennessee, who oversees all contract stations in the state,

All accountable items entrusted to you [contract postal units] (these include cash, stamps, philatelic products, retail products, and money order forms) are the property of the U.S. Postal Service. Postal Service policies and regulations require you to handle these items with care, to uphold security standards, and to perform duties prudently.

In addition, according to the *USPS Operations Manual*, "stamps, postal stationery, blank money orders, and other accountable items must be protected at all times."

### **Failure to Follow Appropriate Physical Safeguards of Postal Inventory**

Based on our discussion with the contract station's Mail Clerk, and as verified by our walkthroughs of internal controls over the contract station, the Mail Clerk stated cash received from the sale of goods (including postage stamps) and services is secured in two locked cash drawers with one drawer assigned to the Mail Clerk and the other drawer assigned to the backup Mail Clerk. Money orders are maintained in a separate drawer near the cash drawers. During our audit fieldwork, we performed one announced visit to the contract station on February 21, 2013, and two unannounced visits on February 27, 2013, and March 8, 2013. The results of our visits are summarized below:

- During our announced visit, we observed that money orders were stored in a drawer that did not have a lock on it.
- During our unannounced visit on February 27, 2013, we observed that the Mail Clerk's cash drawer was closed but left unlocked, and we observed unsecured stamps on the counter behind the Mail Clerk instead of properly secured in the cash drawer.
- During our unannounced visit on March 8, 2013, we observed that the same cash drawer was unlocked again and left ajar. We also observed that the safe was unlocked and left partly open.

Based on our observations, the Postal Services Division contract station staff did not fully comply with USPS policies and regulations, increasing the risk of theft, fraud, waste, or abuse of the postal goods sold at the contract station.

### **Inadequate Receipting Process Controls**

Based on our discussions and observations of the cash receipting processes, we identified two control weaknesses. Specifically, we determined that the Mail Clerk only issues a receipt on a USPS Form 1096 to customers who request one. Additionally, these receipts are not pre-numbered and the Mail Clerk stated he does not keep a copy of the Form 1096, but that he tracks

his sales using an Excel spreadsheet. Although the contract station is precluded from participating in the USPS electronic point-of-sale system due to its low volume of sales, according to the USPS Retail Specialist for Tennessee, the contract station is permitted to implement an electronic or manual receipting process to ensure adequate controls are in place.

We also determined that the Postal Services Division contract staff did not always ensure adequate segregation of duties when performing the reconciliation of the contract station's daily sales to the inventory sold. As noted above, the Mail Clerk tracks his sales using an Excel spreadsheet, and at the end of each day, he prepares Postal Form 1412, *Daily Financial Report*, which shows each type of sales transactions encountered during the day. The Mail Clerk also faxes this form to the Broadway Post Office in Nashville which oversees the state's contract station. He then submits the Excel spreadsheet to the Administrative Assistant 5 for reconciliation, except when the Administrative Assistant is not available. In that case, according to the Mail Clerk and the Mail Services Manager, the Mail Clerk performs the reconciliation.

To maintain an effective control environment over the cash receipting process to prevent the risks of errors, fraud, waste, and abuse, management must maintain proper documentation and segregate duties by ensuring that the individual accepting cash and recording sales does not perform the reconciliation of cash collections to sales records.

### **Contract Station Not Included in Risk Assessment**

Given the problems identified during our fieldwork, we also reviewed the department's risk assessment. Management failed to include any risks associated with the contract station in the department's annual risk assessment.

Staff should properly safeguard federal postal assets under the department's custody in accordance with USPS policies and regulations so the assets are protected against theft, fraud, waste, and abuse. Management of the Division of Postal Services should implement an appropriate cash receipting process that keeps a record of each individual sale to mitigate the risks of errors, theft, fraud, waste, and abuse. This process should include issuing and maintaining proper cash receipt documentation and also segregating cash receipting duties. Management should assess all significant risks, including the risks noted in this observation, in management's documented risk assessment.

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### **STATE PROTEST COMMITTEE**

The State Protest Committee created by *Tennessee Code Annotated*, Title 4, Chapter 56, consists of the Commissioner of the Department of General Services and the Commissioner of the Department of Finance and Administration, and the State Treasurer. If a member is not available to hear a scheduled protest, the member is authorized to appoint a designee to hear the protest on the member's behalf. The State Protest Committee hears all vendor protests of decisions made by the Central Procurement Office's Chief Procurement Officer. The State Protest Committee gives the final word on the protest based on its review; as a result, the committee's decision is crucial for contracts to move forward.

The objectives of our review of the State Protest Committee were to determine if the meetings are held in accordance with statute and are open and transparent.

We reviewed Section 4-56-103, *Tennessee Code Annotated*, pertaining to the State Protest Committee. We also attended the meetings held February 5, 2013, and May 6, 2013, and reviewed the audio recordings of all protests that have been held since the State Protest Committee's creation. Finally, we reviewed minutes for each meeting.

Based on procedures performed, we determined that the State Protest Committee meetings were held in accordance with statute and the meetings were open and transparent; however, we noted that meeting minutes were not available on the Central Procurement Office's website.

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## APPENDICES

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### APPENDIX 1

#### BUSINESS UNIT CODES

Department of General Services business unit codes:

321.01	Administration
321.02	Postal Services
321.06	Motor Vehicle Management
321.07	State of Tennessee Real Estate Management
321.09	Printing and Media Services
321.10	Central Procurement Office
321.18	Warehousing and Distribution

## APPENDIX 2

### CENTRAL PROCUREMENT OFFICE SURVEY RECIPIENTS

Administrative Office of the Courts  
Alcoholic Beverage Commission  
Board of Parole  
Bureau of TennCare  
Commission on Aging and Disability  
Commission on Children and Youth  
Comptroller of the Treasury  
Department of Agriculture  
Department of Children's Services  
Department of Commerce and Insurance  
Department of Correction  
Department of Economic and Community Development  
Department of Education  
Department of Environment and Conservation  
Department of Finance and Administration  
Department of Financial Institutions  
Department of General Services  
Department of Health  
Department of Human Resources  
Department of Human Services  
Department of Intellectual and Developmental Disabilities  
Department of Labor and Workforce Development  
Department of Mental Health and Substance Abuse Services  
Military Department of Tennessee (including the Tennessee Emergency Management Agency)  
Department of Revenue  
Department of Safety and Homeland Security  
Department of State  
Department of Tourist Development  
Department of Transportation  
Department of the Treasury  
Department of Veterans Affairs  
General Assembly Fiscal Review Committee  
Health Services and Development Agency  
Human Rights Commission  
Post-Conviction Defender Commission  
Tennessee Advisory Commission on Intergovernmental Relations  
Tennessee Arts Commission  
Tennessee Bureau of Investigation  
Tennessee Corrections Institute  
Tennessee Higher Education Commission  
Tennessee Housing Development Agency  
Tennessee Regulatory Authority  
Tennessee Rehabilitative Initiative in Correction (TRICOR)  
Tennessee State Museum  
Tennessee Student Assistance Corporation  
Tennessee Veterans' Homes Board  
Tennessee Wildlife Resources Agency