AUDIT REPORT

Tennessee Rehabilitative Initiative in Correction

June 2007

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

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John G. Morgan
Comptroller

June 28, 2007

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Ms. Patricia Weiland, Chief Executive Officer
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 April 1, 2003, through April 30, 2006.

The review of internal control and compliance with 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/ddm
06/061

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May 8, 2006

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 April 1, 2003, through April 30, 2006.

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 Tennessee Rehabilitative Initiative in Correction's compliance with laws and regulations significant to the audit objectives. Management of the Tennessee Rehabilitative Initiative in Correction 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 agency'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 agency's internal control and instances of noncompliance to the Tennessee Rehabilitative Initiative in Correction's management in a separate letter.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/ddm

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

Tennessee Rehabilitative Initiative in Correction

June 2007

AUDIT SCOPE

We have audited the Tennessee Rehabilitative Initiative in Correction for the period April 1, 2003, through April 30, 2006. Our audit scope included a review of internal control and compliance with laws and regulations in the areas of equipment, disbursements, finished goods inventory, facility visits, 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, serving as a member on the Board of Standards, approving certain state contracts, and participating in the negotiation and procurement of services for the state.

AUDIT FINDINGS

TRICOR Has Not Established Adequate Controls Over the Transfer of Equipment to Ensure the Accuracy of the State's Equipment Records, Increasing the Risk of Theft or Abuse of the State's Equipment

The Tennessee Rehabilitative Initiative in Correction (TRICOR) has not adequately updated the Property of the State of Tennessee (POST) system to reflect transfers of equipment. Ten of 92 equipment items tested were not in the location as recorded in POST (page 4).

The Chief Financial Officer Did Not Always Approve the Chief Executive Officer's Travel Claims and the Purchasing Manager's Payment Card Purchases, Increasing the Risk of Fraud, Waste, and Abuse

The Chief Financial Officer or previous fiscal officer did not approve 13 of 17 Chief Executive Officer travel claims tested. In addition, the Chief Financial Officer did not approve 10 of 44 payment card purchases made by the Purchasing Manager (page 7).

Financial and Compliance Audit
Tennessee Rehabilitative Initiative in Correction

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Financial and Compliance Audit
Tennessee Rehabilitative Initiative in Correction

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 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."

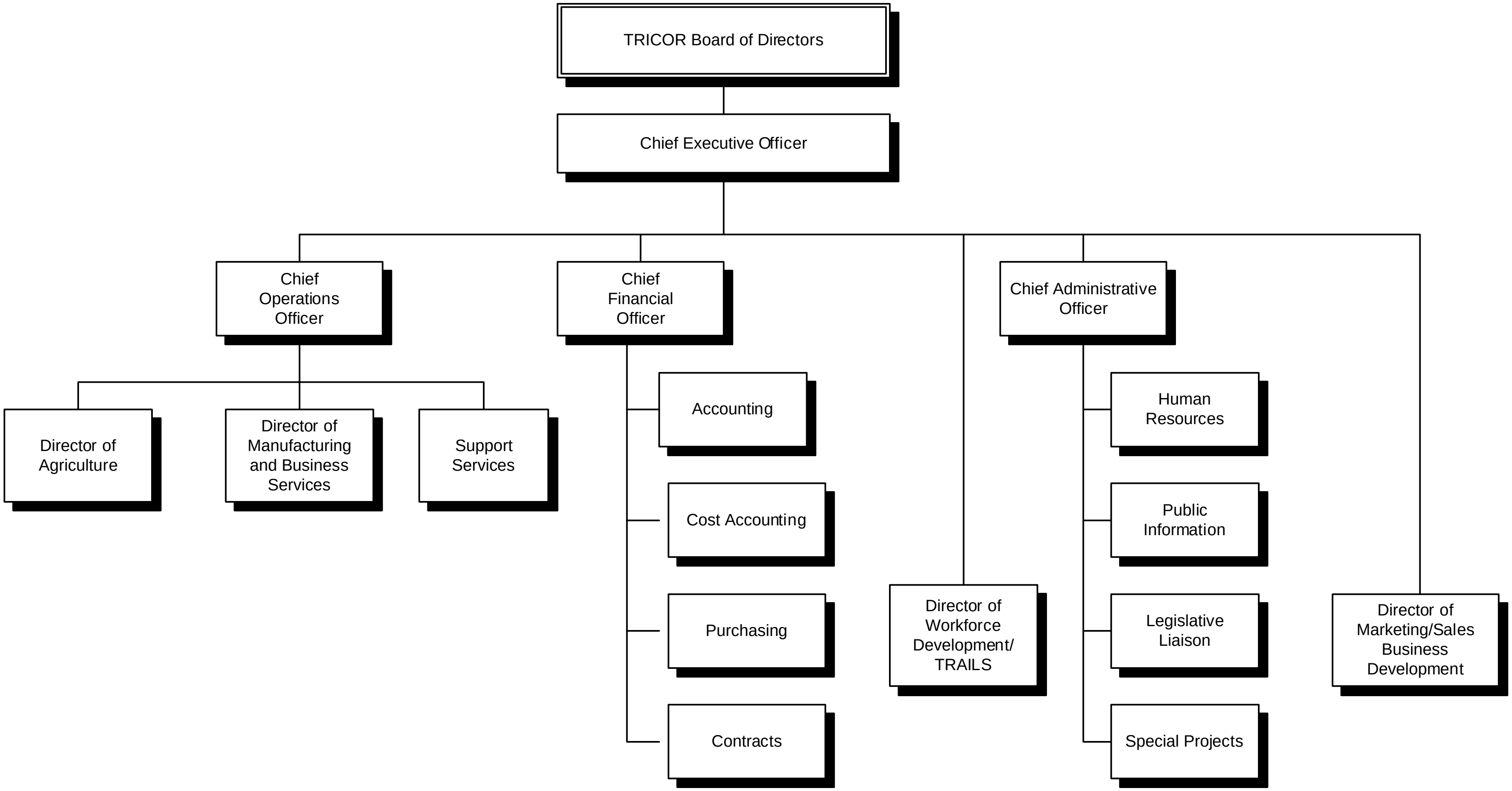
Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The mission of the 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. By providing state and local government and nonprofit agencies with products and services produced by inmate workers, TRICOR is revenue-funded. A board of directors governs TRICOR; members are appointed by the Governor. TRICOR's allotment code is 316.08.

An organization chart of TRICOR is on the following page.

Tennessee Rehabilitative Initiative in Correction (TRICOR)



AUDIT SCOPE

We have audited the Tennessee Rehabilitative Initiative in Correction for the period April 1, 2003, through April 30, 2006. Our audit scope included a review of internal control and compliance with laws and regulations in the areas of equipment, disbursements, finished goods inventory, facility visits, 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, serving as a member on the Board of Standards, approving certain state contracts, and participating in the negotiation and procurement of services for the state.

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Tennessee Rehabilitative Initiative in Correction filed its report with the Department of Audit on March 30, 2004. A follow-up of all prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the Tennessee Rehabilitative Initiative in Correction has corrected previous audit findings concerning its disaster recovery plan and cost accounting system.

OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS

EQUIPMENT

The primary objectives of our review of equipment were to determine whether

- TRICOR's procedures and controls over equipment were adequate,
- equipment was adequately safeguarded, and

- information for equipment was properly recorded in the Property of the State of Tennessee system (POST).

We interviewed TRICOR personnel, observed equipment safeguards, and reviewed supporting documentation to gain an understanding of TRICOR's procedures and controls over equipment and to determine whether equipment was adequately safeguarded. We reviewed TRICOR equipment items which were identified in POST as located in TRICOR's corporate office (including its warehouses and distribution center in Davidson County), the Riverbend Maximum Security Institution in Davidson County, the Turney Central Industrial Prison in Hickman County, and the Tennessee Prison for Women in Davidson County. Our review of the equipment items included a nonstatistical sample and other items considered significant based on dollar value. These equipment items were tested to determine whether the equipment information was properly recorded in POST. Equipment information included state tag number, description, location, and serial number.

Based on our interviews, observations, and reviews of supporting documentation, we determined that TRICOR's procedures and controls over equipment were adequate and equipment was adequately safeguarded, in all material respects. However, based on our testwork, we determined that information for TRICOR's equipment was not always properly recorded in POST (see finding 1).

1. <u>TRICOR has not established adequate controls over the transfer of equipment to ensure the accuracy of the state's equipment records, increasing the risk of theft or abuse of the state's equipment</u>

Finding

The Tennessee Rehabilitative Initiative in Correction (TRICOR) has not adequately updated the Property of the State of Tennessee (POST) system to reflect transfers of equipment. TRICOR uses POST to maintain its equipment information such as descriptions, serial numbers, state tag numbers, acquisition costs, locations, etc. TRICOR's Policy 304, entitled "Management and Inventory of Equipment," requires TRICOR to follow the *POST User Manual*. The policy also requires staff who are responsible for transferring and/or receiving equipment to complete the property management reports along with corrective entries for the location changes which will be entered in POST by the Property Officer.

During our current audit, we reviewed 92 TRICOR equipment items which were identified in POST as located in TRICOR's corporate office (including its warehouses and distribution center in Davidson County), the Riverbend Maximum Security Institution in Davidson County, the Turney Central Industrial Prison in Hickman County, and the Tennessee Prison for Women in Davidson County. Our review of the 92 equipment items included a sample of 58 items and another 34 items considered significant based on dollar value. We found ten equipment items (11%) that were not in the location as recorded in POST. Of the ten items, nine items were sensitive equipment items and included six personal computers, two printers, and one mainframe computer. The remaining item was a woodworking machine acquired in 1985. When we spoke with TRICOR's Information Systems Manager about the sensitive equipment items, he located the items at other TRICOR facilities utilizing a spreadsheet he maintains to track the location of sensitive equipment items. We confirmed the equipment items' existence with staff currently in possession of the items and observed the Information Systems Manager's spreadsheet. However, the Information Systems Manager stated that he had not prepared the property management reports to document the transfers. After we brought these items to his attention, the Information Systems Manager initiated the property management reports to update the equipment location changes in POST. TRICOR staff could not locate the woodworking machine. Based on her research and discussions with staff, the Chief Financial Officer concluded that the machine had been surplused. However, staff did not have any documentation to show the machine was surplused.

When accurate records of equipment locations in POST are not maintained, there is an increased risk of theft or abuse of the state's equipment.

Recommendation

TRICOR's Chief Executive Officer and its Property Officer should ensure that all equipment items are properly recorded in POST when changes occur in accordance with the *POST User Manual*. TRICOR's Chief Executive Officer should also ensure that all employees are aware of their responsibility to complete the proper equipment transfer forms when moving equipment and send the forms to the Property Officer. Management should include the risks noted in this finding in management's documented risk assessment.

TRICOR's Chief Executive Officer and board of directors should also ensure that other risks of improper accountability, noncompliance, fraud, waste, or abuse are adequately identified and assessed in management's documented risk assessment. Management should implement effective controls to ensure compliance with applicable requirements and assign staff to be responsible for ongoing monitoring of the risks and mitigating controls. Management should take appropriate action if deficiencies occur.

Management's Comment

We concur.

TRICOR Policy 304 details the process to be used when equipment is transferred or determined to be no longer of use. The Chief Financial Officer will continue to emphasize the process to employees and audits will be conducted to ensure ongoing compliance.

DISBURSEMENTS

The primary objectives of our review of disbursements were to determine whether

- the design of TRICOR's controls over disbursements was adequate;
- disbursements for goods or services were properly approved, supported, and allowable under applicable policies and procedures;
- goods or services were received prior to payment;
- disbursements for travel were paid in accordance with the Comprehensive Travel Regulations;
- TRICOR's policies and procedures for payment cards were adequate; and
- purchases involving payment cards were supported, allowable, and approved in accordance with TRICOR's policies and procedures.

To accomplish our objectives, we interviewed key personnel to gain an understanding of TRICOR's policies, procedures, and controls over disbursements. We also reviewed written policies and procedures. We performed testwork on a nonstatistical sample of disbursements from April 1, 2003, through January 31, 2006, to determine that disbursements for goods or services were properly approved, supported, allowable under applicable policies and procedures, and received prior to payment. We tested a nonstatistical sample of travel claims and all board member and Chief Executive Officer travel claims from July 1, 2003, through January 31, 2006, to determine that disbursements for travel were paid in accordance with the Comprehensive Travel Regulations. We discussed policies and procedures for payment card purchases with staff and tested all payment card purchases for the month of February 2006 to determine if the purchases were supported, allowable, and approved in accordance with TRICOR's policies and procedures.

As a result of interviews and testwork performed, we determined that

- the design of TRICOR's controls over disbursements was adequate;
- disbursements for goods or services were properly approved, supported, and allowable under applicable policies and procedures;
- goods or services were received prior to payment;
- except for certain Chief Executive Officer travel claims, disbursements for travel were paid in accordance with the Comprehensive Travel Regulations (see finding 2);
- in all material respects, TRICOR's policies and procedures for payment cards were adequate; and
- payment card purchases were supported and allowable but were not always approved in accordance with TRICOR's policies and procedures (see finding 2).

2. <u>The Chief Financial Officer did not always approve the Chief Executive Officer's travel claims and the Purchasing Manager's payment card purchases, increasing the risk of fraud, waste, and abuse</u>

Finding

The Tennessee Rehabilitative Initiative in Correction's (TRICOR) Chief Financial Officer or previous fiscal officer did not always approve travel claims for the Chief Executive Officer. In addition, TRICOR's board of directors and the Chief Executive Officer have not established a formal authorization and approval process for the Chief Executive Officer's travel and travel reimbursement. Also, TRICOR's Chief Financial Officer did not always approve payment card purchases made by the Purchasing Manager.

<u>Travel Claims for the Chief Executive Officer Were Not Always Approved</u>

Currently, TRICOR uses the state's Comprehensive Travel Regulations issued by the Department of Finance and Administration to determine reimbursable amounts for travel. TRICOR's current practice provides that fiscal services staff review all travel claims before payment to determine if the requested amount is allowable under the Comprehensive Travel Regulations. TRICOR's Chief Financial Officer or previous fiscal officer on occasion signed the Chief Executive Officer's travel claims on the approval line as evidence that the requested reimbursement was allowable under the Comprehensive Travel Regulations.

We tested all of the Chief Executive Officer's travel claims for the period July 1, 2003, through January 31, 2006, to determine if the Chief Executive Officer's requests for travel reimbursement were supported, allowable, and approved by the fiscal officer. We found that 13 of 17 travel claims tested (76%) were not approved, including 6 travel claims for out-of-state travel. Based on our testwork, we did determine that the travel expenses were properly supported and that travel was for apparent business purposes. TRICOR reimbursed the Chief Executive Officer $3,408.39 for these 13 travel claims. We discussed the lack of approval of travel claims with TRICOR's current Chief Financial Officer, who stated that there is no policy that requires the approval of the Chief Executive Officer's travel claims. We later discussed this problem with TRICOR's Chief Executive Officer, who stated that it is TRICOR's practice for the fiscal officer to review and approve her travel claims to ensure compliance with the state's travel regulations and that the travel claims in question should have been approved by a fiscal officer. We also reviewed the controls over reimbursement of the Chief Executive Officer's travel and specifically requested evidence of the board's authorization for the Chief Executive Officer's out-of-state travel. The Chief Executive Officer stated that the Board Chairman authorized her out-of-state travel, but documentation of this authorization has not been retained. We contacted the Board Chairman and confirmed that he had authorized the Chief Executive Officer's out-of-state travel for our audit period.

Payment Card Purchases Made by the Purchasing Manager Were Not Always Approved

TRICOR's current approval procedures require that supervisors review the employees' payment card transaction logs each month to ensure purchases are supported and allowable. Supervisors then document their approval by signing the log. We tested all payment card purchases made by TRICOR employees for the month of February 2006 to determine if the purchases were supported, allowable, and approved. Of the 44 payment card purchases tested, we found that 10 payment card purchases (23%), totaling $2,815, made by the Purchasing Manager were not properly reviewed and approved by the Chief Financial Officer. Based on our testwork of the payment card purchases, although staff did not always follow the approval process, the payment card purchases were for appropriate business purposes.

We also examined other payment card transaction logs for the Purchasing Manager for the period January 2005 through January 2006 in order to determine if the lack of approval of payment card purchases for February 2006 was an isolated instance. Based on our testwork, we found that the Chief Financial Officer or former Fiscal Director had not approved transaction logs for 5 of 13 logs examined (38%). The total amount of unapproved payment card purchases on these five logs was $7,913.24. We also found that the current Chief Financial Officer failed to approve three of these payment card transaction logs. The remaining two months of logs were the responsibility of the former Fiscal Director. The Chief Financial Officer stated that the payment card transaction logs were not brought to her for approval. Again, fiscal services staff look over these payment card transaction logs. However, their review would not be as likely to detect inappropriate expenses as the supervisor's review. In addition, the fiscal services staff's review does not constitute approval as required by TRICOR's own internal manual. TRICOR's internal procedures manual entitled *TRICOR Payment Card* states that "the approver/supervisor plays the most important role in the audit process. The approver/supervisor knows first hand what the payment card holder should be purchasing."

The *TRICOR Payment Card* manual also states that "the cardholder and approver must sign the reconciled transaction log before forwarding to Administrative [Fiscal] Services." In addition, the manual states that "the approver/supervisor should review the transaction log and receipts during the cycle period, be on the lookout for unauthorized purchases, and make sure that accounting changes have been noted on the transaction log."

When travel claims and payment card purchases are not properly scrutinized and approved by management, there is an increased risk of fraud, waste, and abuse.

Recommendation

TRICOR's board of directors and audit committee should ensure an internal policy is developed to address the formal documentation of authorization of out-of-state travel and approval of travel claims for the Chief Executive Officer. In addition, the board of directors and Chief Executive Officer should include travel authorizations and approvals for other TRICOR employees in the new policy. Out-of-state travel authorizations by the board of directors for the

Chief Executive Officer should be documented in the board minutes or in another appropriate manner and the documentation retained. Although a TRICOR employee has reviewed the Chief Executive Officer's travel claims in the past, the board of directors should consider requiring that a board member review these Chief Executive Officer travel claims to strengthen controls. For example, the Chief Financial Officer could review the Chief Executive Officer's travel claims before payment, and a board member could review them at the next board meeting. The Chief Financial Officer should ensure that fiscal services staff understand travel expenses are not to be paid until properly approved.

The Chief Financial Officer should instruct the fiscal services staff to return payment card transaction logs to the designated supervisor if they have not been properly approved. Management should include the risks noted in this finding in management's documented risk assessment.

TRICOR's Chief Executive Officer and board of directors should also ensure that other risks of improper accountability, noncompliance, fraud, waste, or abuse are adequately identified and assessed in management's documented risk assessment. Management should implement effective controls to ensure compliance with applicable requirements and assign staff to be responsible for ongoing monitoring of the risks and mitigating controls. Management should take appropriate action if deficiencies occur.

Management's Comment

We concur.

TRICOR has followed and will continue to follow the State of Tennessee Comprehensive Travel Regulations. The TRICOR Board of Directors has implemented an additional process requiring the Board Chairperson to approve, in writing, all out-of-state travel for the Chief Executive Officer.

Fiscal service staff will receive further training to ensure payments are not processed without the appropriate approvals.

FINISHED GOODS INVENTORY

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

- TRICOR's procedures and controls over finished goods were adequate, and
- the finished goods inventory records represent a complete and accurate listing of the goods physically on hand.

To accomplish our objectives, we interviewed key TRICOR personnel and reviewed supporting documentation to gain an understanding of TRICOR's procedures and controls over finished goods. We selected a nonstatistical sample of finished goods from TRICOR'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 TRICOR's procedures and controls 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, in all material respects.

FACILITY VISITS

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

- TRICOR's procedures and controls over the production facilities were adequate,
- the raw materials inventory records represented a complete and accurate listing of raw materials on hand, and
- the agricultural products inventory records represented a complete and accurate listing of agricultural products on hand.

The following procedures were performed at Southeastern Tennessee State Regional Correctional Facility in Bledsoe County and Turney Center Industrial Prison in Hickman County. The Turney Center does not have agricultural products. We interviewed key TRICOR personnel and reviewed supporting documentation to gain an understanding of TRICOR's procedures and controls over the production facilities. We selected a nonstatistical sample of raw materials and agricultural products from TRICOR'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.

Based on our interviews and reviews of supporting documentation, we determined that TRICOR's procedures and controls over 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, in all material respects.

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 objectives were to determine whether

- the agency's June 30 responsibility letters for 2005, 2004, and 2003 and its December 31, 2003, internal accounting and administrative control report were filed in compliance with Section 9-18-104, *Tennessee Code Annotated*;
- documentation to support the agency's evaluation of its internal accounting and administrative control was properly maintained; and
- procedures used in compiling information for the internal accounting and administrative control report were in accordance with the guidelines prescribed under Section 9-18-103, *Tennessee Code Annotated.*

We reviewed the June 30, 2005; June 30, 2004; and June 30, 2003, responsibility letters and the December 31, 2003, internal accounting and administrative control report to determine whether they had been properly submitted to the Comptroller of the Treasury and the Department of Finance and Administration. We reviewed the supporting documentation for the agency's evaluation of its internal accounting and administrative controls. We also interviewed key employees responsible for compiling information for the internal accounting and administrative control report to gain an understanding of the agency's procedures.

We determined that the Financial Integrity Act responsibility letters and internal accounting and administrative control report were properly submitted, support for the internal accounting and administrative control report was properly maintained, and procedures used were in compliance with *Tennessee Code Annotated.*

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 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.

AUDIT COMMITTEE

On May 19, 2005, the Tennessee General Assembly enacted legislation known as the "State of Tennessee Audit Committee Act of 2005." This legislation requires the creation of audit committees for those entities that have governing boards, councils, commissions, or equivalent bodies that can hire and terminate employees and/or are responsible for the preparation of financial statements. Entities, pursuant to the act, are required to appoint the audit committee and develop an audit committee charter in accordance with the legislation. The ongoing responsibilities of an audit committee include, but are not limited to:

1. overseeing the financial reporting and related disclosures, especially when financial statements are issued;
2. evaluating management's assessment of risk and the agency's system of internal controls;
3. formally reiterating, on a regular basis, to the board, agency management, and staff their responsibility for preventing, detecting, and reporting fraud, waste, and abuse;
4. serving as a facilitator of any audits or investigations of the agency, including advising auditors and investigators of any information it may receive pertinent to audit or investigative matters;
5. informing the Comptroller of the Treasury of the results of assessment and controls to reduce the risk of fraud; and
6. promptly notifying the Comptroller of the Treasury of any indications of fraud.

The audit committee charter for the Tennessee Rehabilitative Initiative in Correction was approved by the Comptroller of the Treasury on August 25, 2006. The audit committee had not completed its review of TRICOR's risk assessment as it is still being completed by management.