

Tennessee Rehabilitative Initiative in Correction

August 2003

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
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John G. Morgan
Comptroller

August 28, 2003

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and

Ms. Patricia Weiland, Executive Director
Tennessee Rehabilitative Initiative in Correction
240 Great Circle Road, Suite 310
Nashville, Tennessee 37228-1734

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Rehabilitative Initiative in Correction for the period July 1, 2000, through March 31, 2003.

The review of management's controls and compliance with policies, procedures, laws, and regulations 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/th
03/036



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
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April 21, 2003

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 Tennessee Rehabilitative Initiative in Correction for the period July 1, 2000, through March 31, 2003.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. These standards require that we obtain an understanding of management controls relevant to the audit and that we design the audit to provide reasonable assurance of the Tennessee Rehabilitative Initiative in Correction's compliance with the provisions of policies, procedures, laws, and regulations significant to the audit. Management of the Tennessee Rehabilitative Initiative in Correction is responsible for establishing and maintaining internal control and for complying with applicable laws and regulations.

Our audit disclosed certain findings which are detailed in the Objectives, Methodologies, and Conclusions section of this report. The agency's administration 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 agency's internal controls and/or instances of noncompliance to the Tennessee Rehabilitative Initiative in Correction's management in a separate letter.

Sincerely,

A handwritten signature in black ink that reads "Arthur A. Hayes, Jr." in a cursive script.

Arthur A. Hayes, Jr., CPA
Director

AAH/th

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Tennessee Rehabilitative Initiative in Correction
For the Period July 1, 2000, through March 31, 2003

AUDIT SCOPE

We have audited the Tennessee Rehabilitative Initiative in Correction for the period July 1, 2000, through March 31, 2003. Our audit scope included a review of management's controls and compliance with policies, procedures, laws, and regulations in the areas of equipment, finished goods inventory, facility visits, quarterly profit and loss statements, the cost allocation system, payroll and personnel, the disaster recovery system, and the Financial Integrity Act. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

AUDIT FINDINGS

Cost Accounting System for Raw Materials Needs Improvement

The unit cost for raw materials is not always accurate, and policies covering shipping and handling charges need to be developed (page 7).

Disaster Recovery Plan Needs Updating

The disaster recovery plan has not been updated since June 29, 1999. The agency's cost accounting system is not mentioned in the plan (page 10).

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report, which contains all findings, recommendations, and management comments, please contact

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Audit Report
Tennessee Rehabilitative Initiative in Correction
For the Period July 1, 2000, through March 31, 2003

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Tennessee Rehabilitative Initiative in Correction For the Period July 1, 2000, through March 31, 2003

INTRODUCTION

POST-AUDIT AUTHORITY

This is the report on the financial and compliance audit of the Tennessee Rehabilitative Initiative in Correction. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes 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

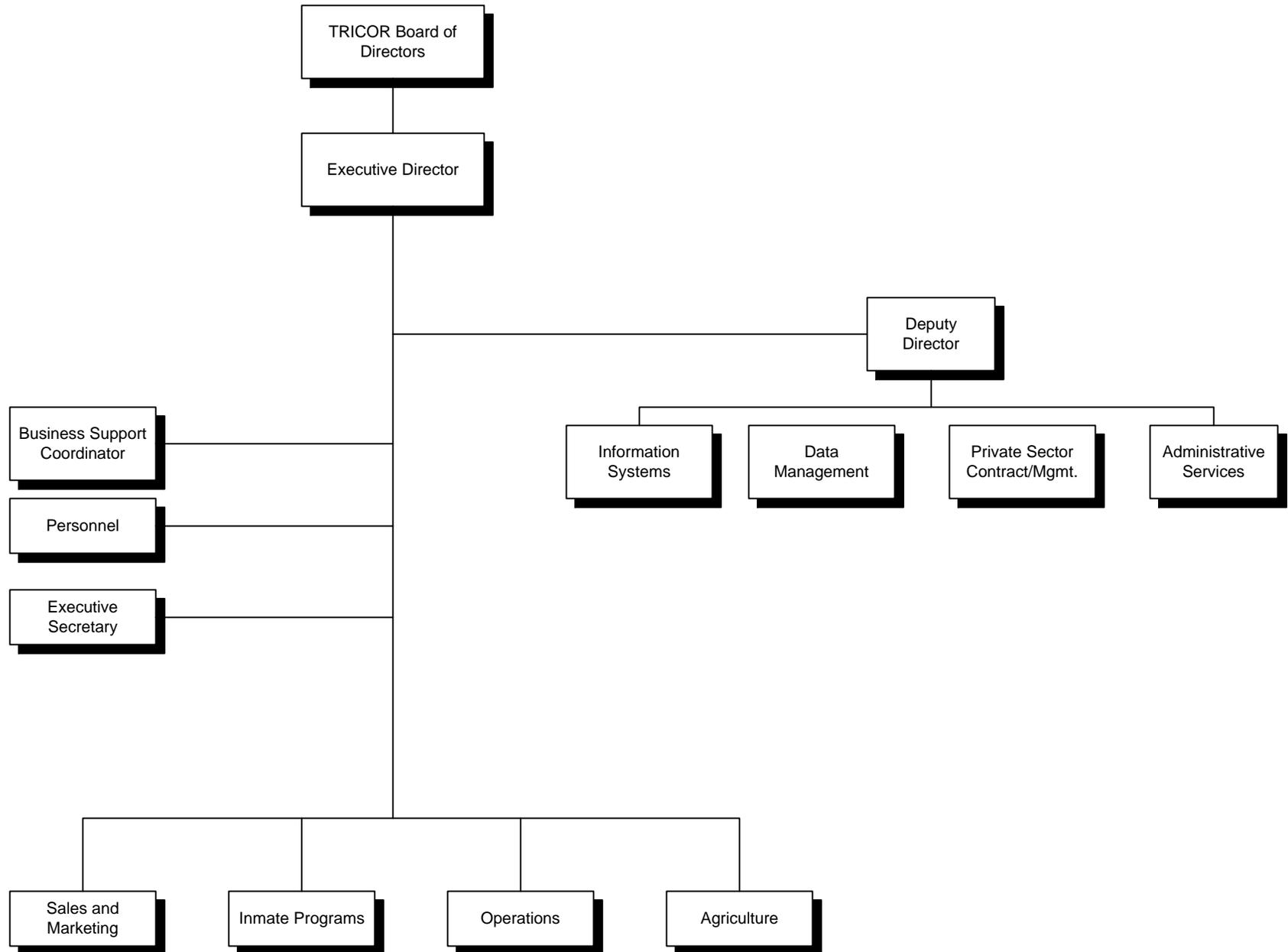
The mission of the Tennessee Rehabilitative Initiative in Correction (TRICOR) is to effectively manage correctional industry, agriculture, and service operations for the purpose of employing and training inmates, providing quality products and services on time to customers, and assisting in post-release employment, all of which reduce the cost of government in Tennessee. TRICOR fulfills its mission through the oversight of work-based rehabilitation programs in Tennessee’s adult correctional institutions. TRICOR is revenue-funded by providing state and local government and nonprofit agencies with products and services produced by inmate workers. TRICOR is governed by a board of directors whose members are appointed by the Governor.

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

AUDIT SCOPE

We have audited the Tennessee Rehabilitative Initiative in Correction for the period July 1, 2000, through March 31, 2003. Our audit scope included a review of management’s controls and compliance with policies, procedures, laws, and regulations in the areas of equipment, finished goods inventory, facility visits, quarterly profit and loss statements, the cost allocation system, payroll and personnel, the disaster recovery system, and the Financial Integrity Act. The audit was conducted in accordance with auditing standards generally accepted in the United States of America

Tennessee Rehabilitative Initiative in Correction (TRICOR)



and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

The Tennessee Rehabilitative Initiative in Correction is accounted for in allotment code 316.08.

PRIOR AUDIT FINDING

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 Tennessee Rehabilitative Initiative in Correction filed its report with the Department of Audit on January 23, 2002. The prior report included a finding on the agency's failure to maintain supporting documentation of management's evaluation of internal accounting and administrative controls in compliance with the Financial Integrity Act, and submit the report on those controls by the deadline. However, since the next evaluation and report is not due until December 31, 2003, the agency's implementation of the recommendation in the prior report could not be evaluated as part of the current audit. A follow-up of this finding will be conducted as part of the next audit.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

EQUIPMENT

Our objectives for reviewing equipment controls and procedures were to determine whether

- policies and procedures regarding equipment were adequate;
- property and equipment were adequately safeguarded;
- equipment information is properly recorded in the Property of the State of Tennessee listing (POST);
- POST access granted to agency employees was appropriately documented, approved, and appeared reasonable, based on the types of duties the employees performed; and
- lost or stolen equipment, reported to the Comptroller of the Treasury, was removed from POST.

We interviewed key agency personnel and reviewed supporting documentation to gain an understanding of the agency's procedures and controls over equipment and whether the property and equipment were adequately safeguarded. We selected three nonstatistical samples of equipment from POST to determine whether the equipment information was properly recorded. Equipment information included state tag number, description, location, and serial number. Equipment items were physically observed at TRICOR's central office and selected facilities. We accessed POST to determine which employees were recognized users and to determine these employees' level of access. We reviewed the documentation authorizing these employees to access POST and compared the employees' level of access to the employees' job description to determine whether the access appeared reasonable, based on the type of duties the employees performed. We examined the listing of equipment from POST to determine whether the lost or stolen equipment, reported to the Comptroller of the Treasury, had been removed.

Based on our interviews and reviews of supporting documentation, we determined that policies and procedures regarding equipment were adequate and property and equipment were adequately safeguarded. Based on our testwork, we determined that equipment information was properly recorded in POST and that POST access granted to agency employees was appropriately documented, approved, and appeared reasonable based on the types of duties the employees performed. Also, lost or stolen equipment, reported to the Comptroller of the Treasury, had been removed from POST.

FINISHED GOODS INVENTORY

Our objectives for reviewing finished goods inventory controls and procedures were to determine whether

- policies and procedures regarding finished goods were adequate and
- the finished goods inventory records represent a complete and accurate listing of the goods physically on hand.

We interviewed key agency personnel and reviewed supporting documentation to gain an understanding of the agency's policies and procedures over finished goods. We selected a nonstatistical sample of finished goods from the agency's inventory of finished goods and located each item to determine whether the finished goods inventory records were a complete and accurate listing of the goods physically on hand. We also selected an additional nonstatistical sample of actual finished goods and traced them to the finished goods inventory records to determine whether the finished goods inventory records were a complete and accurate listing of the goods physically on hand. Finished goods inventory record information included quantity, description, product identification number, and location. We performed these procedures at both of the finished goods warehouses.

Based on our interviews and reviews of supporting documentation, we determined that policies and procedures regarding finished goods were adequate. Based on our testwork, we

determined that the finished goods inventory records represent a complete and accurate listing of the goods physically on hand. Although we had no findings related to finished goods inventory, minor weaknesses were reported to management in a separate letter.

FACILITY VISITS

Our objectives for reviewing the controls and procedures over the production facilities were to determine whether

- policies and procedures regarding the production facilities were adequate,
- the raw materials inventory records represented a complete and accurate listing of raw materials on hand,
- the agricultural products inventory records represented a complete and accurate listing of agricultural products on hand, and
- the individuals being paid for working at the TRICOR production facilities actually exist.

The following procedures were performed at Brushy Mountain Correctional Complex, Riverbend Maximum Security Prison, Northeast Correctional Center, Southeast Tennessee State Regional Correctional Facility, South Central Correctional Center, Turney Center Industrial Prison and Farm, and West Tennessee State Penitentiary. We interviewed key agency personnel and reviewed supporting documentation to gain an understanding of the agency's policies and procedures over the production facilities. We selected a nonstatistical sample of raw materials and agricultural products from the agency's inventory records of raw materials and agricultural products and located each item to determine whether the inventory records represented a complete and accurate listing of raw materials and agricultural products on hand. We also selected an additional nonstatistical sample of raw materials and agricultural products and traced them to the respective inventory records to determine whether the inventory records represented a complete and accurate listing of items on hand. Raw materials and agricultural product inventory record information included quantity, description, and location. In addition, we selected all individuals on the TRICOR production facility payroll register for the pay period ending January 31, 2003, and observed an appropriate form of identification to validate the existence of each employee.

Based on our interviews and reviews of supporting documentation, we determined that policies and procedures regarding the production facilities were adequate. Based on our testwork, we determined that the raw materials and agricultural products inventory records represented a complete and accurate listing of the raw materials and agricultural products on hand, and individuals being paid for working at the TRICOR production facilities exist.

QUARTERLY PROFIT AND LOSS STATEMENTS

Our objectives for reviewing the controls and procedures over the quarterly profit and loss statements were to determine whether

- the policies and procedures regarding the quarterly profit and loss statements were adequate;
- the quarterly profit and loss statements were submitted in accordance with Section 41-22-123(b), *Tennessee Code Annotated*; and
- there was adequate supporting documentation for the quarterly profit and loss statements.

We interviewed key agency personnel and reviewed supporting documentation to gain an understanding of the agency's policies and procedures over quarterly profit and loss statements. We tested all ten quarterly statements due during the audit period for timely submission to the Comptroller of the Treasury and Commissioner of the Department of Finance and Administration and certification by the Fiscal Officer, to determine whether the statements were submitted in accordance with Section 41-22-123(b), *Tennessee Code Annotated*. We traced the quarterly profit and loss statement for the quarter ended June 30, 2002, to supporting documentation.

Based on our interviews and reviews of supporting documentation, we determined that policies and procedures regarding quarterly profit and loss statements were adequate. Based on our testwork, we determined that the quarterly statements were submitted in accordance with Section 41-22-123 (b), *Tennessee Code Annotated*, and there was adequate supporting documentation for the quarterly profit and loss statements.

COST ALLOCATION SYSTEM

TRICOR's current cost accounting system was placed into operation in February 2001 and is comprised of three components: the raw materials program for direct materials, the floor-time program for direct labor, and the cost accounting program for overhead and reporting functions. The reporting functions include valuing raw materials, work-in-process, finished goods inventory, and facilitating management's pricing of products and review of the bill of material listings. The bill of materials lists the standards for direct materials, direct labor, and overhead, associated with the production of one specific item.

Our objectives for reviewing cost allocation system controls and procedures were to determine whether

- policies and procedures regarding the cost allocation system were adequate;
- the current cost accounting system has been implemented agency-wide;

- the cost accounting system will generate appropriate reports for management and value raw materials, work-in-process, and finished goods inventory at cost;
- the current raw material cost is shown in the cost accounting program; and
- overhead rates have been properly calculated.

We interviewed key agency personnel and reviewed supporting documentation to gain an understanding of the agency's policies and procedures over the cost allocation system; to determine whether the cost accounting system has been implemented agency-wide; and to determine whether the system will generate appropriate reports for management and value raw materials, work-in-process, and finished goods inventory at cost. We selected a sample of raw materials purchased during the month of January 2003 to determine whether the raw material cost shown in the cost accounting program is current. We recalculated the applied overhead to determine whether overhead rates have been properly calculated.

Based on our testwork, we determined that overhead rates have been properly calculated. Based on our interviews and reviews of supporting documentation, we determined that the current cost accounting system has been implemented throughout most of the agency. However, based on our interviews, reviews of supporting documentation, and testwork, improvements in the cost allocation system relating to raw materials are still necessary as discussed in finding 1. In addition, a minor weakness relating to the floor-time system for direct labor was reported to management in a separate letter.

Finding, Recommendation, and Management's Comment

1. TRICOR needs to improve its cost accounting system for raw materials

Finding

Tennessee Rehabilitative Initiative in Correction (TRICOR) needs to improve its cost accounting system for raw materials. The need for a fully functioning cost accounting system was noted during prior audits. The current system was placed into operation in February 2001 and is comprised of three components: the raw materials program for direct materials, the floor-time program for direct labor, and the cost accounting program for overhead and reporting functions. During our review, the following problems relating to raw materials in the system were noted.

- The cost for raw materials is not accurately recorded in the cost accounting component of the system. Testwork performed on the raw materials purchased in January 2003 revealed that the last cost recorded in the cost accounting component did not agree with the January invoice for 17 of 38 raw materials tested (44.74%). These cost differences (the total of the absolute value of the difference multiplied by the quantity purchased) totaled \$3,362.51. Although the difference for individual

items was generally minimal, the extended difference for two purchases was greater than \$1,100 because of the large quantity purchased. Furthermore, two additional raw materials items that were purchased for \$295.21 in January 2003 were not reflected in the cost accounting component even though these two items were shown in the raw materials component at the appropriate cost. The agency reports that due to a malfunction in the system, new purchases of raw materials were not adequately updated from the raw materials component into the cost accounting component.

- Shipping and handling costs are not added to the unit cost of a raw material. Three of 25 tested invoices from the month of January 2003 included shipping and handling charges that totaled \$97.01. The agency reports that there are no policies and procedures for the treatment of shipping and handling charges.
- There is no clear audit trail to compare the cost of raw materials in the system with the vendor invoices for the purchase of the materials because only selected information about raw materials is uploaded into the cost accounting system.
- The raw materials component includes obsolete raw material numbers; however, there is nothing identifying these raw material numbers as obsolete. The agency reports that the program is not purged of obsolete raw material numbers to prevent the reuse of the raw material numbers for different items.

Accounting Research Bulletin No. 43, Chapter 4, states that inventory of raw materials and finished goods is to be properly and accurately valued at cost for reporting purposes. Failure to adequately record costs may result in an inaccurate reporting of the raw materials, work-in-process, and finished goods inventory valuations, leading to a misstatement of the financial statements. Furthermore, assuming that cost is a substantial factor in establishing the sales price, calculating the accurate cost is essential to ensuring that TRICOR operations break even.

Recommendation

The agency should improve the cost accounting system for raw materials to accurately record costs. The agency should develop policies to address the inclusion of shipping and handling charges in the cost of raw materials. Adequate audit trail information concerning raw material purchases should be maintained. Obsolete raw material numbers should be identified as such in the raw materials component.

Management's Comment

We concur. The Raw Material Tracking and Control System program has been modified to ensure that the cost of raw material in the system agrees with the cost in STARS. TRICOR Policy 314, Receiving Report, will be amended to ensure that shipping and handling costs are included in the cost of the raw material. The Raw Material Tracking and Control System program has been modified to provide a clear audit trail to compare the cost of the raw materials

in the system with the vendor invoices. The program has been modified to identify and archive obsolete raw material numbers.

PAYROLL AND PERSONNEL

Our objectives for reviewing payroll and personnel controls and procedures were to determine whether

- policies and procedures regarding payroll and personnel were adequate,
- payroll disbursements were authorized, adequately supported, and properly calculated;
- annual, compensatory, and sick leave were earned and taken in accordance with Department of Personnel guidelines;
- State Employee Information System (SEIS) access granted to agency employees was appropriately documented, approved, and appeared reasonable, based on the types of duties the employees performed; and
- annual performance evaluations were given in accordance with Department of Personnel guidelines.

We interviewed key agency personnel and reviewed supporting documentation to gain an understanding of the agency's procedures and controls over payroll and personnel. We also tested a nonstatistical sample of payroll transactions from the audit period to determine whether payroll disbursements were authorized, adequately supported, and properly calculated; and annual, compensatory, and sick leave were earned and taken in accordance with Department of Personnel guidelines. We accessed SEIS to determine which employees were recognized users and to determine these employees' level of access. We reviewed the documentation authorizing these employees to access SEIS and compared the employees' level of access to the employees' job description to determine whether the access appeared reasonable, based on the type of duties the employees performed. We also reviewed annual performance evaluations to determine whether they were given in accordance with Department of Personnel guidelines.

Based on our interviews and reviews of supporting documentation, we determined that policies and procedures regarding payroll and personnel were adequate. Based on our testwork, we determined that payroll disbursements were authorized, adequately supported, and properly calculated; leave was earned and taken in accordance with Department of Personnel guidelines; SEIS access granted to agency employees was appropriately documented, approved, and appeared reasonable, based on the types of duties the employees performed; and annual performance evaluations were given in accordance with Department of Personnel guidelines. Although we had no findings related to payroll and personnel, minor weaknesses were reported to management in a separate letter.

DISASTER RECOVERY SYSTEM

Our objectives for reviewing disaster recovery system controls and procedures were to determine whether

- the agency has a disaster recovery system and
- the policies and procedures concerning the disaster recovery system are adequate.

We interviewed key agency personnel and reviewed supporting documentation to determine whether the agency has a disaster recovery system and gain an understanding of the agency's policies and procedures over the disaster recovery system.

Based on our interviews and reviews of supporting documentation, we determined that the agency has a disaster recovery system, and policies and procedures regarding the disaster recovery system are adequate. However, we determined that the agency's disaster recovery plan has not been adequately updated as discussed in finding 2.

Finding, Recommendation, and Management's Comment

2. The disaster recovery plan needs to be updated

Finding

Tennessee Rehabilitative Initiative in Correction (TRICOR) needs to update its disaster recovery plan to provide continuity of administrative, clerical, and operational functions, in case its data processing facilities at the operation center, plants, or farms are damaged or destroyed. The plan has not been updated or formally tested since it was originally developed on June 29, 1999. The agency's cost accounting system is not mentioned in the plan. The objective of such a plan is to provide reasonable continuity of data processing both for business and accounting functions, if normal operations are disrupted. The potential for interrupted service and lost data increases significantly without an adequate recovery plan.

Recommendation

The agency should thoroughly document specific disaster recovery procedures and actions to be taken from the declaration of a disaster until the time that normal business operations are resumed. The plan should be reviewed, updated, tested, and reapproved periodically.

Management's Comment

We concur. TRICOR will update its Disaster Recovery Plan in a two-phase approach because our current core application system will be updated in FY 2004. The plan will be reviewed, updated, tested, and approved on a periodic basis. The two-phase approach will include:

Phase I – Current Application Systems

A Disaster Recovery Plan for critical existing application systems will be updated within a four-month time period. These application systems include: Supplier, Inmate Placement Program Database, Protrac, and Life Works Data Entry Systems.

The plan will develop recovery instructions and a test plan for each application system.

Phase II – New Integrated System

The new TRICOR integrated system will be implemented within 18 months. The Emergency Disaster Plan for the new system is part of the overall implementation project plan. The plan will include tasks that ensure continuity of administrative, clerical, and operational functions if data processing facilities are damaged or destroyed.

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.

Our objective was to determine whether the agency's June 30, 2002, and June 30, 2001, responsibility letters were filed in compliance with Section 9-18-104, *Tennessee Code Annotated*.

We reviewed the June 30, 2002, and June 30, 2001, responsibility letters submitted to the Comptroller of the Treasury and to the Department of Finance and Administration to determine adherence to the submission deadline. We determined that the Financial Integrity Act responsibility letters were submitted on time in compliance with Section 9-18-104, *Tennessee Code Annotated*.