AUDIT REPORT

Department of Revenue

August 2009

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

Tennessee Comptroller of the Treasury

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August 11, 2009

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable Reagan Farr, Commissioner
Department of Revenue
1200 Andrew Jackson Building
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Revenue for the period May 1, 2007, through May 31, 2008.

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

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

We have reported other less significant matters involving the department's internal control and instances of noncompliance to the Department of Revenue's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/cj
08/054

State of Tennessee

Audit Highlights

Comptroller of the Treasury Division of State Audit

Financial and Compliance Audit
Department of Revenue
August 2009

AUDIT SCOPE

We have audited the Department of Revenue for the period May 1, 2007, through May 31, 2008. Our audit scope included a review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements in the areas of the International Registration Plan, equipment, contracts, taxpayer and vehicle services, E-Way purchases, and revenue. The audit was conducted in accordance with generally accepted government auditing standards.

AUDIT FINDINGS

Due to a Lack of Effective Physical Security Measures for Safeguarding Cash, There is Heightened Risk of Theft and Fraud Within an Office of the Department of Revenue
During our observation of operations at a particular office, we noted several security issues pertaining to collection and custody of cash (page 5).

Management of the Department of Revenue Did Not Adequately Mitigate the Risks of Error, Fraud, Waste, and Abuse Relative to the Information System Used in the Division of Taxpayer and Vehicle Services
The Director of Taxpayer and Vehicle Services has not established critical access controls and did not communicate the contingency plans to the staff who would need them in the event of system failure (page 9).

As Stated in the Prior Audit, Management of the Department of Revenue Did Not Adequately Mitigate the Risks of Error, Fraud, Waste, and Abuse Relative to Motor Vehicle Registration Revenue Collections in the Taxpayer and Vehicle Services Division*
Staff in the Taxpayer and Vehicle Services Division have still not been able to reconcile distributions of vehicle plates and decals with revenue received from the county clerks for the sale of these items. Neither the division staff nor the county clerks maintained records of the number of plates and decals received, sold, or voided or of the total dollar value of the items sold. In addition, 59% of the county clerks did not submit the inventory reports to the state as required by the department (page 13).

* This finding is repeated from the prior audit.

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INTRODUCTION

POST-AUDIT AUTHORITY

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

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

BACKGROUND

The mission of the Department of Revenue is to collect state revenue. Specifically, the department is responsible for the collection of most state taxes, fees, and motor vehicle title and registration fees; enforcing the revenue statutes of the state to ensure that taxpayers are in compliance with all tax laws and motor vehicle registration laws; and preparing monthly apportionment of revenue collections for distribution to various state funds and local units of government. The department also offers taxpayer assistance and taxpayer education. To perform its duties, the department has divided these functions into seven divisions: Administration, Tax Enforcement, Information Technology Resources, Taxpayer and Vehicle Services, C.I.D. Anti-Theft, Audit, and Processing.

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

AUDIT SCOPE

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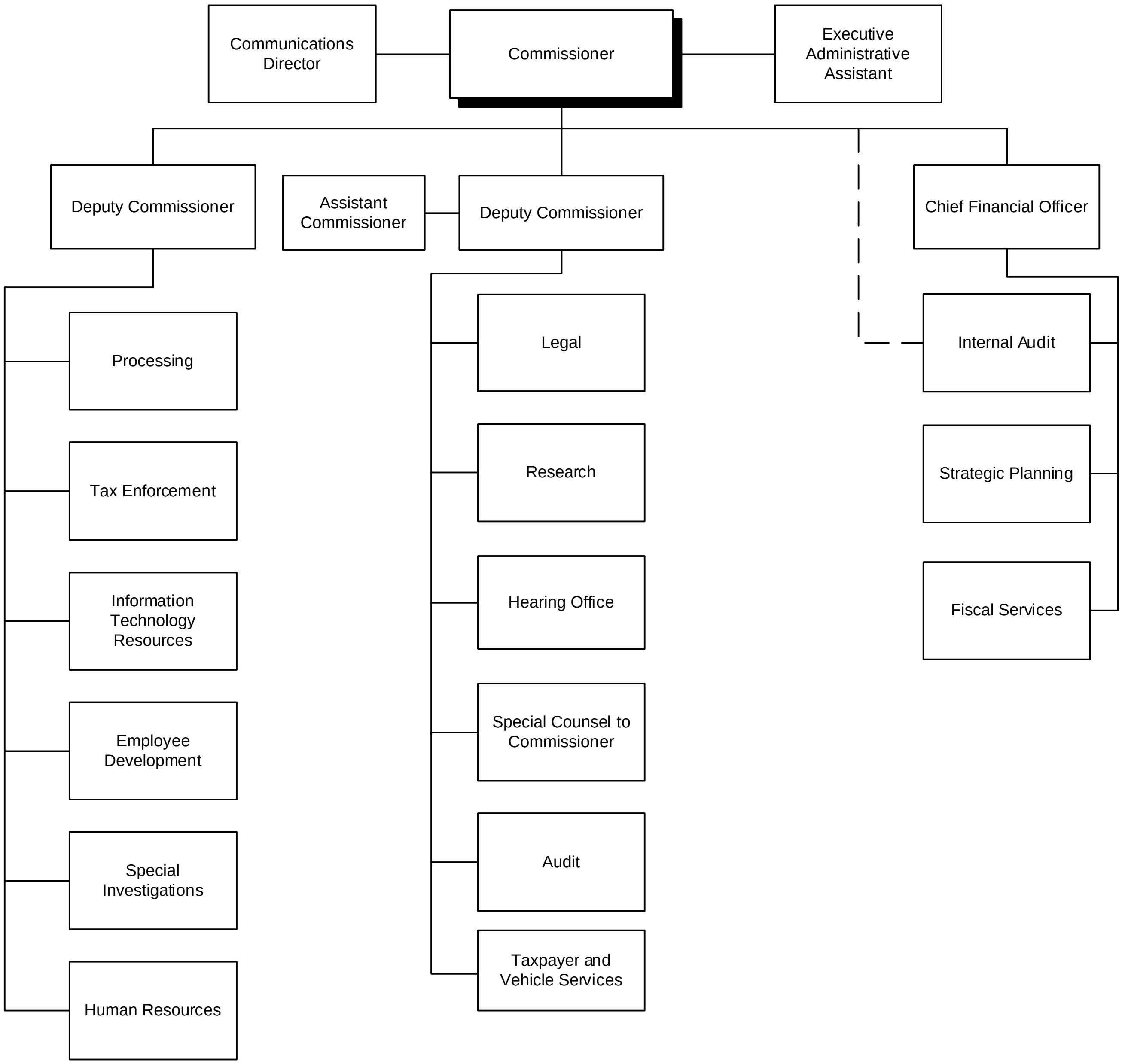
Tennessee Department of Revenue
Organization Chart



PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Department of Revenue filed its report with the Department of Audit on October 2, 2008. Although this report was received after the current audit, we performed a follow-up of all prior audit findings as part of this audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the Department of Revenue has corrected the previous audit findings concerning controls over E-Way purchases, lack of proper communication in updating the dishonored checks list and lack of effective pursuit in the collection of dishonored checks, and controls over cash receipting in the Motor Carrier Section.

REPEATED AUDIT FINDING

The prior audit report also contained a finding concerning reconciling distributions of vehicle plates and decals with revenue received from the county clerks. This finding has not been resolved and is repeated in the applicable section of this report.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

INTERNATIONAL REGISTRATION PLAN

The International Registration Plan (IRP) is the method used to collect registration fees and register commercial vehicles that travel in two or more jurisdictions within the U.S. and Canada. Our objectives in reviewing the IRP were to determine whether

- cash receipts agreed with the related invoices and deposit slips;
- the department followed the applicable procedures to collect any delinquent accounts;
- the department complied with the applicable policies and procedures that govern the IRP; and
- the IRP deposits agreed with amounts reported in the State of Tennessee Accounting and Reporting System (STARS).

We reviewed the IRP procedures manual and interviewed key department personnel. We obtained a listing of all active accounts from May 1, 2007, through February 28, 2008, and tested a nonstatistical sample to determine if the cash receipts agreed with the related invoices and deposit slips. We obtained and reviewed the department's procedures for collecting dishonored checks and obtained and reviewed a list of dishonored checks for the period May 1, 2007, through May 31, 2008. We also tested a nonstatistical sample to determine if the department followed the applicable procedures to collect any delinquent accounts. To determine if the IRP registrations were issued in accordance with the applicable policies and procedures, we tested a nonstatistical sample from all active IRP accounts from May 1, 2007, through February 28, 2008. We tested a nonstatistical sample of IRP deposits made between May 1, 2007, and February 28, 2008, for one office, and in January 2008 for another office to determine if they agreed with amounts reported in STARS.

As a result of our reviews, interviews, walkthrough, and examination of documents, we determined that

- the Motor Carrier Section's cash receipts agreed with the related invoices and deposit slips;
- the department followed the applicable procedures to collect delinquent accounts;
- the department complied with the applicable policies and procedures that govern the IRP; and
- the IRP deposits totals agreed with the amounts reported in STARS.

During the performance of our testwork, we discovered physical security was poor for one of the offices, as noted in Finding 1. As a result of these security concerns, we performed extended auditing procedures on cash receipts at this office. On April 16, 2008, we agreed checks and currency received to the deposit slip. In addition, we obtained a listing of all receipts issued from this office for the period May 1, 2007, through April 23, 2008. From that listing, we selected a nonstatistical sample and confirmed the sample amounts with the vendors. We also selected those receipts that we deemed large or unusual and confirmed the amounts with the vendors. We found no problems when performing the extended auditing procedures.

1. Due to a lack of effective physical security measures for safeguarding cash, there is heightened risk of theft and fraud within an office of the Department of Revenue

Finding

The Department of Revenue receives registration fees to register commercial vehicles that travel in two or more jurisdictions (states). These registration fees are collected for the International Registration Plan.

During our observation of operations and inquiry of personnel regarding the collection of these registration fees, we noted several security concerns involving safeguarding fees collected. The wording of this finding does not identify the specific vulnerabilities that could allow someone to exploit them. We provided management with detailed information regarding our security concerns. After doing so, the department utilized a special agent from its Special Investigations Division to perform a security review. The agent issued a report as a result of this review; however, due to the confidential nature of that report, we are not disclosing in this finding the security concerns that were identified by the special agent. In response to these significant concerns, management stated that various controls have been put in place since our testwork ended. These controls will be verified when we conduct follow-up work.

Due to a lack of physical security measures to safeguard fee collections, management cannot ensure that this office is safe and secure for cash receipting and custody. The lack of security and limited number of personnel increase the risk of fraud and theft of cash receipts.

Recommendation

The Commissioner and Director should take immediate action to remedy the most significant of the physical security issues over the cash receipts. Then, a long-term plan should be developed to correct any remaining concerns. Finally, the Commissioner and the Manager should update the formal documented risk assessments to include the risks identified in this finding that cannot be corrected immediately.

Management's Comment

We concur. After State Audit personnel shared their concerns about the lack of security in the office, we requested that Revenue's Special Investigations Division visit the office and provide us with an assessment of the security needs of the office.

Based on their recommendation, we implemented a series of controls to ensure that staff were safeguarding state funds and were provided the best security possible, for their personal protection. The full details of the updates are confidential and were provided to the Comptroller's Office, separate from this report.

In addition, Motor Carrier management in Nashville implemented information system controls to monitor the internal control functions, including a reconciliation of the receipts processed through the ACS computer system. All irregular activity relating to receipts, like voids or skipped numbers, must be explained in writing and the receipt numbers accounted for immediately.

However, because we do not believe we can achieve the standard of security we require at the current location, we plan to close this office and consolidate its functions with one of our existing offices.

EQUIPMENT

Our objectives for the review of equipment were to determine whether

- equipment information was properly recorded in the Property of the State of Tennessee (POST) system;
- equipment could be physically located or confirmed;
- lost or stolen equipment was promptly reported to the Comptroller's Office and reported to the Department of General Services for removal from POST;
- the department maintained proper accountability over confiscated property; and
- employee access to POST was appropriate.

We interviewed key personnel to gain an understanding of the department's procedures and controls over the inventory of equipment owned by the department. We reviewed supporting documentation and tested a nonstatistical sample of equipment at January 28, 2008, to determine if the equipment items were properly recorded in POST. We selected a nonstatistical sample of equipment items in POST at January 7, 2008, to determine if the items could be physically located or confirmed. We reviewed supporting documentation to determine if lost equipment for the period May 1, 2007, through April 30, 2008, was promptly reported to the Comptroller's Office, and made inquiries to determine if the department reported such equipment losses to the Department of General Services so that General Services could remove the items from POST. Based on our discussion with department personnel, there were no stolen items during this period. We interviewed personnel, reviewed applicable laws, and tested a nonstatistical sample of contraband inventory at February 19, 2008, and a nonstatistical sample of assets seized to satisfy tax liabilities for the time period May 1, 2007, through April 30, 2008, to determine if the department maintained proper accountability over confiscated property. We selected a nonstatistical sample of POST users at December 12, 2007, to determine if only active employees had POST access, if the level of access was appropriate for the job duties, and if there was an adequate segregation of duties.

As a result of our interviews, reviews, and testwork, we concluded that

- equipment information was properly recorded in POST;
- except for minor exceptions, equipment items could be physically located or confirmed;
- lost equipment was promptly reported to the Comptroller's Office and reported to the Department of General Services for removal from POST;
- the department maintained proper accountability over confiscated property; and
- employee access to POST was appropriate.

CONTRACTS

The objectives of our review of contracts were to determine whether

- contracts were made in accordance with regulations and established in compliance with purchasing guidelines, and
- contract payments were in compliance with contract terms and purchasing guidelines.

We obtained a listing of contracts as of January 7, 2008, that had effective dates from May 1, 2007, through April 30, 2008, and selected a nonstatistical sample. We reviewed supporting documentation for the sample contracts to determine if the contracts were made in accordance with regulations and established in compliance with purchasing guidelines. We reviewed the supporting documentation for payments to determine if the payments were in compliance with contract terms and purchasing guidelines.

As a result of our review and testwork, we concluded that contracts were made in accordance with regulations and established in compliance with purchasing guidelines, with minor exceptions. We also concluded that contract payments were in compliance with contract terms and purchasing guidelines, with minor exceptions.

TAXPAYER AND VEHICLE SERVICES

Our objectives for the review of the Taxpayer and Vehicle Services Division were to determine whether

- county clerks submitted renewal registration transmittals timely as required by *Tennessee Code Annotated*;
- county clerks submitted daily invoice remittance reports and the related remittances timely as required by *Tennessee Code Annotated*;

- refunds issued by the department were proper;
- reconciliations were performed between the number of inquiries to Tennessee AnyTime (the Internet web page for vehicle title and registration information) and the fees collected for that access, and there were no material differences;
- correct title and registration fees were charged, and they were properly deposited;
- taxpayer and vehicle services' deposits reconciled to STARS;
- physical inventory counts of license plates were performed;
- county clerks submitted license plate inventory reports in accordance with department requirements;
- the department reconciled the distribution of vehicle plates and decals with revenue received from the county clerks for the sale of these items; and
- applicable procedures were followed to collect any delinquent accounts.

We interviewed key personnel to gain an understanding of the department's procedures and controls over the Taxpayer and Vehicle Services Division. We interviewed staff to determine if the county clerks' offices were transmitting renewal registrations timely, as required by *Tennessee Code Annotated*. In order to test county clerks' daily invoices and remittances for timeliness, we first selected a nonstatistical random sample of 25 counties and then selected 25 random days from May 1, 2007, through April 1, 2008. We tested a nonstatistical sample of 25 refunds from a population of all refunds issued during the month of May 2007 for propriety. We reviewed the July, November, and December 2007 Tennessee AnyTime reconciliations to ensure that they were being performed and that there were no material differences. We tested a nonstatistical sample of 25 title and registration transactions processed at the Vantage Way location on December 21, 2007, to ensure the correct fee was charged and the revenue was properly deposited. We performed a reconciliation between taxpayer and vehicle services deposits and STARS for the month of February 2008. We obtained and reviewed the physical inventory count sheets and the inventory totals. We obtained the license plate inventory reports submitted by the county clerks for the four quarters from April 1, 2007, through March 31, 2008, to determine if the county clerks submitted them in accordance with department requirements. We interviewed management to gain an understanding of the procedures and controls over the accountability for vehicle plates and decals and the reconciliation process. We obtained and reviewed the department's procedures for collecting dishonored checks, and obtained and tested a list of dishonored checks from July 1, 2007, through April 30, 2008, to determine if the department followed the applicable procedures to collect delinquent accounts.

As a result of our interviews with key personnel about the Taxpayer and Vehicle Services Division's cashiering-based information system (BIS), we determined that management did not adequately mitigate the risks of error, fraud, waste, and abuse relative to the information system (see finding 2 below).

As a result of our interviews, reviews, and testwork, we concluded that

- county clerks submitted renewal registration transmittals timely as required by *Tennessee Code Annotated*, with minor exceptions;
- county clerks submitted daily invoice remittance reports and the related remittances timely as required by *Tennessee Code Annotated*;
- refunds issued by the department were proper, with minor exceptions;
- reconciliations were performed between the number of inquiries to Tennessee AnyTime and the fees collected for that access, and there were no material differences in the reconciliations;
- correct title and registration fees were charged and properly deposited;
- taxpayer and vehicle services' deposits reconciled to STARS with no material differences;
- physical inventory counts of license plates were performed;
- county clerks were not always submitting license plate inventory reports in accordance with department requirements (see finding 3);
- the department had not reconciled issuances of vehicle plates and decals with the revenue received from the county clerks for the sale of these items (see finding 3); and
- applicable procedures were followed to collect delinquent accounts, with minor exceptions.

2. Management of the Department of Revenue did not adequately mitigate the risks of error, fraud, waste, and abuse relative to the information system used in the Division of Taxpayer and Vehicle Services

Finding

The Department of Revenue's Division of Taxpayer and Vehicle Services uses a cashiering-based information system, the Business Information Systems (BIS), to process data. An integral part of any information system includes user access controls to ensure proper segregation of duties and a contingency plan that has been communicated to staff in the event of system failure. However, in our review of this division, we found that the Director of Taxpayer and Vehicle Services has not established critical access controls for the BIS environment and did not communicate the contingency plans (the department has two) to the staff who would need them in the event of system failure.

User Access

Within BIS, there are a total of 30 "functional" levels. Access to these functional levels allows employees to complete various tasks. Normally, an information system should have further access restrictions, only allowing user access to specific tasks within a level based on the employees' job duties. However, we found that with BIS, when employees are granted access to a functional level, they automatically have access to all tasks in that level. Information Technology Resources management did not ensure that BIS was designed to restrict access to specific tasks within a level. Also, BIS was not designed to provide a "Read Only" access level. As a result of these system limitations, there is a greater risk of errors, fraud, waste, and abuse. For example, an employee with access to the safe could misappropriate funds and delete the specific items from the deposit record in BIS. Furthermore, if that employee also had access to the "Online MVD Registration Menu," he or she could change or delete the supporting title, invoice, or other documentation from the system so there was no record of the transaction. During audit fieldwork, we found 29 employees who had access to BIS, and all of them had access to the level where deposit information is keyed—the "Bookkeeping Menu." Twenty-two employees had access to the "Online MVD Registration Menu." Eight of the 22 employees mentioned above also had access to the safe.

We also found that employees were given access to levels that were not necessary based on their job duties. For example, 26 of the 29 employees had access to the "Refund System Menu." However, our review of job duties and interviews with employees revealed that only three employees processed refunds. Further, we found that all 21 non-supervisory employees were granted more access than needed for their day-to-day job duties. These issues create a lack of segregation of duties, and increase the risk of errors, fraud, waste, and abuse.

Contingency Plan

Based on our review, we found that staff in Information Technology Resources and former management of the Division of Taxpayer and Vehicle Services had formulated two different contingency plans in the event of an information system failure. However, the Director of Taxpayer and Vehicle Services failed to appropriately communicate either plan to the staff that would need the plans to take immediate action in the event of system failure.

While we were performing observations of the receipting process in May 2008, there was a BIS failure that lasted a day and a half. Although there was a back-up server, it did not function as planned, so department management and staff were unable to access the information system.

In our follow-up of this problem, we were initially informed by the Assistant Director of Vehicle Services that there were no contingency plans and that staff were formulating plans as they performed specific tasks, which included writing manual receipts with carbon paper. We then reviewed the department's Risk Assessment document to determine if system failure was an identified risk. We found that it was included in the Risk Assessment document and that a receipting process was outlined in the document.

The Risk Assessment document makes reference to a receipt template that has been created in Microsoft Excel. It further states that “each counter staff was asked to locate and open and save the Excel receipt on their desktop” and that “all staff can open, make and save changes to [the] alternate receipting system in Excel.” This receipting process was developed in December 2006, but this was not the receipting process being used by staff during our observation.

Later in the day, the Assistant Director informed us that staff had found the contingency plan. Apparently, due to a breakdown in communication among department personnel, the contingency plan had not been disseminated to all the staff that needed it, nor were all employees trained to implement the plan.

We later discovered that the Division of Information Technology Resources had also prepared a contingency plan to be followed in the event of a BIS failure and had e-mailed these procedures to the Director of Taxpayer and Vehicle Services and the Assistant Director of Vehicle Services, among others. However, due to a typo, this list of procedures was not e-mailed to the Assistant Director, but rather to someone with a similar name who was not an employee of the Department of Revenue. When we asked the Director of the division in May 2008 about this list of alternate procedures, she said that she had not opened the December 21, 2007, e-mail. As a result, she did not notice the typo, nor did she ensure that the procedures were communicated to appropriate staff.

The contingency plans were developed to ensure accountability and to help employees serve taxpayers as efficiently as possible in the event of an information system failure. Although the Director of the Taxpayer and Vehicle Services Division asserts that transactions ran smoothly during the computer downtime, it is impossible to ensure that errors, fraud, waste, or abuse did not occur during the period of the outage.

Recommendation

The Commissioner and the Director of the Taxpayer and Vehicle Services Division should ensure employees of the division only have access within the information system to those levels which are necessary for daily job duties, and user access should be monitored. Transaction approvals should continue to be required in order to help compensate for the lack of segregation of duties within the system.

In addition, the Commissioner and the Director of the Taxpayer and Vehicle Services Division should ensure that the contingency plans are communicated to all necessary employees of the division and that those employees are adequately trained to implement the plans in the event of an information system failure. The same should hold true for new employees as they are hired. Fortunately, even though neither contingency plan had been communicated to the Assistant Director, he was able to think quickly and implement an alternative receipting process in a very short period of time.

Finally, the Commissioner and the Director of the Taxpayer and Vehicle Services Division should identify specific staff to be responsible for ongoing monitoring for compliance with the policies in place and to be responsible for taking prompt action should exceptions to internal controls occur.

Management's Comment

We concur in part. The BIS system was not designed by the Revenue Information Technology Resources Division (ITR). The BIS system was in place when Title and Registration operations were transferred to our department, and Revenue took immediate action to address concerns the auditors brought to management's attention related to the system. An audit/security review was performed by the Internal Audit and Consulting Services section, in conjunction with all pertinent divisions, shortly after the end of State Audit fieldwork in 2008.

Internal Audit's recommendations were implemented, and all employee security requests were standardized to meet Revenue's regular departmental approval procedures. Each employee's security access was reset to only allow access to the portions of the system necessary for them to complete their specific job function. The current BIS system will no longer be utilized after the implementation of TRUST. The TRUST system has built-in security requirements that will mitigate the weaknesses defined in this report.

Relative to the statements concerning the Contingency Plan portion of the finding, the ITR Division document referenced was promulgated to more specifically address the procedures in the Processing Division. Though the document included aspects of the Taxpayer and Vehicle Services Division operation, Vehicle Services personnel had a separate Contingency Plan and procedure, developed and tested by their Managers. Both plans were utilized that day.

The state auditor was on site for a limited amount of time and exposed to a limited number of Vehicle Services staff. The auditor observed activities prior to commencement of business that day and made their assessment based on that time frame.

We want to make it clear that no action or lack of action identified in this report hindered the implementation of an effective plan that day. An appropriate Contingency Plan was completed and successfully deployed when the BIS system went down. The department served the same number of customers as we would have during a "normal" business day, and both Processing and Taxpayer and Vehicle Services were able to balance at the end of the day.

Auditor's Rebuttal

The auditor based her assessment of the contingency plan on inquiries with staff and her observation. The system failed while she was conducting her observation. Once she learned that the back-up server also failed, she performed follow-up inquiries and observation, during business hours, to determine what contingency procedures were in place. Although management quickly developed, and staff utilized, an appropriate contingency plan, there is a higher risk that errors or fraud could occur and escape detection. Effective communication of the established contingency plans would reduce this risk.

3. <u>As stated in the prior audit, management of the Department of Revenue did not adequately mitigate the risks of error, fraud, waste, and abuse relative to motor vehicle registration revenue collections in the Taxpayer and Vehicle Services Division</u>

Finding

Effective July 1, 2006, the Governor determined that it was in the best interest of economy, efficiency, and better coordination of the functions of state government to transfer the Division of Title and Registration from the Department of Safety to the Department of Revenue (this division is now referred to as the Taxpayer and Vehicle Services Division). While the division was under the responsibility of the Department of Safety, we reported that since 1989, management of the Department of Safety had not adequately mitigated the risks of error, fraud, waste, and abuse relative to motor vehicle registration revenue collections by reconciling revenue collections with distributions of vehicle plates and decals. During this time period, the Department of Safety was responsible for corrective actions. However, we found the same problem during our last audit of the Department of Revenue which included the ten-month period (July 1, 2006, through April 30, 2007) after the division was transferred from the Department of Safety.

In our review of the Taxpayer and Vehicle Services Division covering this audit period, May 1, 2007, to May 31, 2008, we found that the staff have still not been able to reconcile distributions of vehicle plates and decals with revenue received from the county clerks for the sale of these items. In order to reconcile the distributions of vehicle plates and decals to the revenue collected, the Department of Revenue must coordinate with parties outside of their Taxpayer and Vehicle Services Division staff. Those parties include the county clerks' offices, which sell the registration plates and decals, and Tennessee Rehabilitative Initiative in Correction (TRICOR), which is responsible for making the plates and shipping the plates and decals to the county clerks' offices.

The collection of vehicle plate and decal revenues is inherently risky because of the decentralized nature of the collection process. When one entity collects fees on behalf of another, there is always a risk that the collecting entity may fail to remit the collections. The department relies on the county clerks' offices to distribute vehicle registration plates and decals and remit the revenue to the department. It is possible that a county clerk could issue a vehicle registration, collect the fees, fail to enter the vehicle registration renewal into the system, and retain the fees that should be sent to the state. One of the most fundamental controls the Department of Revenue can implement to mitigate the risks of non-remittances by the clerks is a regularly performed reconciliation of independently obtained or verified license plate and decal distributions amounts with fees collected and remitted.

During our examination, we found that vehicle plate and decal inventory lists submitted by the county clerks only included the number of plates and decals on hand. Neither the division staff nor the county clerks maintained records of the number of plates and decals received, sold, or voided or of the total dollar value of the items sold. Therefore, we could not determine if all of the revenue of the plates and decals sold was in fact remitted to the state. This risk was not included in the division's formal risk assessment document.

In addition, our inquiry disclosed that the division made no attempt to obtain inventories from the counties. Section 55-6-105(a)(8), *Tennessee Code Annotated*, instructs the county clerks to "Account to the department for all registration plates so consigned to such clerk." When the division was under the Department of Safety, inventory reports were required to be submitted quarterly, and the Department of Revenue has continued using this guideline. However, 56 of 95 county clerks (59%) did not meet this requirement, and 22 of the 56 county clerks did not submit any quarterly inventory reports for the time period examined (April 1, 2007, through March 31, 2008).

In the previous audit, management's comment to the finding stated,

> Revenue has completely rewritten the TRUST [Title and Registration's User's System for Tennessee] Data Model and continues to define new Business Rules that will streamline the processing of all transactions on the system. TRUST will provide more accurate record keeping capability; and more immediate reconciliation ability on license plate and decal inventories in house, at the manufacturer, and in the County Clerk's offices.

However, as of the end of our audit, May 31, 2008, the TRUST Data Model has still not been implemented. In addition, our review showed that interim procedures to detect, deter, and prevent fraud related to motor vehicle registration revenue collections by the county clerks' offices were not in place during the audit period.

In management's follow-up comment to the prior audit finding, dated October 1, 2008, they state that the target "go live" date for TRUST is June 15, 2009. They also indicate that they continue to have problems obtaining quarterly reports from some counties. However, they state that they are sending reminder notices in advance of each new quarter and follow-up notices for those who have not submitted their report.

Without adequate controls over motor vehicle registration revenue collections, such as the controls described in this finding, there is a greater risk that error, fraud, waste, and abuse will occur and escape detection.

Recommendation

As recommended in the prior audit, and until management is able to implement the TRUST Data Model, the Commissioner and the Director of the Taxpayer and Vehicle Services

Division should ensure that all county clerks submit the inventory report timely and should coordinate with all involved parties to ensure that a reconciliation is performed between the revenue received from each of the county clerks and the inventory reports of distributions of vehicle plates and decals. Any differences should be thoroughly reviewed and resolved. Any indications of fraud, waste, or abuse should be immediately reported to the Office of the Comptroller of the Treasury.

The Director of the Taxpayer and Vehicle Services Division should ensure that the risks identified in this finding are included in the division's formal risk assessment document. The Director and staff should also design and implement mitigating internal controls to adequately address all assessed risks. The risk assessment and the documented internal controls should be presented to the Commissioner for review, modifications, and approval. Also, as recommended in the prior audit, the Commissioner and the Director should identify specific staff to be responsible for ongoing monitoring for compliance with the policies in place and to be responsible for taking prompt action should exceptions to internal controls occur.

Management's Comment

We concur. However, the Department of Revenue has made significant progress in addressing all of the weaknesses noted in this report. Since obtaining the Title and Registration operation, now located in our Taxpayer and Vehicle Services (TPVS) and Processing Divisions, we have made significant strides in updating operations.

Revenue's Processing Division processes all collections from the county clerks and reconciles those collections to the aggregate sales totals represented in the remittance documents provided by the county. The money and the reported sales must agree prior to completing the deposit and collection recognition process. In addition, the Fiscal Office has the responsibility of reviewing funds collected prior to their being apportioned.

The new "Title and Registration Users System for Tennessee" (TRUST), which is scheduled to go on-line before the end of 2009, will afford the department complete front-end reconciliation of funds and documents. In addition, we will be able to perform back-end reconciliations of sales and inventory balances at the county level. The system will track all controlled items from the time they are shipped from the supplier to actual issuance to the customer. Sales and perpetual inventory balances will be documented through management and accounting reports in or interfacing with TRUST.

As stated in the finding, TCA Section 55-6-105(a)(8) requires the county clerks to "account to the department for all registration plates so consigned to such clerk." The statute does not provide a required time frame; however, historically, reports were requested on a quarterly basis and also sent in a fiscal-year-end inventory report. Revenue is now sending an e-mail prior to the end of each quarter to remind the clerks to submit the required reports to the department. An additional e-mail is sent to clerks that do not remit their inventory report timely.

Every year at June 30, Revenue's Internal Audit and Consulting Services Division performs year-end counts of all plates and decals on hand in the department and at the TRICOR manufacturing facility in Henning, Tennessee. These inventories are valued and the information is provided to the Department of Finance and Administration.

E-WAY PURCHASES

E-Way is a web-based system for purchasing supplies through a state-wide contract. Our objectives in reviewing E-Way purchases were to determine if they were reasonable and properly approved. To accomplish our objectives, we selected a nonstatistical sample of E-Way purchases made from May 21, 2007, through November 30, 2007, and reviewed the related invoices and supporting documentation. Based on our testwork, we found that E-Way purchases were reasonable and properly approved.

REVENUE

Our objectives for the review of revenue were to determine whether

- tax amounts in the Revenue Integrated Tax System (RITS) were adequately supported, properly recorded, and deposited; and
- revenue was apportioned correctly based on *Tennessee Code Annotated*.

We selected a nonstatistical sample of tax collections in RITS from July 1, 2007, through December 31, 2007, and compared the sample items to tax return information to determine if they were adequately supported and properly recorded. We further agreed the amounts in RITS to deposit documentation. We reviewed *Tennessee Code Annotated* for apportionment amounts and recalculated apportionments for a nonstatistical sample of local government gasoline payments during the period July 1, 2007, through December 31, 2007.

As a result of our testwork, we concluded that tax information in RITS was adequately supported, properly recorded, and deposited; and local government gasoline payments were properly apportioned.

OBSERVATIONS AND COMMENTS

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

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

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

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

FRAUD CONSIDERATIONS

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

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

TITLE VI OF THE CIVIL RIGHTS ACT OF 1964

Section 4-21-901, *Tennessee Code Annotated*, requires each state governmental entity subject to the requirements of Title VI of the Civil Rights Act of 1964 to submit an annual Title VI compliance report and implementation plan to the Department of Audit by October 1 each year beginning with the Title VI compliance report and implementation plan due in 2007. Prior to 2007, the Title VI compliance report and implementation plan were due by June 30 each year. The Department of Revenue filed its compliance report and implementation plan on June 27, 2007.

Title VI of the Civil Rights Act of 1964 is a federal law. The act requires all state agencies receiving federal money to develop and implement plans to ensure that no person shall, on the grounds of race, color, or origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal funds. The Tennessee Title VI Compliance Commission is responsible for monitoring and enforcement of Title VI. A summary of the dates state agencies filed their annual Title VI compliance reports and implementation plans is presented in the special report *Submission of Title VI Implementation Plans*, issued annually by the Comptroller of the Treasury.

APPENDIX

ALLOTMENT CODES

Department of Revenue Allotment Codes:

347.01	Division of Administration
347.02	Tax Enforcement
347.11	Information Technology Resources Division
347.13	Taxpayer and Vehicle Services Division
347.14	Audit Division
347.16	Processing Division
347.18	CID Anti-Theft Unit
347.99	Revenue Refunds