AUDIT REPORT

Department of Revenue

May 2008

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

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STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

State Capitol
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John G. Morgan
Comptroller

May 29, 2008

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:

Transmitted herewith is the financial and compliance audit of the Department of Revenue for the period April 1, 2006, through April 30, 2007.

The review of internal control and compliance with laws, regulations, and provisions of contracts or grant agreements resulted in certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/cj
07/043

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COMPTROLLER OF THE TREASURY
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June 8, 2007

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have conducted a financial and compliance audit of selected programs and activities of the Department of Revenue for the period April 1, 2006, through April 30, 2007.

We conducted our audit in accordance with *Government Auditing Standards,* issued by the Comptroller General of the United States. These standards require that we obtain an understanding of internal control significant to the audit objectives and that we design the audit to provide reasonable assurance of the Department of Revenue's compliance with laws, regulations, and provisions of contracts or grant agreements significant to the 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 to the Department of Revenue's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/cj

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

Financial and Compliance Audit
Department of Revenue
May 2008

AUDIT SCOPE

We have audited the Department of Revenue for the period April 1, 2006, through April 30, 2007. 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, travel claims, equipment, contracts, title and registration, E-Way purchases, and the Financial Integrity Act. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; participating in the negotiation and procurement of services for the state; and approving compromises of tax liabilities.

AUDIT FINDINGS

With the Absence of Effective Controls and Heightened Risk of Fraud in the Department of Revenue's Motor Carrier Section, Neither Management nor the Auditors Could Ensure That All Cash Receipts for Registration Fees Were Collected and Recorded

Staff could not explain why receipts were missing from the registration fee database. No one ensured that all receipts were accounted for or compared receipts to the information actually recorded in the database program. Furthermore, receipts can be altered within the system without detection since the system does not provide an audit trail (page 4).

The Department of Revenue's Tax Enforcement Division and Motor Carrier Section Lack the Proper Communication in Updating the Dishonored Checks List, and the Tax Enforcement Officers Did Not Effectively Pursue Collection of Dishonored Checks

Information provided to the auditors on the status of dishonored checks differed from division to division. In addition, the dishonored checks were not pursued in a timely manner (page 9).

Management of the Department of Revenue Did Not Adequately Mitigate the Risks of Fraud, Waste, and Abuse Relative to Motor Vehicle Registration Revenue Collections in the Motor Vehicle Title and Registration Division

The division did not reconcile the quarterly inventory reports of distributions of vehicle plates and decals with revenue received from the county clerks for the sale of these items. Neither the department nor the county clerks maintained records of the number of plates received, sold, or voided or of the total dollar value of the items sold. In addition, not all county clerks submit the inventory reports to the state quarterly as required by state law (page 14).

The Department Has Not Established Adequate Controls Over Purchases Made Through E-Way, Increasing the Risk of Unauthorized Purchases

Purchases made through the on-line office supply contract were not properly approved. Nine individuals were able to both initiate and approve E-Way purchase transactions (page 17).

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Department of Revenue

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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

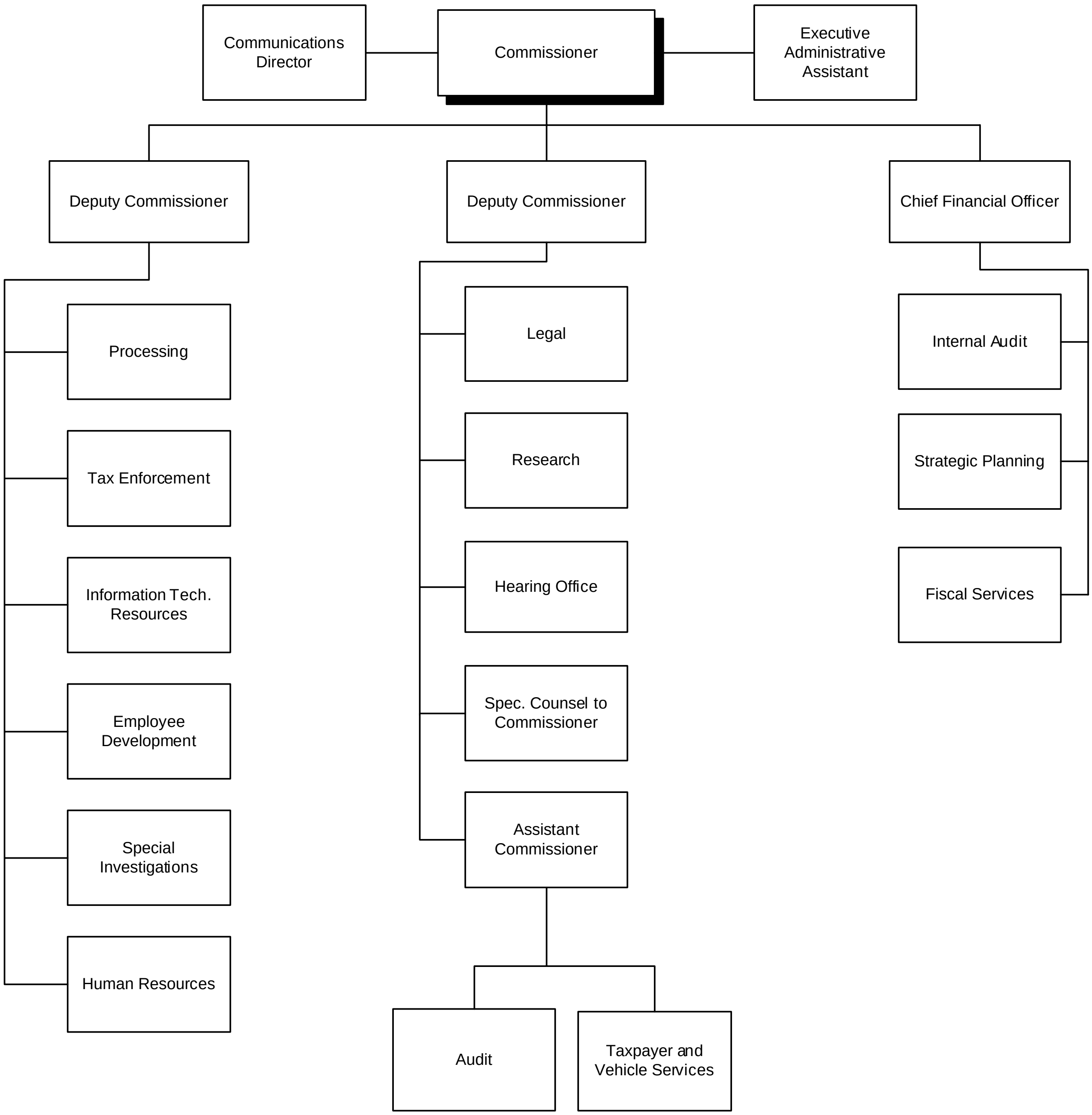
The mission of the Department of Revenue is to collect state revenue. Specifically, the department is responsible for the collection of most state taxes, fees, and motor vehicle title and registration fees; for enforcing the revenue statutes of the state to ensure that taxpayers are in compliance with all tax laws and motor vehicle laws; and for 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

We have audited the Department of Revenue for the period April 1, 2006, through April 30, 2007. 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, travel claims, equipment, contracts, title and registration, E-Way purchases, and the Financial Integrity Act. The audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States.

Tennessee Department of Revenue
Organization Chart



Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; participating in the negotiation and procurement of services for the state; and approving compromises of tax liabilities.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

INTERNATIONAL REGISTRATION PLAN

The International Registration Plan (IRP) is the method 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 IRP were to determine whether

- cash receipts were posted correctly to the accounting records;
- the reconciliation between cash receipts and invoicing documents was performed, and all cash received was deposited into the state's bank accounts;
- all deposit slips were accounted for;
- the department followed the applicable procedures to collect any delinquent accounts;
- the department complied with the applicable policies and procedures that govern the IRP;
- the IRP deposits agreed with the State of Tennessee Accounting and Reporting System (STARS); and
- the inventory of commercial vehicle plates and decals was properly documented and the reconciliation between inventory count reports to the accounting records was performed.

To accomplish our objectives, we reviewed the IRP procedures manual and interviewed key department personnel. We obtained documents and performed analytical procedures on a computer generated listing of cash receipts issued for July 3, 2006, through February 22, 2007, to determine if cash receipts were posted correctly to the accounting records. Also, we obtained documents and performed analytical procedures on a computer generated listing to determine if a reconciliation between cash receipts and invoicing documents was performed and all cash received was deposited into the state's bank accounts. We obtained a list of all deposit slips for October 2, 2006, through January 2, 2007, to determine if all of the deposit slips were accounted for including spoiled and/or voided deposit slips. In addition, we obtained and reviewed the department's procedures for collecting dishonored checks and obtained and reviewed a list of dishonored checks 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 obtained listings of new and renewed IRP accounts and reviewed a nonstatistical sample of renewed IRP accounts. We performed a reconciliation between IRP deposits and amounts reported into STARS to determine if the IRP deposits agreed with STARS. We inquired of management about the inventory of the commercial vehicle plates and decals records and examined documents of plates and decals inventory to determine if the inventory of commercial vehicle plates and decals was properly documented and reconciliation between inventory count reports to the accounting records was performed.

As a result of our reviews, interviews, walkthrough, and examination of documents, we determined that the Motor Carrier Section's internal controls were not effective and neither management nor the auditors could ensure all cash receipts for registration fees were collected and recorded, as noted in Finding 1. All IRP deposit slips were accounted for, but we could not gain enough evidence to determine if cash receipts were posted correctly to the accounting records. Due to improper control over the cash receipts database, we could not determine if all cash received was deposited into the state's bank accounts. The Tax Enforcement Division, Revenue Processing Center, and Motor Carrier Section lack the proper communication in updating the dishonored checks list, and the Tax Enforcement officers did not effectively pursue the collection of all of the IRP delinquent accounts, as noted in finding 2. In addition, the inventory of plates and decals was not adequate, as noted in finding 1.

The Motor Carrier Section registration of new and renewed accounts was in compliance with the applicable policies and procedures that govern the IRP. The IRP deposit totals agree with the amounts reported in STARS; however, an immaterial difference was noted and corrected by management.

1. <u>With the absence of effective controls and heightened risk of fraud in the Department of Revenue's Motor Carrier Section, neither management nor the auditors could ensure that all cash receipts for registration fees were collected and recorded</u>

Finding

The Department of Revenue's Motor Carrier Section receives registration fees to register commercial vehicles that travel in two or more jurisdictions (states). The Motor Carrier Section collects these registration fees for the International Registration Plan (IRP) in Nashville and Humboldt. To be operational, each commercial vehicle must be issued a tag, decal, and a cab card. According to the Tennessee Department of Revenue Collection Reports for the period July 2006 through March 2007, the Motor Carrier Section collected $52,883,597 in registration fees for the International Registration Plan.

The department uses a database to process registration fees collected. During our initial inquiry and observation of the receipting process, the Motor Carrier Section supervisor at the Humboldt location stated that the database program automatically assigns a unique receipt number every time an addition or change is made to an IRP account, and that the receipt numbers are issued in sequence. However, observing the computer screen, we noted that some receipts were missing from the database. We also reviewed a cash receipts report generated for the period July 3, 2006, through February 22, 2007, and found that eight receipts were missing and were not shown in the database or the Daily Receipts Report. The supervisor could not explain why the receipts were missing, but stated the computer program "sometimes" skips receipt numbers. Also, 12 receipts were issued without registration fee amounts listed. One of these blank receipts even indicated that cash had been received even though an amount was not recorded. These circumstances reflect an increased risk of fraud. In light of the large amount of funds involved—some transactions are in excess of $200,000—the risk is potentially material.

To determine whether Motor Carrier Section management had controls in place to prevent or detect potential theft of the IRP registration fees, we inquired about the staff's reconciliation procedures. According to the Humboldt Office Supervisor, when the clerk collects the money, the clerk prints out a receipt. Reconciliation procedures were performed by the Humboldt Office Supervisor to ensure that the cash collected equaled the amount recorded on the receipts; however, no one ensured that all receipts were accounted for or compared receipts to the information actually recorded in the database program. Cash could easily be stolen by one of the clerks who simply does not include the related receipt in the documentation provided for the reconciliation.

Furthermore, we determined that receipts can be altered. We identified an instance when one of the clerks issued two cash receipts with different amounts for the same receipt number. The clerk entered the IRP applicant's information into the database and issued the first receipt with one amount and printed it, and then the clerk edited the amount from the first receipt for a different amount and printed a second receipt with the same receipt number. In this case, the clerk was making an appropriate adjustment; however, the situation established that someone could easily alter receipt information without detection since the system does not provide an audit trail and only the last edited receipt amount remains in the database. So even if a receipt is prepared for the customer, the clerk could later delete or alter the information in the system and take the money. Based on our additional discussion with personnel at the Humboldt office, we found that any person who has access to the database could edit, add, and delete information. All three employees at the Humboldt office and several employees at the Nashville office have access to the database.

In the absence of a reliable receipt reconciliation process, we attempted to compare the funds received to the commercial vehicle tags and decals issued. However, when we inquired about the number of tags and decals issued, we were told that the Humboldt location staff does not know how to generate and print reports of all tags and decals sold. In further attempts to make this comparison, we attempted to examine the tag and decal inventory records. However, we found that staff had not adequately performed inventories of the tags and decals. Motor Carrier section staff had performed a simple count of the tag and decal inventory for restocking purposes, but not for accountability purposes. They had not compared tags and decals on hand with items that should be on hand after deducting those sold. Furthermore, we found that staff at the Humboldt location had not maintained records of the beginning balances or issuances of tags and decals or the related monetary value of tags and decals issued. Therefore, we could not determine the number or the value of the tags sold. We also determined that the Nashville location does not reconcile inventory to the accounting records for accountability. Reconciliation of assets sold is an essential control to determine if clerks are selling tags and decals but retaining the receipts for their own financial gain. Because many receipts involve several thousand dollars and because applicants occasionally pay their registration fees in cash, a clerk could easily sell the tags and decals, keep the money, and the theft would likely not be detected. In addition, based on our observations of current practices of the Motor Carrier Section, staff have the ability to alter the system to show that a company's registration is active when in fact it should be on suspension due to lack of payment. This ability could allow staff to cover up misappropriated funds since the company would never know that the payment was not actually received by the state.

Because, in the absence of adequate controls, we could not assure ourselves that fraud had not occurred, we asked a series of questions to the Humboldt office employees to try to identify indicators of fraud. The supervisor disclosed that there was an instance prior to the scope of our audit in which the computer record showed one person who owed about $4,000 for his registration. When this same individual returned the following year to register his truck, staff asked the individual about the past-due amount. According to the staff, the individual said that he paid it, and he had the receipt as evidence of his payment. The staff clerk asked the individual if he would bring the receipt or canceled check in, but went ahead and renewed his registration at the time. The supervisor said that the person never came back; however, he had little motivation to do so since his registration was renewed. The supervisor stated that she did not remember the name or the account number of that person. Unfortunately, the lack of control calls into question whether this individual had indeed made the earlier payment but the funds were never deposited by the state, or whether the individual never paid but still received his registration. Either situation would result in a loss of revenue to the state.

During our audit fieldwork, as we reported our results to management, management disclosed that the problems with the Motor Carrier Section had already been discovered by Department of Safety's Office of Internal Audit before the section's responsibilities were transferred to the Department of Revenue on July 1, 2006. The Director of Internal Audit and Consulting Services for the Department of Revenue thought the problem had been fixed by the Department of Safety. However, we found that Motor Carrier Section management did not appropriately respond to this risk or make needed changes in internal control at each of the locations (Humboldt and Nashville) to mitigate this risk.

After we contacted Department of Safety Internal Audit Staff, we were advised that the Office of Internal Audit had previously specifically identified receipts that were unaccounted for at the Nashville office. When the internal auditors followed up on some of the incomplete receipts that included a company name, they were able to obtain documentation from the companies that the IRP registration fees had been paid; however, the fee collections could not be traced to any of the Nashville office's deposits. As this was uncovered, the Manager of the Motor Carrier Section did not make immediate changes to internal control and did not conduct a thorough investigation to determine the full extent of any problems related to cash receipts and IRP registrations. According to the Manager of the Motor Carrier Section, as a result of our review, the section has since made database changes at the Nashville office to ensure that transactions on the database program cannot be edited or deleted. However, the section has not made the changes in the Humboldt system, leaving that facility completely exposed to the risk of significant fraud. Also, the Manager of the Motor Carrier Section has neither performed a formal risk assessment of the Motor Carrier Section nor designed or implemented internal controls in Humboldt to effectively mitigate the risk associated with not performing inventory and reconciliations.

Recommendation

The Director of the Taxpayer and Vehicle Services Division should completely reevaluate the controls over the cash receipts for the IRP registration fees. At a minimum, the Director should ensure that (1) the receipting system is designed to ensure that all receipts are accounted for and to ensure that transactions cannot be altered and deleted after entry; (2) the system creates an adequate audit trail for all receipting transactions that cannot be circumvented or changed; (3) reconciliation procedures are adequate so that all receipts are accounted for and all transactions are included; and (4) the reconciliation ties the cash received back to the computer system to determine that staff account for all transactions.

The Manager of the Motor Carrier Section should ensure that proper controls over the inventory of tags and decals are adequate and in place. The Manager of the Motor Carrier Section should ensure that an annual physical inventory of tags and decals is taken, and that the inventory is adequately documented to account for all tags and decals that were issued, voided, or transferred to another location. Also the value of tags and decals sold should be compared to accounting records, and all differences should be investigated and resolved. The Director of Internal Audit should thoroughly follow up on problems identified by our office and the Department of Safety's Internal Audit. If it is determined that funds are missing, there should be a thorough investigation, and appropriate action should be taken against the individuals that were responsible for collecting the funds. Formal, documented risk assessments should be performed by the Motor Carrier Section Manager and staff over all operations including those noted in this report. The Manager 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.

The Commissioner should ensure that the activities of the Motor Carrier Section are carefully evaluated as part of the department's documented risk assessment activities. The Commissioner should ensure controls are developed to mitigate risks related to motor carrier activities and evaluate such controls to ensure that exceptions are prevented or detected in a timely manner. The Commissioner should also 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.

Our Motor Carrier Section's operating procedures have been changed to ensure that all receipts written in the Humboldt office are properly accounted for and that only approved staff has the authorization to edit or delete receipt numbers. This restricted access was already in place in the Nashville office, where only certain members of management have the ability to modify receipt transactions, and is now in place in the Humboldt office. All Humboldt remittances are reconciled back to the computer system through the accounts receivable report daily, by management in Nashville.

We are working to implement the ACS [Affiliated Computer Systems] information system in Humboldt. The system is already in use in Nashville. The Access system that was being utilized in Humboldt had certain inherent weaknesses that made tracking consecutive receipt numbers difficult at times, like when an employee for some reason had to stop a transaction and then go back into the system. Access would sometimes drop those transactions, leaving gaps in the numbering. The change to ACS should eliminate this problem.

As part of the Department's Risk Assessment, a review and test of the receipting process was completed. The Motor Carrier Section Manager visited the Humboldt office to review operations and perform a physical inventory of license plates and decals. The Section Manager will make at least two visits to the Humboldt location annually to ensure that procedures are consistently followed and operational standards are met.

At June 30, 2007, Internal Audit performed a complete physical inventory of all decals and license plates in the Motor Carrier Section and reconciled the counts to perpetual inventory records.

The license plates and decals will be counted and reconciled annually and an internal audit of ACCESS transactions for the period July 1, 2007, to December 31, 2007 is currently in progress.

2. <u>The Department of Revenue's Tax Enforcement Division and Motor Carrier Section lack the proper communication in updating the dishonored checks list, and the Tax Enforcement officers did not effectively pursue collection of dishonored checks</u>

Finding

The Department of Revenue's Motor Carrier Section collects registration fees through the International Registration Plan (IRP) for the registration of commercial vehicles that are based in Tennessee and that travel in two or more jurisdictions (states). Based on an international agreement, all IRP member jurisdictions have agreed to allow one jurisdiction to collect registration fees for all jurisdictions at one time. The fees are then divided among the other IRP jurisdictions based on the percentage of mileage traveled in each jurisdiction, vehicle-specific information, and maximum weight. Member jurisdictions of the IRP must comply with basic principles which allow registrants to obtain a single registration plate and a single registration cab card and allow registrants to operate both interstate and intrastate movements. The Motor Carrier Section also collects fees and taxes for the Single State Registration and International Fuel Tax Agreement.

The Manager of the Motor Carrier Section provided us with a list from the state's Treasurer's Office of dishonored checks received from individuals and companies for these fees and taxes that had not been collected. According to the list, the state had received notification of 118 dishonored checks totaling $288,191 between October 2003 and December 2006, most of which were checks presented to pay IRP registration fees. The individual bad checks ranged in amount from $30 to $61,465.

According to the Manager of the Motor Carrier Section, staff had sent collection letters to those companies and individuals for IRP registrations, and when no response was received, staff placed the delinquent accounts on suspension and sent the suspension information to the Tax Enforcement Division to continue the collection process. The Motor Carrier Section maintains these delinquent accounts as "suspended accounts" until Tax Enforcement Division personnel provide follow-up and communicate to Motor Carrier Section personnel the collection outcome.

According to an assistant director in the Tax Enforcement Division, current practice provides that staff start the collection process when the Tax Enforcement officer receives the notice of the delinquent account from the Motor Carrier Section. Also, the assistant director stated that the Tax Enforcement Division's process to collect on the account or deem the account uncollectible is not typically a lengthy process. However, we found that some of the accounts had been delinquent and in suspension status for two or more years.

Staff in the Tax Enforcement Division also stated they only received documentation from the Motor Carrier Section for 115 of the 118 dishonored checks. Apparently, the Motor Carrier Section staff never sent the appropriate documentation to the Tax Enforcement Division for three of the dishonored checks.

When we reviewed the status of the 115 dishonored checks for which documentation was received, we found there was a discrepancy in the number of outcomes reported. Specifically, we found the following:

- The Tax Enforcement Division claimed that the outcome of 55 delinquent accounts had been acted upon and communicated to the Motor Carrier Section. However, the Motor Carrier Section claimed only 13 delinquent accounts had been acted upon and communicated to the section by the Tax Enforcement Division.

  Our testwork of the Tax Enforcement records found that the 55 cases included

  13 cases deemed uncollectible (these were the same 13 cases the Motor Carrier Section had acknowledged);

  24 cases in "partial repayment status" or that were designated as "uncollectible"; and

  18 cases that were marked "dormant" and final determination regarding the collection status of these accounts was unclear.

- For the remaining 60 cases that were still active in the Tax Enforcement Division, some of the cases were received as far back as January 2004.

We also noted that the Motor Carrier Section staff allowed registrants who had written bad checks and were in delinquent status to write subsequent checks. The section accepted two checks from registrants whose prior checks were returned by the bank uncollected. The new checks were also returned by the bank, and the department has not collected either of the fees.

The Tax Enforcement Division and the Motor Carrier Section lack the proper communication and coordination to ensure the department maintains a current dishonored checks list and makes a final determination on registrants' delinquent accounts. Without proper communication and coordination between the department's divisions, registrants may still be on the delinquent accounts list erroneously. Furthermore, when the Motor Carrier Section and the Tax Enforcement Division do not effectively communicate and coordinate their efforts to recover unpaid IRP registration fees, the state loses the benefit of the revenue collections. This also reflects a less than optimum control environment, since the department as a whole is not working efficiently and effectively.

Recommendation

Management and staff of the Tax Enforcement Division and the Motor Carrier Section should communicate information relating to taxpayers promptly and ensure that taxpayer accounts are updated properly and timely. A formal process for improving communication and coordination should be developed by management of the Tax Enforcement Division and the Motor Carrier Section. The Manager of the Motor Carrier Section should confirm that staff have provided all information about all dishonored checks to the Tax Enforcement Division, and the Manager should follow up with that division when items have been on the delinquent accounts listing for a long period of time.

The Director of the Tax Enforcement Division should periodically review the items that have been turned over to the division from other divisions to ensure that staff are pursuing collection efforts promptly and report back to the appropriate division accordingly. The Director of Tax Enforcement should also review the cases to determine the status of cases that have been outstanding for long periods of time.

The Manager of the Motor Carrier Section should ensure that the dishonored checks list is maintained appropriately and utilized to reduce bad checks accepted by the department. The Manager should ensure that registrants who have funds outstanding for dishonored checks are not allowed to present checks for payment of future services.

The Commissioner should consider the implications for the department's control environment arising from the conditions noted in this finding. The Commissioner should ensure that the risks associated with lack of coordination and communication between divisions throughout the department is considered part of the formal risk assessment. The Commissioner should ensure that department officials and staff design and implement internal controls that effectively mitigate these risks.

Because the Motor Carrier Section is new to the Department of Revenue, the Commissioner should ensure that the activities of the Motor Carrier Section are carefully evaluated as part of the department's documented risk assessment activities. The Commissioner should ensure controls are developed to mitigate risks related to Motor Carrier Section activities and evaluate such controls to ensure that exceptions are prevented or detected in a timely manner. The Commissioner should also 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.

The Taxpayer and Vehicle Services (TPVS) and Tax Enforcement Divisions have refined the collection procedures for IRP dishonored checks. The dishonored check procedures were updated to ensure that in processing these items, we clearly distinguish the type of collections being made. Taxpayer and Vehicle Services now produces a monthly report for reconciliation of dishonored checks. Additionally, Tax Enforcement now has immediate access to an inventory list of dishonored checks and regularly reviews the list to ensure appropriate follow-up is being conducted.

Current procedures prevent any Motor Carrier registrant from completing a new transaction, if liabilities exist on the system. TPVS now sends a monthly report to the Tax Enforcement Division for reconciliation purposes. The report has been implemented and the divisions are currently following up on exceptions noted.

The Department has significantly reduced aged dishonored check accounts. We are also exploring how we could functionally add dishonored checks to the RITS [Revenue Integrated Tax System] database, so that the collection of dishonored checks would become a semi-automatic process and would allow follow up, review, and documentation by all parties; making for more timely and efficient management and administration of the dishonored check inventory.

TRAVEL CLAIMS

The objectives of our review of controls and procedures for travel claims were to determine whether

- travel claims and related receipts complied with the travel regulations;
- the travel claims were properly approved;
- travel claims were correctly classified in the State of Tennessee Accounting and Reporting System (STARS); and
- commissioner travel was warranted and in compliance with travel regulations.

Key personnel were interviewed to gain an understanding of the department's procedures and controls over travel claim expenditures. A nonstatistical sample of travel claims for the period April 1, 2006, through November 30, 2006, was selected and tested to determine whether travel claims were properly approved. Travel claims and related receipts were also tested to determine compliance with travel regulations and correct classification in STARS. Also, the Commissioner's travel was tested by selecting five travel claims with the highest dollar amounts to determine compliance with travel regulations and that travel was warranted.

Based on reviews, interviews, and testwork, it was determined that travel claims and related receipts complied with travel regulations, were properly approved, and were correctly classified in STARS. The Commissioner's travel also complied with the proper travel regulations and travel was warranted.

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 system (POST);
- 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;
- the department maintained proper accountability over confiscated property; and
- employee access to POST was appropriate.

Key personnel were interviewed to gain an understanding of the department's procedures and controls over the inventory of equipment owned by the department. Supporting documentation was reviewed, and nonstatistical samples were selected to determine if the equipment was properly recorded in POST and could be physically located or confirmed. Supporting documentation was also reviewed to determine if lost or stolen equipment was promptly reported to the Comptroller's Office, and inquiry was made to determine if the department reported such equipment losses to the Department of General Services so that General Services could remove items from POST. Personnel were interviewed, supporting documentation and applicable laws were reviewed, and logs and property were observed to determine if the department maintained proper accountability over confiscated property. In addition, personnel files were reviewed 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 review and testwork, we concluded that equipment information in POST was properly recorded. Except for minor exceptions, equipment items were physically located or confirmed, and lost or stolen equipment was properly reported to the Office of the Comptroller and forwarded to 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 the review of contracts were to determine whether

- contracts were made in accordance with regulations and were established in compliance with purchasing guidelines;
- contract payments were in compliance with contract terms and purchasing guidelines; and
- contracts were monitored to ensure contract objectives were met.

Personnel were interviewed and applicable laws were reviewed to determine if the department followed proper procedures when entering into contracts. We selected a nonstatistical sample of contracts and reviewed supporting documentation to determine if contracts were made in accordance with regulations and established in compliance with purchasing guidelines. The supporting documentation for payments was reviewed to determine compliance with contract terms and purchasing guidelines. In addition, contract files, invoice files, vendor files, and STARS expenditures were reviewed to determine if the contracts were monitored to ensure contract objectives were met.

As a result of our review and testwork, we concluded that contracts were made in accordance with regulations and were established in compliance with purchasing guidelines. We also concluded that contract payments were in compliance with the contract terms. In addition, purchasing guidelines and contracts were appropriately monitored to ensure contract objectives were met with minor exceptions.

TITLE AND REGISTRATION

Our objective in reviewing the Motor Vehicle Title and Registration Division was to determine whether the department reconciled the distribution of vehicle plates and decals with revenue received from the county clerks for the sale of these items. We interviewed management to gain an understanding of the procedures and controls over the accountability for vehicle decals and the reconciliation process. Based on our discussions, we concluded that the department had not reconciled issuances of vehicle plates and decals to revenue, as discussed further in finding 3.

3. <u>Management of the Department of Revenue did not adequately mitigate the risks of fraud, waste, and abuse relative to motor vehicle registration revenue collections in the Motor Vehicle Title and Registration 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. 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 fraud, waste, and abuse relative to motor vehicle registration revenue collections by reconciling revenue collections with distributions of vehicle plates and decals. See the appendix on page 21 for the Department of Safety's management's comments to all previous findings.

The Commissioner of the Department of Revenue accepted responsibility for the Division of Title and Registration on July 1, 2006. The department's primary objective was to ensure the continuity of services to the citizens of Tennessee. In addition, department management was responsible for transferring 229 employees, equipment, contracts, and funds from the Department of Safety to the Department of Revenue. Once these initial objectives were accomplished, the Department of Revenue began evaluating the Division of Title and Registration's (now referred to by the Department of Revenue as the Taxpayer and Vehicle Services Division) processes and identifying risks and controls associated with the processes, including issues addressed in any repeated audit findings reported while the division was under the Department of Safety's jurisdiction.

In our review of this division covering the period July 1, 2006, through April 2007, we found that the staff of the Vehicle Services Section have not yet been able to reconcile the quarterly inventory reports of 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 the department's Title and Registration Section staff. Those parties include the county clerks' offices that sell the registration plates and decals and Tennessee Rehabilitative Initiative in Correction (TRICOR), which is responsible for making the plates and shipping them to the county clerks' offices.

When one entity collects fees on behalf of another, there is always a risk that the collecting entity may fail to remit the collections. 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 license plates and decals with fees collected and remitted.

The collection of vehicle plate and decal revenues is inherently risky because of the decentralized nature of the collection process. The department relies on the county clerks' offices to distribute vehicle registration plates and decals and remit the revenue to the department. Because the department has not yet effectively mitigated its risk by reconciling motor vehicle plates and decals to revenue collected, 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.

During our examination, we found that inventory lists submitted by the county clerks only included the number of plates and decals on hand. Neither the department staff nor the county clerks maintained records of the number of plates 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 sold was in fact transferred to the state. Staff told us that efforts had been made to perform the reconciliations; however, as of April 2007, personnel had still not provided us with any reconciliations or documentation of an attempt to perform the reconciliations.

In addition, our inquiry disclosed that not all of the county clerks submit the inventory reports to the state quarterly as required by Section 55-6-105(a)(8), *Tennessee Code Annotated*, which instructs the county clerks to "Account to the department for all registration plates so consigned to such clerk."

Without adequate controls related to the issuance of plates and decals to the revenue collected and the inventory of the vehicle plates and decals, the risks that fraud or theft of cash collected from the sales of vehicle titles and registrations may occur and not be detected is greatly increased.

Recommendation

The Commissioner should ensure that personnel responsible for the Motor Vehicle Title and Registration operations adequately assess the risks of fraud, waste, or abuse. 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 of the inventory reports of distributions of vehicle plates and decals with revenue received from each of the county clerks is performed. 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 Commissioner should ensure that the activities of the division are carefully evaluated as part of the department's documented risk assessment activities. The Commissioner should ensure controls are developed to mitigate any risks identified and evaluate such controls to ensure that exceptions are prevented or detected in a timely manner. The Commissioner and the Director of the Taxpayer and Vehicle Services Division should also 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.

As stated in this report, the Department of Revenue assumed responsibility of the Motor Vehicle operation on July 1, 2006, just eight months prior to the commencement of this State Audit review. This was hardly enough time to implement all of the initiatives we have planned for Vehicle Services. However, we have made great strides in updating the processing of titles, registrations, and other Vehicle Services transactions.

Former Safety personnel and positions were placed in six Revenue Divisions: (Field) Audit, Information Technology Resources, Internal Audit & Consulting Services, Processing, Special Investigations, and Taxpayer and Vehicle Services. There has been a comprehensive effort to not only maintain these operations, but to enhance our procedures and performance.

The Department recently completed a full round of Risk Assessment and internal control testing. The review has been implemented as an ongoing best business practice, performance enhancement, and risk aversion effort. We are working to be more proactive in identifying any areas where we could be susceptible to any possible fraud, waste, and abuse.

Revenue has completely rewritten the TRUST [Title and Registration 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.

The TRUST system will also incorporate the iNovah Point of Sale financial transaction and cash sales system currently in development in the EDISON project. Additionally, Revenue has implemented later phases of the initial TRUST project model, with the utilization of automated remittance and document imaging equipment and procedures already in place in our department.

We are committed to the most efficient operation and timely issuance of title and registration documents possible, and likewise are committed to the continued improvement of controls to avoid fraud, waste, and abuse.

E-WAY PURCHASES

E-Way is a web-based system for purchasing supplies through a statewide contract. Our objectives in reviewing E-Way purchases were to gain an understanding of controls to determine if purchases were properly approved and if E-Way users had the proper spending limits.

We interviewed department personnel and reviewed a nonstatistical sample of 25 E-Way purchases from May 2006 through December 2006 to gain an understanding of the controls related to E-Way purchases. We also reviewed invoices and supporting documentation to determine if purchases were properly approved. We reviewed a listing of E-Way users and their system settings in E-Way to determine if users had the proper spending limits.

Based on our interviews, testwork, and review of documentation, we found that purchases were not properly approved and users did not have the proper spending limits, as noted in finding 4.

4. The department has not established adequate controls over purchases made through E-Way, increasing the risk of unauthorized purchases

Finding

The department has not established adequate controls over departmental purchases made through E-Way. As of February 1, 2006, the state entered into an office supply contract which allows department personnel to purchase supplies on-line. The Department of General Services Purchasing Division's website regarding the use of E-Way states,

> Approvals may be established for all orders or limited by dollar amount. The approver may approve, change or cancel the order. If approved, the order is automatically submitted.

When the Department of Revenue designated which employees were authorized to use E-Way and which employees were authorized to approve the transactions, the Fiscal Director neglected to assign independent approvers to nine of the authorized E-Way users. As a result, these nine individuals were able to both initiate and approve E-Way purchase transactions.

Our review of a sample of the department's E-Way purchases found that 6 of 25 invoices tested (24%) were not properly approved. Four of these invoices were not approved because the Fiscal Director did not assign the approver when establishing the user's account. Also, for one of the invoices, even though an approver had been designated for the user, the approver did not approve the user's purchase. For the final invoice, the supporting purchase requisition was not approved. We also found that each of the 68 E-Way users for the Department of Revenue had a maximum spending limit of $1,000,000, which seems excessive for the purchase of supplies. Without proper controls, management and staff cannot ensure that supplies purchased are adequately protected from fraud, waste, and abuse and are necessary, authorized, and in compliance with purchasing policies and procedures.

Recommendation

The Commissioner and the Fiscal Director should establish adequate controls over the E-Way purchasing process. Approvers should be assigned to authorize transactions, and approve user purchases and supporting purchase requisitions for all E-Way users. The Fiscal Director should review and monitor the E-Way purchases to ensure the purchases are properly approved, that user's spend within their purchasing limits, and that spending limits are reviewed for reasonableness.

The Commissioner should ensure the risks related to this method of purchasing are carefully evaluated as part of the department's documented risk assessment activities. The Commissioner should evaluate controls developed to mitigate the risks to ensure that exceptions are prevented or detected in a timely manner. The Commissioner should also 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.

We believe, with reasonable assurance, that no material weaknesses of controls exist concerning E-Way purchases. During the audit scope, the Fiscal Services Section had over eighty-six percent (86%) of E-Way users matched with approvers and noted only two purchases over $2,000. There were no indications of misuse or abuse.

The department complies with all state E-Way purchasing policies and procedures. Twice a month Fiscal Services conducts a reconciliation to detect unauthorized purchases by:

1) Comparing the items shown on the signed priced packing slips from employees acknowledging receipt of the goods with credit card summary statements, and

2) Comparing journal vouchers charges to priced packing slip charges.

In May 2007, Fiscal Services requested the Department of General Services to make all E-Way users have at least one approval level, and Fiscal Services will follow up on future changes. A $2,000 single purchase policy is now in place.

FINANCIAL INTEGRITY ACT

Section 9-18-104, *Tennessee Code Annotated*, requires the head of each executive agency to submit a letter acknowledging responsibility for maintaining the internal control system of the agency to the Commissioner of Finance and Administration and the Comptroller of the Treasury by June 30 each year. In addition, the head of each executive agency is required to conduct an evaluation of the agency's internal accounting and administrative control and submit a report by December 31, 1999, and December 31 of every fourth year thereafter.

Our objective was to determine whether the department's June 30, 2006, responsibility letter was filed in compliance with Section 9-18-104, *Tennessee Code Annotated.*

We reviewed the June 30, 2006, responsibility letter submitted to the Comptroller of the Treasury and the Department of Finance and Administration to determine adherence to the submission deadline. We determined that the Financial Integrity Act responsibility letter was submitted on time.

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 June 30 each year. The Department of Revenue filed its compliance report and implementation plan on June 28, 2006.

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 enforcing 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.

APPENDICES

PREVIOUS RESPONSES FROM THE DEPARTMENT OF SAFETY MANAGEMENT TO REPEATED AUDIT FINDING INCLUDED IN THIS REPORT

FINDING 3

Management of the Department of Revenue did not adequately mitigate the risks of fraud, waste, and abuse relative to motor vehicle registration revenue collections in the Motor Vehicle Title and Registration Division

<u>For the years ended June 30, 1989, and June 30, 1990</u>

This issue was first noted in the audit for the years ended June 30, 1989, and June 30, 1990. In response to that audit, management stated:

> . . . The computer program which is designed for this process has never worked efficiently. It is an expensive and cumbersome task to do this reconciliation. Recently the consultants who reviewed our operation suggested that we abandon that program in favor of the one in the new TWVIS system which we are seeking. However, on a sample basis we shall attempt to reconcile these inventories to remittances received from the county clerks during the coming year. Several other changes that we have made to programs of our present system have enhanced the present inventory system. County clerks are instructed on page 2 of their manual to submit inventory reports on June 30, September 30, and December 31. Close-out inventories are required on the last day of February for trucks and March 31 for all other classifications. We suggest that county clerks take monthly inventories. However, they are required to submit them only on the dates indicated. We began reconciling temporary operation permit and drive-out tag issuances with the related revenue received in October 1991.

For the years ended June 30, 1991, and June 30, 1992

In the audit for the years ended June 30, 1991, and June 30, 1992, we reported that the department had not enforced the requirement that county clerks submit quarterly inventory reports as set forth in the existing policies and procedures manual. Management concurred with that finding and stated:

> . . . The Division of Titling and Registration is designing a new inventory system in conjunction with our systems division at this time, and it will be ready for the new plate issuance beginning January 1994. At that time we will be in a position to appropriately reconcile inventory reports.

For the years ended June 30, 1993, and June 30, 1994

In the audit for the years ended June 30, 1993, and June 30, 1994, we reported that the new system was still not functional. Furthermore, we again noted that the department still had not enforced the requirement that county clerks submit quarterly inventory reports as set forth in the existing policies and procedures manual. Management again concurred with that finding and stated:

> . . . A computerized system is being tested to provide an inventory system that will track all registration plates, decals, and any numbered items from the time of manufacture to the destruction of the plate. This system is scheduled to be implemented by January 1, 1996. The County Clerks will be notified to submit quarterly reports as set forth in the policies and procedures manual. Procedures are being implemented to provide a means of verifying the inventory of County Clerks by performing a random audit of the actual inventory against the inventory reports provided by the County Clerks. This system will be monitored by top management to ensure that it is adequate and fully implemented.

For the years ended June 30, 1995, and June 30, 1996

In the audit for the years ended June 30, 1995, and June 30, 1996, we reported that according to management, no progress had been made and the new system was still not functional. Furthermore, the department still had not enforced the requirement that county clerks submit quarterly inventory reports as set forth in the policies and procedures manual. Management concurred with that finding and stated:

> . . . We realize the importance of a system for accountability over plates and decals issued. However, our present computer system is over twenty (20) years old and will not accommodate the changes necessary to facilitate a comprehensive inventory accounting system. We will attempt to reconcile plates and decals to revenue received manually on a sample basis. A letter was mailed to each clerk notifying them of the changes in reporting deadlines. These changes will be included in the next revision of our policies and procedures manual.

For the years ended June 30, 1997, and June 30, 1998

However, in the audit for the years ended June 30, 1997, and June 30, 1998, we reported that no manual reconciliations were performed and the computer system was still not capable of performing the inventory reconciliation. Management concurred with that finding and stated:

> . . . One of the most important features of our new motor vehicle computer system will include an inventory of license plates and decals that can be reconciled. Until that time a manual reconciliation is practically impossible. However, the Internal Audit Division did physically inventory license plates and decals in several counties in this past year. Also, the Internal Audit division will reconcile remittances from the county clerks with county inventories as time permits. Further, the Motor Vehicle Title and Registration Division has diligently sought and acquired quarterly inventory reports from all ninety-five county clerks and will continue this practice until a central computer system maintains and reconciles license plates and decals.

For the years ended June 30, 1999, and June 30, 2000

In the audit for the years ended June 30, 1999, and June 30, 2000, we reported that based on the results of audit testwork, no manual reconciliations were performed, the current computer system was still not capable of performing inventory reconciliations, and the new system was not operational. Management concurred with that finding and stated:

> We will attempt to reconcile remittances from the county clerks to their inventory on a sample basis until the new motor vehicle computer system is in place.

For the period July 1, 2000, through June 16, 2003, released in November 2003

In the audit covering July 1, 2000, through June 16, 2003, we reported management began a monthly reconciliation of the two smallest counties but decided that the effort was too time-consuming. The new system was still not operational, and the department did not know when the new system would be operational.

Management concurred with that finding, and stated they would "attempt to periodically reconcile with each county's inventory given the limitations of the current computer system and available manpower." During current fieldwork, we determined that management had not completed such a reconciliation. Discussions with management revealed that these efforts were directed toward a new system that would better account for these items. According to management, the new system would allow for better tracking and reporting of this information, and the phase of the new system that has an inventory component is scheduled to be implemented October 4, 2006.

For the period June 1, 2003, through June 30, 2005, released in February 2006

In the audit covering June 1, 2003, through June 30, 2005, released in February 2006, we again reported that management has not effectively mitigated its risk by reconciling motor vehicle plates and decals to revenue collected. If management does not periodically reconcile the remittances from the sales of vehicle registration decals by the county clerks with each county's reported inventory or implement the new system, the department cannot be assured it has received all the revenue it is due. Management responded to this finding and stated:

> We concur. Throughout the last sixteen years, several leaders have attempted to resolve this area of weakness through manual reconciliation practices, all of which were dependent on hard copy documentation from the point of production to the point of sale.
>
> The current computer system in use for the last sixteen years to provide title and registration services never included cash or inventory capabilities. Nor did it account for decentralized points of sale in the ninety-five counties. Adding to the deficiencies of the current system stated above is that the point of manufacture is performed by TRICOR, not the department. TRICOR also does the shipping and distribution of the plate and decal inventory. The county clerks, who order stock as needed, do so by contacting the Title and Registration Warehouse, which is under the direction of the Support Services Division.
>
> Therefore, current management has determined that the solution must include the Title and Registration and Support Services Divisions of the Department of Safety, and TRICOR to address the limitations of the current computer system. Previous efforts have failed or fallen short of satisfying this audit finding due either to the massive workload volume of manual reconciliation required in comparison to staff available to complete the tasks, or failed attempts to design and implement computerized systems capable of electronically handling the process. To complicate the objective even further, county clerks independently contract with software vendors for the processing of registration information and then batch update to the state mainframe.
>
> In 1999 a funding mechanism for design and development of a new computerized system containing cash and inventory capabilities was created. The contract to complete the project was awarded to Covansys Corporation. This effort, too, proved unsuccessful and upon contract expiration in August 2004 the Department of Safety and the Office of Information Resources assumed management of the project, known as TRUST, and moved forward with a phased design model which is currently being developed and implemented. The cash and inventory segments of the system are in phase 5 of the project and are dependent on the implementation of previous phases. Phase 1 has been completed and implemented. Phase 2 is currently being deployed and is forming the hardware

and communications foundation needed to support real-time communications. Phases 3, 4 and 5 are all in various stages of design and implementation.

Shortly after the reduction of staff in the Division in 2003 to forty-one (41) permanent and temporary employees, the Division came under new direction and additional manual reconciliation attempts and tests to resolve this finding were attempted but were unsuccessful.

As with previous attempts to manually reconcile inventory, additional attempts proved to be impossible with resources available. Procedural changes and interim solutions have improved the process, but the true resolution to this finding is electronic control and management of inventory. The targeted pilot date for the point of sale and inventory portions of the computer system is January 2007. The project is currently progressing on target.

TRICOR, who is responsible for manufacturing and distribution, has already converted to the digitized license plate production system, which includes inventory capabilities, and has extended their partnership with the Title and Registration division to address distribution and electronic delivery confirmations. Further cash and inventory development plans include the use of bar coding and scanning technology as well as electronic signature capabilities. The new 2006 license plate design is evidence of this development and has a bar code printed on each new license plate. It will take at least five years to convert all plate types to this format due to the vastness of the license plate system. Renewal decals issued in 2007 will utilize this technology and will contain bar codes to facilitate inventory and reporting reconciliation requirements. In addition to technological developments currently underway, the contract with the county clerks will be amended to require them to notify the Title and Registration division of discrepancies identified in plate and decal deliveries.

In summary, the department will continue to work with OIR to develop the new TRUST system, which we believe will be the ultimate solution for correcting the above deficiencies. The Director of the Title and Registration Division will be responsible for developing a plan to adequately address the risks first noted in the audit 16 years ago and to direct efforts to engage in an adequate assessment of other risks of fraud, waste, or abuse in this area.

ALLOTMENT CODES

Department of Revenue Allotment Codes:

347.01	Administration
347.02	Tax Enforcement
347.11	Information Technology Resources
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