STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

TENNESSEE REHABILITATIVE INITIATIVE IN CORRECTION

Financial and Compliance Audit Report

For the Year Ended June 30, 2016

Justin P. Wilson, Comptroller

Division of State Audit
Financial and Compliance Section

Deborah V. Loveless, CPA, CGFM, CGMA
Director

Edward Burr, CPA, CGFM
Assistant Director

Robyn Probus, CPA, CFE, CGFM, CGMA
Audit Manager

Donald Vanatta, CFE
In-Charge Auditor

Justin Massman
Mark White, CPA
Staff Auditors

Gerry C. Boaz, CPA, CGFM, CGMA
Technical Manager

Amy Brack
Editor

Amanda Adams
Assistant Editor

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

Reports are available at
www.comptroller.tn.gov/sa/AuditReportCategories.asp

Mission Statement
The mission of the Comptroller's Office is
to make government work better.

Comptroller Website
www.comptroller.tn.gov

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-1402

PHONE (615) 401-7897
FAX (615) 532-2765

October 2, 2017

The Honorable Bill Haslam, Governor
Members of the General Assembly
Board of Directors, Tennessee Rehabilitative Initiative in Correction

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Rehabilitative Initiative in Correction for the year ended June 30, 2016. You will note from the independent auditor's report that a disclaimer of opinion was issued on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance disclosed certain deficiencies, which are detailed in the Findings and Recommendations section of this report. The agency's management has responded to the audit findings; the responses are included following each finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit findings.

Sincerely,

Deborah V. Loveless, CPA
Director

16/215

Audit Report
Tennessee Rehabilitative Initiative in Correction
For the Year Ended June 30, 2016

TABLE OF CONTENTS

TABLE OF CONTENTS (Continued)

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

For the Year Ended June 30, 2016

Opinion on the Financial Statements

A disclaimer of opinion was issued on the financial statements.

Audit Findings

Management needs to improve procedures for recording, reconciling, and reporting financial information to prevent errors
Tennessee Rehabilitative Initiative in Correction's (TRICOR) procedures for recording, reconciling, and reporting financial information are not adequate to ensure the accuracy and proper classification of information. Because of the issues noted, we were unable to obtain sufficient appropriate audit evidence on which to form an opinion on the financial statements (page 42).

Management did not ensure staff followed procedures to account for capital assets
Management did not ensure staff followed TRICOR property management policies and procedures. We could not determine the total value of TRICOR's capital assets due to inaccurate records (page 46).

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-1402

PHONE (615) 401-7897
FAX (615) 532-2765

Independent Auditor's Report

The Honorable Bill Haslam, Governor
Members of the General Assembly
Board of Directors, Tennessee Rehabilitative Initiative in Correction

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the Tennessee Rehabilitative Initiative in Correction (TRICOR), an internal service fund of the State of Tennessee, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the 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. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

We were not engaged as auditors for the Tennessee Rehabilitative Initiative in Correction until after June 30, 2015, and, therefore, did not observe the counting of physical inventories at the beginning of the year. We were unable to satisfy ourselves by other auditing procedures concerning the inventory held at June 30, 2015, which is stated in the statement of net position at $3,875,795. We could also not physically locate capital assets based on the information on the capital asset list and were not able to satisfy ourselves of the balance of capital assets reported in the statement of net position of $12,735,377 at June 30, 2016, by other auditing procedures. In addition, management was unable to provide a capital assets note to the financial statements that agreed to the capital assets amount in the statement of net position. Furthermore, the agency uses two accounting systems to maintain its financial information, and management was unable to provide a reconciliation or explain differences between the two systems. As a result of these matters, we were unable to determine whether any adjustments might have been necessary with respect to recorded or unrecorded elements making up the statement of net position; statement of revenues, expenses, and changes in net position; and the statement of cash flows.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Emphasis of Matters

As discussed in Note 1, the financial statements present only the Tennessee Rehabilitative Initiative in Correction, an internal service fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2016, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 12, the agency implemented Governmental Accounting Standards Board Statement (GASBS) 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement No. 27*, and GASBS 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, during the year ended June 30, 2015. Our opinion is not modified with respect to this matter.

Other Matters

Comparative Statements

The accompanying financial statements of the Tennessee Rehabilitative Initiative in Correction of the State of Tennessee, as of and for the year ended June 30, 2015, and the related notes to the financial statements, were not audited, reviewed, or compiled by us, and, accordingly, we do not express an opinion or any other form of assurance on them.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 11, the schedule of TRICOR's proportionate share of the net pension liability for the Closed State and Higher Education Employee Pension Plan on page 35, the schedule of TRICOR's proportionate share of the net pension asset for the State and Higher Education Employee Retirement Plan on page 36, the schedule of TRICOR's contributions to the Closed State and Higher Education Employee Pension Plan on page 37, the schedule of TRICOR's contributions to the State and Higher Education Employee Retirement Plan on page 38, and the other postemployment benefits schedule of funding progress on page 39, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 18, 2017, on our consideration of the Tennessee Rehabilitative Initiative in Correction's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Tennessee Rehabilitative Initiative in Correction's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
September 18, 2017

TENNESSEE REHABILITATIVE INITIATIVE IN CORRECTION
Management's Discussion and Analysis

Introduction

Tennessee Rehabilitative Initiative in Correction (TRICOR) provides this management's discussion and analysis of its financial statements. This narrative overview and analysis of the financial activities is for the fiscal years ended June 30, 2016, and June 30, 2015 (unaudited), with comparative information presented for the fiscal year ended June 30, 2014 (unaudited). We encourage readers to consider this information in conjunction with the independent auditor's report, TRICOR's financial statements, and the notes to the financial statements. The basic financial statements, notes, and this discussion are the responsibility of management.

Financial Highlights

Year Ended June 30, 2016

- TRICOR's operating revenues increased 4.7%, or $2,220,929, from fiscal year 2015 to fiscal year 2016.
- TRICOR's operating expenses decreased 14.3%, or $7,758,468, from fiscal year 2015 to fiscal year 2016.
- TRICOR's net position increased 23.4%, or $3,494,610, from June 30, 2015, to June 30, 2016.

Year Ended June 30, 2015

- TRICOR's operating revenues increased 4.8%, or $2,167,817, from fiscal year 2014 to fiscal year 2015.
- TRICOR's operating expenses increased 18.4%, or $8,414,359, from fiscal year 2014 to fiscal year 2015.
- TRICOR's net position decreased 5.1%, or $809,234, from June 30, 2014, to June 30, 2015.

Financial Analysis of TRICOR - State of Tennessee

TRICOR is an internal service fund of the State of Tennessee and presents its financial statements using the economic resources measurement focus and accrual basis of accounting, which is the same measurement focus and basis of accounting employed by private sector business enterprises. This discussion and analysis is intended to serve as an introduction to TRICOR's basic financial statements. The financial statements consist of the following basic financial statements and notes to the financial statements:

The management's discussion and analysis introduces the basic financial statements and provides an analytical overview of TRICOR's financial activities.

The statement of net position presents information on TRICOR's assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the difference reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of TRICOR is improving or deteriorating.

The statement of revenues, expenses, and changes in net position is the basic statement of activities for business-type activities. This statement presents information on TRICOR's operating revenues and expenses; nonoperating revenues and expenses; other revenues, expenses, gains or losses; and whether TRICOR's financial position has improved or deteriorated as a result of the year's activities.

The statement of cash flows presents the change in TRICOR's cash during the year. This information can assist the user of the report in determining how TRICOR financed its activities and how it met its cash requirements.

The notes to the financial statements provide additional information essential to a full understanding of the data provided in the basic financial statements.

In addition to the three basic financial statements, the reader should also review the schedules of TRICOR's proportionate share of the net pension liability *(asset)*, the schedules of TRICOR's pension contributions, and the other postemployment benefits schedule of funding progress to gain an understanding of the funded status of TRICOR's benefits over time. This information provides an indication of TRICOR's ability to meet both current and future benefit payment obligations.

Statement of Net Position

As noted earlier, net position may serve over time as a useful indicator of TRICOR's financial position. A summary of TRICOR's net position at June 30, 2016; June 30, 2015; and June 30, 2014, is presented below:

Summary of Net Position

	2016	2015	2014
Assets:			
Current assets and other assets	$13,794,716	$10,593,401	$18,272,622
Capital assets	12,735,377	13,719,468	4,508,182
Total assets	26,530,093	24,312,869	22,780,804
Deferred outflows of resources	949,408	801,798	-

Liabilities:			
Current liabilities	4,276,303	5,073,482	5,633,726
Noncurrent liabilities	3,977,162	2,938,390	1,421,153
Total liabilities	8,253,465	8,011,872	7,084,879
Deferred inflows of resources	814,735	2,186,104	-
Net position:			
Net investment in capital assets	12,735,377	13,719,468	4,508,182
Restricted for pensions	8,390	-	-
Unrestricted	5,667,534	1,197,223	11,217,743
Total net position	$18,411,301	$14,916,691	$15,725,925

2016 to 2015

TRICOR's current assets increased from $10,593,401 in 2015 to $13,786,326 in 2016, while current liabilities decreased from $5,073,482 to $4,276,303 in 2016, representing an increase in working capital of approximately $4 million. This was driven by the increase of cash of nearly $6 million resulting from 2016 operations. The increase of cash was enhanced by lower accounts receivable and inventory, offset by a decrease in current liabilities.

TRICOR's net position at the end of fiscal year 2016 totaled $18,411,301. This compares to $14,916,691 at the end of fiscal year 2015. The unrestricted portion of TRICOR's net position (30.8%) may be used to meet TRICOR's obligations as they come due. Net investments in capital assets provides a clear indication of whether TRICOR owns the capital assets or creditors have a stronger claim.

Deferred outflows of resources for pensions increased from 2015 to 2016 primarily because of the difference between the actuarial assumptions and actual experience. Deferred inflows of resources for pensions decreased primarily because of the difference between projected and actual earnings on pension plan investments. In addition, the net pension liability increased significantly.

2015 to 2014

TRICOR's net position at the end of fiscal year 2015 totaled $14,916,691. This compares to $15,725,925 at the end of fiscal year 2014. The unrestricted portion of TRICOR's net position (8%) may be used to meet TRICOR's obligations as they come due. The largest portion of TRICOR's net position (92%) is invested in capital assets (e.g., land, buildings, and equipment).

TRICOR's current assets decreased from $18,272,622 in 2014 to $10,593,401, primarily due to the financial loss sustained during 2015.

The increase during 2015 in noncurrent liabilities, deferred outflow of resources, and deferred inflows of resources is due to the implementation of GASB Statement 68, *Accounting and Financial Reporting for Pensions* (see note 8 to the financial statements).

Capital Assets

At June 30, 2016, TRICOR had $12,735,377 invested in capital assets, net of accumulated depreciation of approximately $19,484,603. Depreciation charges totaled $1,024,579 for 2016. At June 30, 2015, TRICOR had $13,719,468 invested in capital assets, net of accumulated depreciation of approximately $18,527,991. Depreciation charges totaled $840,087 for 2015.

More detailed information about TRICOR capital assets is presented in Note 4 to the financial statements.

Statement of Revenues, Expenses, and Changes in Net Position

TRICOR's operating revenue for FY 2016 of $49,564,397 was generated by the four Strategic Business Units (SBU) listed: 1) business services, 2) manufacturing, 3) agriculture, and 4) consumables. The four diverse SBU groups have provided TRICOR with the ability to be open to more competitive opportunities. Furthermore, this flexibility has allowed greater offender participation, with several sites across the State of Tennessee. Labor is provided by offenders paid by TRICOR through the Tennessee Department of Correction's Central Trust Fund system.

Summary of Revenues, Expenses, and Changes in Net Position

	2016	2015	2014
Operating revenues:			
Sales	$39,766,893	$38,618,993	$37,471,252
Services	9,797,504	8,724,475	7,704,399
Total operating revenues	49,564,397	47,343,468	45,175,651
Operating expenses:			
Cost of sales and services			
Cost of sales	23,566,579	29,266,875	22,777,331
Cost of services	4,197,170	3,675,728	3,476,940
Selling, general, and administrative expenses			
Salaries, wages & benefits	7,439,644	7,462,016	9,481,066
Other	10,094,549	12,836,283	9,005,749
Depreciation	1,024,579	840,087	925,544
Total operating expenses	46,322,521	54,080,989	45,666,630
Operating income (loss)	3,241,876	(6,737,521)	(490,978)
Non-operating revenues (expenses)	252,734	(591,318)	86,279
Income (loss) before other revenues	3,494,610	(7,328,839)	(404,699)
Other revenues (expenses)	-	9,996,899	(409,672)

Increase in net position	3,494,610	2,668,060	(814,371)
Net position, beginning	14,916,691	15,725,925	16,540,296
Cumulative effect of a change in accounting principle	-	(3,477,294)	-
Net position, beginning, restated	14,916,691	12,248,631	16,540,296
Net position, ending	$18,411,301	$14,916,691	$15,725,925

2016 to 2015

In fiscal year 2016, operating revenues increased $2,220,929, or 4.7%, primarily as a result of favorable services sector revenue of $1,073,380, led by hand-finished hardwood flooring, and favorable manufacturing revenue of $997,219 impacted by food services. Operating expenses decreased $7,758,468, or 14.3%. This decrease was caused primarily by lower material costs for food services, along with more efficient manufacturing and overhead costs than were realized in 2015.

2015 to 2014

In fiscal year 2015, operating revenues increased $2,167,817, or 4.8%, primarily as a result of improved revenue by the services sector of $1,280,463, with CPG Flooring having the most impact. The manufacturing sector also had favorable revenue of $337,394, which was driven by Cook Chill's performance. Operating expenses increased $8,414,359, or 18.4%. This increase was due primarily to higher material costs, along with unfavorable manufacturing variances for the Cook Chill facility.

TRICOR Revenues by SBU 2016 to 2015

SBU	2016	2015	Difference
Business Services	$ 9,797,155	$ 8,724,475	$1,072,680
Consumables	23,832,996	22,606,485	1,226,511
Farms/Agriculture	2,330,662	2,620,692	(290,030)
Manufacturing	13,603,584	13,391,816	211,768
Total	$49,564,397	$47,343,468	$2,220,929

Total TRICOR revenue for FY 2016 was $49,564,397, or 4.7%, favorable to FY 2015.

Business Services for FY 2016 generated $9,797,155, or 19.8%, of total revenues. Hardwood flooring finishing was the leading revenue producer with $8.2 million, or 83.1%, of business services revenue.

Consumables SBU, or the Cook Chill operation, generated $23,832,996, or 48.1%, of FY 2016 total revenues. The increase of 5.4% was due to an increase in pricing of approximately 28% offset by a decrease in orders of approximately 22%.

Manufacturing for FY 2016 generated $13,603,584, or 27.4%, of total revenues. Textiles generated $5.4 million of total manufacturing revenue, followed by $4.8 million generated by the license plate operations. These two operations combined provided 75.3% of manufacturing revenue for FY 2016.

Manufacturing revenue remained flat for FY 2016, with only a slight increase in revenue of approximately $200,000, or 1.6%, better than FY 2015. The Tag Plant increased revenue by approximately $360,000, and textiles also increased by approximately $214,000, or 4.1%. The remaining manufacturing sites were unfavorable compared to FY 2015.

Agriculture for FY 2016 generated $2,330,662, or 4.7%, of FY 2016 total revenues. This was approximately $290,000, or 11.1%, unfavorable to FY 2015. For FY 2016, both farms were unfavorable compared to FY 2015.

The following were considered major variances, or differences of $125,000 or greater when comparing FY 2016 to FY 2015.

Expenses	2016	2015	Difference
Cost of Goods Sold	$23,566,579	$29,266,875	$(5,700,296)
Communications	777,131	529,473	247,658
Offender Labor	4,197,169	3,675,728	521,441
Professional Services	1,806,330	1,606,067	200,263
Supplies	2,120,600	2,459,263	(338,663)
Travel	379,518	645,888	(266,370)

Cost of goods sold for FY 2016 was $23,566,579, which was 19.5% less than FY 2015. The most significant decrease was in the consumables SBU of approximately $5.3 million, due to a 22% decrease in orders.

Communications costs for FY 2016 were $777,131, which was 46.8% greater than FY 2015, due partially to the consumables SBU which increased by approximately $227,000.

Offender labor costs for FY 2016 were $4,197,169, which was 14.2% greater than FY 2015. This was driven by greater business services SBU costs, especially the hardwood flooring operation.

Professional services were $1,806,330, which was 12.5% higher than FY 2015. This increased cost was related to the business services SBU.

Supplies expenses for FY 2016 decreased approximately $339,000, or 13.8%. A reduction in basically every SBU and overhead cost center attributed to the change.

Finally, travel for FY 2016 was $379,518, which was 41.2% less than FY 2015. Administrative and overhead costs generally declined throughout TRICOR due to TRICOR's cost reduction emphasis during 2016.

Economic Factors

TRICOR continued to improve its financial position during the year. Below are some of the potential challenges for FY 2017:

- Consumables SBU was discontinued in September FY 2017.
- Packaging of manufactured sports equipment consolidated operations in two facilities to one facility due to a decline in operating activity.
- Offset printing has continued to decline in favor of on-demand printing.
- Agriculture prices continue to be lower than historical experience.

TRICOR anticipated the challenges for FY 2017 and has reacted so that budgeted projections are met and TRICOR will remain sustainable without accepting any appropriations.

Contacting TRICOR Management

This financial report is designed to provide a general overview of TRICOR's finances for all those with an interest. If you have any questions about this report or need additional information, contact James Bickmore, 6185 Cockrill Bend Circle, Nashville, TN 37209.

TENNESSEE REHABILITATIVE INITIATIVE IN CORRECTION
Statements of Net Position
June 30, 2016, and June 30, 2015

	June 30, 2016	June 30, 2015 (unaudited)
Assets		
Current assets:		
Cash (Note 2)	$9,525,188	$3,667,726
Accounts receivable, net of allowance for doubtful accounts of $430,724 at June 30, 2016, and $325,022 at June 30, 2015 (Note 3)	983,208	1,719,695
Due from primary government	299,927	1,159,438
Inventories	2,872,157	3,875,795
Prepaid items	105,846	170,747
Total current assets	13,786,326	10,593,401
Noncurrent assets:		
Net pension asset (Note 8)	8,390	-
Capital assets (Note 4):		
Land and improvements	961,158	961,158
Buildings and improvements	9,400,100	9,872,795
Furniture and equipment	2,374,119	2,885,515
Total noncurrent assets	12,743,767	13,719,468
Total assets	26,530,093	24,312,869
Deferred outflows of resources		
Deferred outflows related to pensions (Note 8)	949,408	801,798
Total deferred outflows of resources	949,408	801,798
Liabilities		
Current liabilities:		
Accounts payable and accruals (Note 6)	4,043,579	4,822,322
Compensated absences (Note 7)	232,724	251,160
Total current liabilities	4,276,303	5,073,482
Noncurrent liabilities:		
Net pension liability	2,592,196	1,517,238
Compensated absences (Note 7)	370,103	419,629
Other postemployment benefits (Note 9)	1,014,863	1,001,523
Total noncurrent liabilities	3,977,162	2,938,390
Total liabilities	8,253,465	8,011,872
Deferred inflows of resources		
Deferred inflows related to pensions (Note 8)	814,735	2,186,104
Total deferred inflows of resources	814,735	2,186,104
Net position		
Net investment in capital assets	12,735,377	13,719,468
Restricted for pensions	8,390	-
Unrestricted	5,667,534	1,197,223
Total net position	$18,411,301	$14,916,691

The notes to the financial statements are an integral part of this statement.

TENNESSEE REHABILITATIVE INITIATIVE IN CORRECTION
Statements of Revenues, Expenses, and Changes in Net Position
For the Years Ended June 30, 2016, and June 30, 2015

	Year Ended June 30, 2016	Year Ended June 30, 2015 (unaudited)
Operating revenue		
Sales	$39,766,893	$38,618,993
Services	9,797,504	8,724,475
Total operating revenue	49,564,397	47,343,468
Operating expenses		
Costs of sales and services		
Cost of sales	23,566,579	29,266,875
Cost of services	4,197,170	3,675,728
Selling, general, and administrative expenses		
Salaries, wages, and benefits	7,439,644	7,462,016
Freight and communications	777,131	529,473
Maintenance and repairs	742,712	3,148,395
Professional services	1,806,330	1,606,067
Rentals and insurance	890,977	1,001,867
Supplies	2,120,600	2,459,263
Travel	379,518	645,888
Utilities	1,716,415	1,612,979
Other	1,660,866	1,832,351
Depreciation	1,024,579	840,087
Total operating expenses	46,322,521	54,080,989
Operating income (loss)	3,241,876	(6,737,521)
Nonoperating revenues (expenses)		
Miscellaneous revenue (expenses)	252,734	(591,318)
Total nonoperating revenues (expenses)	252,734	(591,318)
Income before other revenues (expenses)	3,494,610	(7,328,839)
Transfer of property from STREAM	-	9,187,125
Net transfers from TDOC	-	809,774
Total other revenues	-	9,996,899
Increase in net position	3,494,610	2,668,060
Cumulative effect of a change in accounting principle (Note 12)	-	(3,477,294)
Net position - beginning of year	14,916,691	15,725,925
Net position - end of year	$18,411,301	$14,916,691

The notes to the financial statements are an integral part of this statement.

TENNESSEE REHABILITATIVE INITIATIVE IN CORRECTION
Statements of Cash Flows
For the Years Ended June 30, 2016, and June 30, 2015

	Year Ended June 30, 2016	Year Ended June 30, 2015 (unaudited)
Cash flows from operating activities		
Payments from customers	$ 51,160,394	$ 46,935,560
Other miscellaneous receipts	232,733	-
Payments to suppliers for goods and services	(37,545,859)	(44,742,396)
Payments to employees	(5,647,052)	(9,243,481)
Payments for benefits	(2,322,268)	-
Net cash provided (used) by operating activities	5,877,948	(7,050,317)
Cash flows from capital and related financing activities		
Transfers from TDOC	-	809,774
Receipts from disposal of capital assets	20,000	-
Payments for additions to capital assets	(40,486)	(864,251)
Net cash used for noncapital financing activities	(20,486)	(54,477)
Net increase (decrease) in cash	5,857,462	(7,104,794)
Cash - beginning of year	3,667,726	10,772,520
Cash - end of year	$ 9,525,188	$ 3,667,726
Reconciliation of operating income to net cash provided (used) by operating activities:		
Operating income	$ 3,241,876	$ (6,737,521)
Other miscellaneous receipts	232,733	(591,318)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation	1,024,579	840,087
Pension expense	-	226,049
Change in assets and liabilities:		
Accounts receivable, net	736,487	1,342,848
Due from primary government	859,511	(1,159,438)
Inventories	1,003,638	508,100
Prepaid expenses	64,901	(117,082)
Net pension asset	(8,390)	-
Accounts payable and accruals	(778,743)	174,014
Compensated absences	(67,963)	(734,258)
Net pension liability	1,074,958	-
Other postemployment benefits	13,340	-
Change in deferred outflows of resources	(147,610)	(801,798)
Change in deferred inflows of resources	(1,371,369)	-
Net cash provided (used) by operating activities	$ 5,877,948	$ (7,050,317)

The notes to the financial statements are an integral part of this statement.

Note 1. Summary of Significant Accounting Policies

Reporting Entity

TRICOR, the Tennessee Rehabilitative Initiative in Correction, was created by the Tennessee General Assembly in 1994 under the provisions of Title 41, Chapter 22, *Tennessee Code Annotated*, to manage and operate the correctional industry program for the State of Tennessee. TRICOR has been included as an internal service fund in the *Tennessee Comprehensive Annual Financial Report.* That report is available on the state's website at www.tn.gov/finance/article/fa-accfin-cafr. TRICOR's statutorily mandated mission (Section 41-22-403, *Tennessee Code Annotated*) includes these objectives:

- work offenders in manufacturing, business services, or agricultural jobs;
- offset the costs of incarceration by generating revenue through the sale of products or business services;
- develop work opportunities that minimize the impact on free-world jobs;
- integrate work opportunities with education and vocational training;
- develop good work habits and marketable skills;
- develop and operate a post-release placement system; and
- provide or create other programs and services as deemed necessary by TRICOR to support an offender's rehabilitation and reintegration efforts.

The General Assembly created a board of directors (Section 41-22-404, *Tennessee Code Annotated*) to govern TRICOR. The board is responsible for developing jobs; training and selecting Tennessee Department of Correction offenders for participation in industry, business services, or agricultural programs; and for the sale of products or services for the purpose of generating revenue to offset the costs of incarceration. In addition, the board is responsible for approving the annual operating plan of TRICOR (Section 41-22-408[c], *Tennessee Code Annotated*).

The statute designated the Tennessee Department of Correction (TDOC) a partner in this mission by making it responsible for assigning offenders to TRICOR jobs that are developed by the board of directors. A large percentage of TRICOR operations are located within TDOC institutions, while others are operated outside the secure perimeters with offender labor, and in some cases, a TDOC security presence.

Program services are provided using a self-sustaining business model that aligns distinct strategic business units (SBUs) and the support structure necessary to achieve performance expectations. Business units serve customers through the sale of products and services provided by the offender workforce participating in TRICOR programs. Businesses are operated using both cognitive behavioral skill development and occupational skills training. TRICOR also focuses on the life skills needed to successfully transition from prison to society, which include “soft” skills such as those needed to gain and retain employment. These training opportunities are made available to program participants through the sale of products and services, and the programming is funded wholly by the collection of workforce development funds from offenders assigned to Private Industry Enhancement program operations across the state. They are provided within TDOC at no charge to that agency or to the taxpayers of Tennessee. In addition, as industry positions are highly prized by the offender population, the behavior management benefits aid TDOC in overall prison management issues.

Presentation, Measurement Focus, and Basis of Accounting

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

The financial statements have been prepared using the accrual basis of accounting and the economic resources measurement focus. Revenues are recorded when earned and expenses are recorded at the time the liabilities are incurred, regardless of the timing of the related cash flows.

The preparation of financial statements in accordance with the accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

TRICOR distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing goods and services in connection with principal ongoing operations. TRICOR’s mission is “to prepare offenders for success after release.” This is accomplished by engaging offenders in productive work and in programming offenders. Any revenues and expenses not generated in these related activities would be reported as nonoperating revenues and expenses.

TRICOR’s restricted resources deal only with net pension assets.

Cash

Cash is defined as demand deposits in the State Pooled Investment Fund.

Inventories

At year-end, inventories are determined by physical count and are valued at standard cost. This valuation is not materially different from historical cost. Standard cost is used by TRICOR.

However, at June 30, 2016, TRICOR's inventory balance reasonably reflects approximate cost under FIFO.

Capital Assets and Depreciation

Capital assets are defined as assets with a useful life of at least two years and a single-item value in excess of $5,000. Capital assets are recorded at historical costs. All capital assets other than land are depreciated using the straight-line method using these asset lives:

Buildings and building improvements	20 to 50 years
Furniture and equipment	3 to 20 years

Compensated Absences

TRICOR's employees accrue annual leave at varying rates, depending on length of service or classification.

TRICOR's employees accrue sick leave at a rate of 7.5 hours per month.

The amount of the liability for annual leave and the related benefits are reported in the statements of net position. There is no liability for unpaid accumulated sick leave because TRICOR's policy is to pay this only if the employee is sick or upon death.

Pensions

For purposes of measuring the net pension liability (asset), deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Closed State and Higher Education Employee Pension Plan and the State and Higher Education Employee Retirement Plan in the Tennessee Consolidated Retirement System (TCRS) and additions to/deductions from the plans' fiduciary net positions have been determined on the same basis as they are reported by the TCRS. For this purpose, benefits (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms of the Closed State and Higher Education Employee Pension Plan and the State and Higher Education Employee Retirement Plan. Investments are reported at fair value.

Note 2. Deposits

TRICOR had $9,525,188 and $3,667,726 in the State Pooled Investment Fund (SPIF) at June 30, 2016, and June 30, 2015, respectively. The SPIF, administered by the State Treasurer, is authorized by statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The current resolution of that board gives the Treasurer approval to invest in collateralized certificates of deposit in authorized state depositories; prime commercial paper; prime bankers' acceptances; bonds, notes, and bills of the Unites States Treasury or other obligations guaranteed as to principal and interest by the United States or any of its agencies;

repurchase agreements for obligations of the United States or its agencies; and securities lending agreements whereby securities may be loaned for a fee.

There are no minimum or maximum limitations on withdrawals from the SPIF with the exception of a 24-hour notification period for withdrawals of $5 million or more. Investments in the SPIF are measured at amortized cost. The pooled investment fund's required risks disclosures are presented in the *State of Tennessee Treasurer's Report*. That report is available on the state's website at www.treasury.tn.gov or by calling (615) 741-2956.

Note 3. Accounts Receivable

Receivables at June 30 consist of the following:

	2016	2015
Receivables from local governments	$ 53,388	$ 89,466
Receivables from private sector	932,773	637,919
Other receivables	427,771	1,317,332
Allowance for doubtful accounts	(430,724)	(325,022)
Accounts receivables, net	$ 983,208	$ 1,719,695

The net accounts receivable amount represents the amount that is expected to be collected within one year.

Note 4. Capital Assets

Capital asset activity for the year ended June 30, 2016, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Land and improvements	$ 961,158	$ -	$ -	$ 961,158
Buildings and improvements	19,904,554	-	(1,627,304)	18,277,250
Furniture and equipment	14,540,032	-	(1,129,717)	13,410,315
Total	35,405,744	-	(2,757,021)	32,648,723
Less accumulated depreciation:				
Buildings and improvements	(8,054,551)	-	(393,855)	(8,448,406)
Furniture and equipment	(11,250,235)	214,038	-	(11,036,197)
Total	(19,304,786)	214,038	(393,855)	(19,484,603)
Capital assets, net	$ 16,100,958	$214,038	$(3,150,876)	$13,164,120

Capital asset activity for the year ended June 30, 2015, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Land and improvements	$ 961,158	$ -	$ -	$ 961,158
Buildings and improvements	17,330,870	2,573,684	-	19,904,554
Furniture and equipment	13,363,741	1,176,291	-	14,540,032
Total	31,655,769	3,749,975	-	35,405,744
Less accumulated depreciation:				
Buildings and improvements	(7,140,982)	(913,569)	-	(8,054,551)
Furniture and equipment	(11,162,293)	(87,942)	-	(11,250,235)
Total	(18,303,275)	(1,001,511)	-	(19,304,786)
Capital assets, net	$13,352,494	$2,748,464	$ -	$16,100,958

Note 5. Leasing Arrangements

TRICOR's leasing arrangements consist of noncancelable operating leases for warehouse space and farm equipment that expire at various dates through 2019.

The following is a schedule by years of future minimum rental payments required of TRICOR under all noncancelable operating leases with original terms of one year or more:

For the Year Ending June 30	
2017	$383,804
2018	225,103
2019	199,630
2020	55,350
Total minimum rental payments	$863,887

The following schedule shows the composition of total rental expense for all operating leases for the years ended June 30:

Minimum rentals:	2016	2015
Property	$166,050	$110,700
Equipment	69,657	115,795
Total minimum rentals	$235,707	$226,495

Note 6. Accounts Payable and Accruals

Payable at June 30 consists of the following:

	2016	2015
Payables to suppliers	$1,192,906	$2,569,797
Accrued liabilities	2,610,514	1,978,242
Accruals for salaries and benefits	240,159	274,283
Accounts payable and accruals	$4,043,579	$4,822,322

The accounts payable and accrued liabilities represent the amounts due within one year.

Note 7. Noncurrent Liabilities

TRICOR noncurrent liabilities for the year ended June 30 include compensated absences described as follows:

	2016	2015
Beginning balance compensated absences	$ 670,789	$ 649,509
Additions	423,761	451,995
Deductions	(491,723)	(430,715)
Ending balance compensated absences	$ 602,827	$ 670,789
Compensated absences due within one year	$ 232,724	$ 251,160

Note 8. Pension Plans

Defined Benefit Plans

Closed State and Higher Education Employee Pension Plan

General Information about the Pension Plan

Plan Description – State employees and higher education employees with membership in the Tennessee Consolidated Retirement System (TCRS) before July 1, 2014, are provided with pensions through the Closed State and Higher Education Employee Pension Plan. This plan is a component of the Public Employee Retirement Plan, an agent, multiple-employer defined benefit pension plan. The Closed State and Higher Education Employee Pension Plan stopped accepting new membership on June 30, 2014, but will continue providing benefits to existing members and retirees. Beginning July 1, 2014, a new agent defined benefit retirement plan, the State and Higher Education Employee Retirement Plan, became effective for state employees and higher education employees hired on or after July 1, 2014.

The TCRS was created by state statute under Title 8, Chapters 34-37, *Tennessee Code Annotated*. The TCRS Board of Trustees is responsible for the proper operation and administration of all employer pension plans in the TCRS. The Tennessee Treasury Department, an agency in the legislative branch of state government, administers the plans of the TCRS. The TCRS issues a publicly available financial report that can be obtained at www.treasury.tn.gov/tcrs.

Benefits Provided – Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes the benefit terms and can be amended only by the Tennessee General Assembly. Members of the Closed State and Higher Education Employee Pension Plan are eligible to retire with an unreduced benefit at age 60 with 5 years of service credit or after 30 years of service credit regardless of age. Benefits are determined using the following formula:

Average of member's highest compensation for 5 consecutive years (up to Social Security integration level)	x	1.50%	x	Years of Service Credit	x	105%
Plus:						
Average of member's highest compensation for 5 consecutive years (over the Social Security integration level)	x	1.75%	x	Years of Service Credit	x	105%

A reduced early retirement benefit is available at age 55 and vested. Members are vested with five years of service credit. Service-related disability benefits are provided regardless of length of service. Five years of service is required for non-service-related disability eligibility. The service-related and non-service-related disability benefits are determined in the same manner as a service retirement benefit but are reduced 10% and include projected service credits. A variety of death benefits are available under various eligibility criteria. Member and beneficiary annuitants are entitled to automatic cost-of-living adjustments (COLAs) after retirement. A COLA is granted each July for annuitants retired prior to the 2nd of July of the previous year. The COLA is based on the change in the consumer price index (CPI) during the prior calendar year, capped at 3%, and applied to the current benefit. No COLA is granted if the change in the CPI is less than 0.5%. A 1% COLA is granted if the CPI change is between 0.5% and 1%. A member who leaves employment may withdraw employee contributions, plus any accumulated interest.

Contributions – Contributions for state employees and higher education employees are established in the statutes governing the TCRS and may only be changed by the Tennessee General Assembly. TRICOR's employees are non-contributory, as are most members in the Closed State and Higher Education Employee Pension Plan. State and higher education agencies make employer contributions at the rate set by the Board of Trustees as determined by an actuarial valuation. By law, employer contributions for the Closed State and Higher Education Employee Pension Plan are required to be paid. Employer contributions by TRICOR for the years ended June 30, 2016, and June 30, 2015, to the Closed State and Higher Education Employee Pension Plan were $652,190 and $789,083, respectively, which is 15.03% of covered payroll. The employer rate, when combined with member contributions, is expected to finance the costs of benefits earned by members during the year and the cost of administration, as well as an amortized portion of any unfunded liability.

Pension Liabilities (Assets), Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

Pension Liability – At June 30, 2016, TRICOR reported a liability of $2,592,196 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. TRICOR's proportion of the net pension liability was based on a projection of TRICOR's contributions during the year ended June 30, 2015, to the pension plan relative to the contributions of all participating state and higher education agencies. At the June 30, 2015, measurement date, TRICOR's proportion was 0.201057%.

At June 30, 2015, TRICOR reported a liability of $1,517,238 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. TRICOR's proportion of the net pension liability was based on a projection of TRICOR's contributions during the year ended June 30, 2014, to the pension plan relative to the contributions of all participating state and higher education agencies. At the June 30, 2014, measurement date, TRICOR's proportion was 0.219906%, representing the first-time presentation of this proportion.

Pension Expense – For the year ended June 30, 2016, TRICOR recognized pension expense of $215,253. Allocated pension expense was $278,737 before being decreased by $63,484 due to a change in proportionate share. For the year ended June 30, 2015, TRICOR recognized a pension expense of $226,049.

Deferred Outflows of Resources and Deferred Inflows of Resources – For the year ended June 30, 2016, TRICOR reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$274,297	$224,442
Net difference between projected and actual earnings on pension plan investments	-	333,234
Changes in proportion	-	253,938
TRICOR's contributions subsequent to the measurement date of June 30, 2015	652,190	-
Total	$926,487	$811,614

For the year ended June 30, 2015, TRICOR reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ -	$ 327,310
Net difference between projected and actual earnings on pension plan investments	-	1,858,794
TRICOR contributions subsequent to the measurement date June 30, 2014	789,083	-
Total	$789,083	$2,186,104

Deferred outflows of resources, resulting from TRICOR's employer contributions of $652,190 subsequent to the measurement date, will be recognized as a decrease in net pension liability in the year ending June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ended June 30	
2017	$(259,250)
2018	(259,250)
2019	(259,249)
2020	240,432
Thereafter	-

In the table above, positive amounts will increase pension expense, while negative amounts will decrease pension expense.

Actuarial Assumptions – The total pension liability as of the June 30, 2015, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.0%
Salary increases	Graded salary ranges from 8.97% to 3.71% based on age, including inflation, averaging 4.25%
Investment rate of return	7.5%, net of pension plan investment expenses, including inflation
Cost-of-living adjustment	2.5%

Mortality rates were based on actual experience from the June 30, 2012, actuarial experience study adjusted for some of the expected future improvement in life expectancy.

The actuarial assumptions used in the June 30, 2015, actuarial valuation were based on the results of an actuarial experience study performed for the period July 1, 2008, through June 30, 2012. The demographic assumptions were adjusted to more closely reflect actual and expected future experience.

The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees in conjunction with the June 30, 2012, actuarial experience study by considering the following three techniques: (1) the 25-year historical return of the TCRS at June 30, 2012; (2) the historical market returns of asset classes from 1926 to 2012 using the TCRS investment policy asset allocation; and (3) capital market projections that were utilized as a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. Four sources of capital market projections were blended and utilized in the third technique. The blended capital market projection established the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding inflation of 3%. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Long-term Expected Real Rate of Return	Target Allocation
U.S. equity	6.46%	33%
Developed market international equity	6.26%	17%
Emerging market international equity	6.40%	5%
Private equity and strategic lending	4.61%	8%
U.S. fixed income	0.98%	29%
Real estate	4.73%	7%
Short-term securities	0.00%	1%
		100%

The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees as 7.5% based on a blending of the three factors described above.

Discount Rate – The discount rate used to measure the total pension liability was 7.5%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current rate and that contributions from all state and higher education agencies will be made at the actuarially determined contribution rate in accordance with the funding policy of the TCRS Board of Trustees and as required to be paid by state statute. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make projected future benefit payments of current active and inactive members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the net pension liability *(asset)* to changes in the discount rate – The following presents TRICOR's proportionate share of the net pension liability calculated using the discount rate of 7.5%, as well as what TRICOR's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.5%) or 1 percentage point higher (8.5%) than the current rate:

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
TRICOR's net pension liability *(asset)*	$6,073,911	$2,592,196	$(342,219)

Pension plan fiduciary net position – Detailed information about the pension plan's fiduciary net position is available in a separately issued TCRS financial report at www.treasury.tn.gov/tcrs.

Payable to the Pension Plan

At June 30, 2016, and June 30, 2015, TRICOR reported a payable of $25,165 and $29,382, respectively, for the outstanding amount of legally required contributions to the pension plan required for the years ended June 30, 2016, and 2015.

State and Higher Education Employee Retirement Plan

General Information about the Pension Plan

Plan Description – State and higher education employees with membership in the Tennessee Consolidated Retirement System (TCRS) before July 1, 2014, are provided with pensions through the Closed State and Higher Education Employee Pension Plan, an agent plan within the Public Employee Retirement Plan administered by the TCRS. TCRS is a multiple-employer pension plan. The Closed State and Higher Education Employee Pension Plan was closed effective June 30, 2014, and covers employees hired before July 1, 2014. Employees hired after June 30, 2014, are provided with pensions through a legally separate plan referred to as the State and Higher Education Employee Retirement Plan, an agent plan within the Public Employee Retirement Plan administered by the TCRS. The TCRS was created by state statute under Title 8, Chapters 34-37, *Tennessee Code Annotated*.

Benefits Provided – Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes the benefit terms and can be amended only by the Tennessee General Assembly. Members of the State and Higher Education Employee Retirement Plan are eligible to retire at age 65 with 5 years of service credit or pursuant to the rule of 90 in which the member's age and service credit total 90. Members are entitled to receive unreduced service retirement benefits, which are determined by a formula multiplying the member's highest five consecutive years' average compensation by 1% multiplied by the member's years of service credit. A reduced early retirement benefit is available at age 60 with 5 years of service credit or pursuant to the rule of 80 in which the member's age and service credit total 80. Service-related disability benefits are provided regardless of length of service. Five years of service is required for non-service-related disability eligibility. The service-related and non-service-related disability benefits are determined in the same manner as a service retirement benefit but are reduced 10% and include projected service credits. A variety of death benefits are available under various eligibility criteria.

Member and beneficiary annuitants are entitled to automatic cost-of-living adjustments (COLAs) after retirement. A COLA is granted each July for annuitants retired prior to the 2nd of July of the previous year. The COLA is based on the change in the consumer price index (CPI) during the prior calendar year, capped at 3%, and applied to the current benefit. No COLA is granted if the change in the CPI is less than 0.5%. A 1% COLA is granted if the CPI change is between 0.5% and 1%. A member who leaves employment may withdraw employee contributions, plus any accumulated interest. Moreover, there are defined cost controls and unfunded liability controls that provide for the adjustment of benefit terms and conditions on an automatic basis.

Contributions – Contributions for state and higher education employees are established in the statutes governing the TCRS and may only be changed by the Tennessee General Assembly. Employees contribute 5% of their salary to the State and Higher Education Employee Retirement Plan. TRICOR makes employer contributions at the rate set by the TCRS Board of Trustees as determined by an actuarial valuation. Per the statutory provisions governing the TCRS, the employer contribution rate cannot be less than 4% for all aggregate employee groups, except in years when the maximum funded level, approved by the TCRS Board of Trustees, is reached. By law, employer contributions for the State and Higher Education Employee Retirement Plan are required to be paid. Employer contributions by TRICOR for the years ended June 30, 2016, and June 30, 2015, to the State and Higher Education Employee Retirement Plan were $22,435 and $12,715, respectively, which is 2.97% and 3.87%, respectively, of covered payroll for the years then ended. The employer rate, when combined with member contributions, is expected to finance the costs of benefits earned by members during the year and the cost of administration, as well as an amortized portion of any unfunded liability.

Pension Liabilities (Assets), Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

Pension Asset – At June 30, 2016, TRICOR reported an asset of $8,390 for its proportionate share of the net pension asset. The net pension asset was measured as of June 30, 2015, and the total pension asset used to calculate the net pension asset was determined by an actuarial valuation as of that date. TRICOR's proportion of the net pension asset was based on a projection of TRICOR's contributions during the year ended June 30, 2015, to the pension plan relative to the contributions of all participating state and higher education agencies. At the June 30, 2015, measurement date, TRICOR's proportion was 0.301709%, representing the first-time presentation of this proportion.

Pension expense – For the year ended June 30, 2016, TRICOR recognized a pension expense of $6,959.

Deferred outflows of resources and deferred inflows of resources – For the year ended June 30, 2016, TRICOR reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

Fiscal Year 2016	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ -	$ 3,121
Net difference between projected and actual earnings on pension plan investments	486	-
TRICOR's contributions subsequent to the measurement date of June 30, 2015	22,435	-
Total	$ 22,921	$ 3,121

Fiscal Year 2015	Deferred Outflows of Resources	Deferred Inflows of Resources
TRICOR's contributions subsequent to the measurement date of June 30, 2014	$ 12,715	$ -

Deferred outflows of resources, resulting from TRICOR's employer contributions of $22,435 subsequent to the measurement date, will be recognized as a decrease in net pension liability in the year ending June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ended June 30:	
2017	$ (269)
2018	(269)
2019	(269)
2020	(268)
2021	(390)
Thereafter	(1,170)

In the table above, positive amounts will increase pension expense, while negative amounts will decrease pension expense.

Actuarial assumptions – The total pension asset as of the June 30, 2015, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.0%
Salary increases	Graded salary ranges from 8.97% to 3.71% based on age, including inflation, averaging 4.25%

Investment rate of return	7.5%, net of pension plan investment expenses, including inflation
Cost-of-Living Adjustment	2.5%

Mortality rates were based on actual experience from the June 30, 2012, actuarial experience study adjusted for some of the expected future improvement in life expectancy.

The actuarial assumptions used in the June 30, 2015, actuarial valuation were based on the results of an actuarial experience study performed for the period July 1, 2008, through June 30, 2012. The demographic assumptions were adjusted to more closely reflect actual and expected future experience.

The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees in conjunction with the June 30, 2012, actuarial experience study by considering the following three techniques: (1) the 25-year historical return of the TCRS at June 30, 2012; (2) the historical market returns of asset classes from 1926 to 2012 using the TCRS investment policy asset allocation; and (3) capital market projections that were utilized as a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. Four sources of capital market projections were blended and utilized in the third technique. The blended capital market projection established the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding inflation of 3%. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Long-Term Expected Real Rate of Return	Target Allocation
U.S. equity	6.46%	33%
Developed market international equity	6.26%	17%
Emerging market international equity	6.40%	5%
Private equity and strategic lending	4.61%	8%
U.S. fixed income	0.98%	29%
Real estate	4.73%	7%
Short-term securities	0.00%	1%
		100%

Discount Rate – The discount rate used to measure the total pension asset was 7.5%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current rate and that contributions from all state and higher education agencies will be made at the actuarially determined contribution rate in accordance with the funding policy of the TCRS Board of Trustees and as required to be paid by state statute. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make projected future benefit payments of current active and inactive members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension asset.

Sensitivity of the net pension liability *(asset)* to changes in the discount rate – The following presents TRICOR's proportionate share of the net pension asset calculated using the discount rate of 7.5%, as well as what TRICOR's proportionate share of the net pension asset would be if it were calculated using a discount rate that is 1 percentage point lower (6.5%) or 1 percentage point higher (8.5%) than the current rate:

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% increase (8.5%)
TRICOR's net pension asset	$(3,296)	$(8,390)	$(12,203)

Pension Plan Fiduciary Net Position – Detailed information about the pension plan's fiduciary net position is available in a separately issued TCRS financial report at www.treasury.tn.gov/tcrs.

Payable to the Pension Plan

At June 30, 2016, and June 30, 2015, TRICOR reported a payable of $548 and $1,107, respectively, for the outstanding amount of legally required contributions to the pension plan required for the years ended June 30, 2016, and June 30, 2015.

Total Defined Benefit Pension Expense

The total pension expense for the years ended June 30, 2016, and June, 30, 2015, for all state and local government defined benefit pension plans was $222,212 and $226,049, respectively.

Defined Contribution Plans

Deferred Compensation Plans

Employees are offered two deferred compensation plans. TRICOR, through the State of Tennessee, provides two plans, one established pursuant to the *Internal Revenue Code* (IRC), Section 457, and the other pursuant to IRC, Section 401(k). The plans are outsourced to third-party vendors, and the administrative costs assessed by the vendors of these plans are the responsibility of plan participants. Section 401(k) and Section 457 plan assets remain the property of the contributing employees; therefore, they are not presented in the accompanying financial statements. Sections 401(k) and 457 establish participation, contribution, and withdrawal provisions for the plans. Participation in the 457 plan is voluntary for employees. TRICOR provides up to a $50 monthly employer match for employees who participate in the state's 401(k) plan. Employees hired before July 1, 2014, voluntarily participate in the state's 401(k) plan. Pursuant to Chapter 259 of the Public Acts of 2013, employees hired after June 30, 2014, are automatically enrolled in the state's 401(k) plan and contribute 2% of their salary, with the employer contributing an additional non-matching 5%. Employees may opt out of the 2% auto enrollment. Such contribution rates may only be amended by the Tennessee General

Assembly. There are certain automatic cost controls and unfunded liability controls in the defined benefit plan where the employees participate that may impact the non-matching 5% employer contribution to the 401(k) plan.

Employees are immediately vested in both the employee and employer contributions in all plans. The IRC establishes maximum limits that an employee can contribute to these plans. The employee may increase, decrease, or stop contributions at any time for both plans.

During the year ended June 30, 2016, contributions totaling $221,904 were made by employees participating in the 401(k) plan and TRICOR recognized pension expense of $79,548 for employer contributions. During the year ended June 30, 2015, contributions totaling $199,016 were made by employees participating in the 401(k) plan, and TRICOR recognized pension expense of $57,567 for employer contributions.

Note 9. Other Postemployment Benefits

Plan description

Healthcare is the only "other postemployment benefit" (OPEB) provided to employees. The State of Tennessee administers a group health insurance program that provides postemployment health insurance benefits to eligible retirees. This program includes two plans — the State Employee Group Plan and the Medicare Supplement Plan. For accounting purposes, the plans are agent multiple-employer defined benefit OPEB plans. Benefits are established and amended by an insurance committee created by Section 8-27-201, *Tennessee Code Annotated*, for the State Employee Group Plan and for the Medicare Supplement Plan. The State Employee Group Plan covers retirees until they reach the age of 65. Members have the option of choosing between the standard or partnership preferred provider organization (PPO) plan for healthcare benefits. Subsequent to age 65, members who are also in the state's retirement system may participate in a state-administered Medicare supplement that does not include pharmacy. Employees hired on or after July 1, 2015, are not eligible to continue insurance coverage at retirement in either the Employee Group plan or the Medicare Supplement plan. The plans are reported in the *Tennessee Comprehensive Annual Financial Report* (CAFR). That report is available on the state's website at www.tn.gov/finance/article/fa-accfin-cafr.

Funding Policy

The premium requirements of plan members are established and may be amended by the insurance committee. The plans are self-insured and financed on a pay-as-you-go basis with the risk shared equally among the participants. Claims liabilities of the plan are periodically computed using actuarial and statistical techniques to establish premium rates. Administrative costs of the plan are allocated to plan participants. Retired members pay the same base premium, adjusted for years of service, as active employees. Retirees with 30 years of service are subsidized 80%; 20 but less than 30 years, 70%; and less than 20 years, 60%. Retired employees who are 65 years of age or older have flat rate premium subsidies based on years of service.

Retirees with 30 years of service receive $50 per month; 20 but less than 30 years, $37.50; and 15 but less than 20 years, $25.

TRICOR's Annual OPEB Cost and Net OPEB Obligation
State Employee Group Plan
(Expressed in thousands)

	June 30, 2016	June 30, 2015
Annual required contribution (ARC)	$ 137	$ 146
Interest on the Net OPEB obligation	38	40
Adjustment to the ARC	(38)	(39)
Annual OPEB cost	137	147
Amount of contribution	(124)	(134)
Increase in Net OPEB Obligation	13	13
Net OPEB Obligation – beginning of year	1,002	989
Net OPEB Obligation – end of year	$1,015	$1,002

Year End	Plan	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation at Year-End
6/30/2016	State Employee Group Plan	$137	91%	$1,015
6/30/2015	State Employee Group Plan	$147	91%	$1,002
6/30/2014	State Employee Group Plan	$141	87%	$ 989

Funding Status and Funding Progress

The funded status of the TRICOR portion of the State Employee Group Plan as of July 1, 2015, was as follows (expressed in thousands):

Actuarial valuation date	July 1, 2015
Actuarial accrued liability (AAL)	$1,136
Actuarial value of plan assets	-
Unfunded actuarial accrued liability (UAAL)	$1,136
Actuarial value of assets as a percentage of the AAL	0.00%
Covered payroll (active plan members)	$5,156
UAAL as a percentage of covered payroll	22%

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Methods and Assumptions

Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and on the pattern of sharing of costs between the employer and plan members to that point. Actuarial calculations reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

In the July 1, 2015, actuarial valuation for each plan, the Projected Unit Credit actuarial cost method was used. The actuarial assumptions included a 3.75% investment rate of return (net of administrative expenses) and an annual healthcare cost trend rate of 6.5% initially. The rate decreased to 6% in fiscal year 2016 and then reduces by decrements to an ultimate rate of 4.7% in fiscal year 2050. All rates include a 2.5% inflation assumption. Premium subsidies in the Medicare Supplement plan are projected to remain unchanged, and, consequently, trend rates are not applicable. The unfunded actuarial accrued liability is being amortized as a level percentage of payroll on a closed basis over a 30-year period beginning with July 1, 2007. Payroll is assumed to grow at a rate of 3%.

Note 10. Insurance-Related Activities

Risk Management Fund

It is the policy of the state not to purchase commercial insurance for the risks associated with casualty losses for general liability, automobile liability, professional medical malpractice, and worker's compensation. The state's management believes it is more economical to manage these risks internally and set aside assets for claim settlement in its internal service fund, the Risk Management Fund (RMF). The state purchases commercial insurance for real property; builder's risk (for construction projects starting prior to July 1, 2012); and crime and fidelity coverage on the state's officials and employees. The contractor is responsible for acquiring builder's risk insurance for all construction projects after June 30, 2012; thus, builder's risk is no longer covered by the RMF. For property coverage, the deductible for an individual state agency is the first $25,000 of losses. The RMF is responsible for property losses for the annual aggregate deductible of $10 million for perils other than earthquakes and flood. Purchased insurance coverage is responsible for losses exceeding the $10 million annual aggregate deductible. For earthquake and flood, there is a deductible of $10 million per occurrence. The maximum insurance coverage is $750 million per year for perils other than earthquake and flood. The maximum flood insurance coverage is $50 million per occurrence, except there is only $25 million of coverage in flood zones A and V. The maximum earthquake insurance coverage is

$50 million per occurrence. The amounts of settlements have not exceeded insurance coverage for each of the three past fiscal years.

TRICOR participates in the RMF. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to TRICOR based on a percentage of the agency's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Information regarding the determination of claims liabilities and the changes in balances of the claims liabilities for the year ended June 30, 2016, is presented in the *Tennessee Comprehensive Annual Financial Report* (CAFR). The CAFR is available on the state's website at www.tn.gov/finance/article/fa-accfin-cafr. Since TRICOR participates in the RMF, it is subject to the liability limitations established by statute. The maximum liability for general liability, automobile liability, and medical malpractice liability is $300,000 per person and $1,000,000 per occurrence. Claims are paid through the state's RMF. At June 30, 2016, and June 30, 2015, the RMF held $142.9 million and $127.9 million, respectively, in cash designated for payment of claims. At June 30, 2016, the scheduled coverage for TRICOR was $2,551,637 for buildings $14,004,200 for furniture and equipment.

Employee Group Insurance Fund

The state has also set aside assets in the Employee Group Insurance Fund, an internal service fund, to provide a program of health insurance coverage for the employees of the state with the risk retained by the state. The agency participates in the Employee Group Insurance Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the agency based on estimates of the ultimate cost of claims, including the cost of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims.

Note 11. Commitments and Contingencies

Litigation

TRICOR is involved in a lawsuit that is not expected to have a material effect on the accompanying financial statements.

Note 12. Cumulative Effect of a Change in Accounting Principle

During fiscal year 2015, TRICOR implemented GASB Statement 68, *Accounting and Financial Reporting for Pensions,* and GASB Statement 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date.* These statements establish standards for the measurement, recognition, and display of the net pension liability (asset) and related expenses, deferred outflows of resources, deferred inflows of resources, note disclosures, and required supplementary information. The implementation of these statements resulted in a cumulative adjustment to beginning net position of $3,477,294. This cumulative adjustment does not include related deferred outflows and deferred inflows of resources.

Note 13. Subsequent Event

Discontinued Operation

For the years ended June 30, 2016, and June 30, 2015, TRICOR operated a cook/chill food manufacturing operation and a dairy processing operation located at the Tennessee Cook Chill facility in Nashville, Tennessee. TRICOR discontinued these operations as of September 30, 2016. While the operations were significant, their discontinuation did not affect TRICOR’s ability to continue as a going concern.

TENNESSEE REHABILITATIVE INITIATIVE IN CORRECTION
Required Supplementary Information
Schedule of TRICOR's Proportionate Share of the Net Pension Liability
Closed State and Higher Education Employee Pension Plan Within TCRS

	TRICOR's Proportion of the Net Pension Liability	TRICOR's Proportionate Share of the Net Pension Liability	TRICOR's Covered Payroll	TRICOR'S Proportionate Share of the Net Pension Liability as a Percentage of Its Covered Payroll	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
2016	0.201057%	$2,592,196	$5,250,051	49.37%	91.26%
2015	0.219906%	$1,517,238	$5,938,855	25.55%	95.11%

1) To correspond with the measurement date, the amounts presented were determined as of June 30 of the prior fiscal year.

2) This is a 10-year schedule. However, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future years until 10 years of information are available.

TENNESSEE REHABILITATIVE INITIATIVE IN CORRECTION
Required Supplementary Information
Schedule of TRICOR's Proportionate Share of the Net Pension Asset
State and Higher Education Employee Retirement Plan Within TCRS

	TRICOR's Proportion of the Net Pension Asset	TRICOR's Proportionate Share of the Net Pension Asset	TRICOR's Covered Payroll	TRICOR's Proportionate Share of the Net Pension Asset as a Percentage of Its Covered Payroll	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
2016	0.301709%	$8,390	$328,549	2.55%	142.55%

1) To correspond with the measurement date, the amounts presented were determined as of June 30 of the prior fiscal year.

2) This is a 10-year schedule. However, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future years until 10 years of information are available.

TENNESSEE REHABILITATIVE INITIATIVE IN CORRECTION
Required Supplementary Information
Schedule of TRICOR's Contributions
Closed State and Higher Education Employee Pension Plan Within TCRS

	TRICOR's Contractually Determined Contributions	Contributions in Relation to Contractually Determined Contributions	Contribution Deficiency (Excess)	Covered Payroll	Contributions as a Percentage of Covered Payroll
2016	$652,190	$652,190	-	$4,339,254	15.03%
2015	$789,083	$789,083	-	$5,250,051	15.03%

This is a 10-year schedule. However, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future years until 10 years of information are available.

TENNESSEE REHABILITATIVE INITIATIVE IN CORRECTION
Required Supplementary Information
Schedule of TRICOR's Contributions
State and Higher Education Employee Retirement Plan Within TCRS

	TRICOR's Contractually Determined Contributions	TRICOR's Contributions Related to Contractually Determined Contributions	Contribution Deficiency (Excess)	TRICOR's Covered Payroll	Contributions as a Percentage of TRICOR's Covered Payroll
2016	$22,434	$22,434	-	$756,567	2.97%
2015	$12,715	$12,715	-	$328,549	3.87%

This is a 10-year schedule. However, contributions to this plan began in 2015. Years will be added to this schedule in future fiscal years until 10 years of information are available.

TENNESSEE REHABILITATIVE INITIATIVE IN CORRECTION
Required Supplementary Information
Other Postemployment Benefits Schedule of Funding Progress
State Employee Group Plan

(Expressed in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll [(b-a)/c)]
7/01/11	$0	$2,131	$2,131	0.0%	$4,999	43%
7/01/13	$0	$1,337	$1,337	0.0%	$4,841	28%
7/01/15	$0	$1,136	$1,136	0.0%	$5,156	22%

The amount reported here for covered payroll relates to the fiscal year in which the valuations were performed.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-1402

PHONE (615) 401-7897
FAX (615) 532-2765

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

The Honorable Bill Haslam, Governor
Members of the General Assembly
Board of Directors, Tennessee Rehabilitative Initiative in Correction

We were engaged to 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, the financial statements of the Tennessee Rehabilitative Initiative in Correction (TRICOR) as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the fund's basic financial statements, and have issued our report thereon dated September 18, 2017. Our report disclaims an opinion on such financial statements because we were unable to observe or otherwise verify the beginning physical inventory count; we could not physically locate capital assets; the financial statements and notes to the financial statements do not agree; and TRICOR uses two accounting systems that do not reconcile.

Internal Control Over Financial Reporting

In connection with our engagement to audit the financial statements, we considered TRICOR's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of TRICOR's internal control. Accordingly, we do not express an opinion on the effectiveness of TRICOR's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, we identified the following deficiencies in internal control that we consider to be material weaknesses:

- Management needs to improve procedures for recording, reconciling, and reporting financial information to prevent errors
- Management did not ensure staff followed procedures to account for capital assets.

These deficiencies are described in the Findings and Recommendations section of this report.

Compliance and Other Matters

In connection with our engagement to audit the financial statements of TRICOR, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our engagement, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Tennessee Rehabilitative Initiative in Correction's Responses to Findings

The agency's responses to the findings identified in our engagement are included in the Findings and Recommendations section of this report. The agency's responses were not subjected to the auditing procedures applied in the engagement to audit the financial statements and, accordingly, we express no opinion on them.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an engagement to perform an audit in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
September 18, 2017

Findings and Recommendations

1. Management needs to improve procedures for recording, reconciling, and reporting financial information to prevent errors

<u>**Condition**</u>

Tennessee Rehabilitative Initiative in Correction's (TRICOR) procedures for recording, reconciling, and reporting financial information are not adequate to ensure the accuracy and proper classification of information.

<u>**Criteria**</u>

Management is responsible for the preparation and fair presentation of the entity's financial statements and the accompanying notes in accordance with accounting principles generally accepted in the United States of America. This includes the design, implementation, and maintenance of internal control relevant to the recording of financial transactions and the preparation and fair presentation of financial statements that are free of material misstatement.

Section 9-18-102, *Tennessee Code Annotated*, states:

> (a) Each agency of state government and institution of higher education . . . shall establish and maintain internal controls, which shall provide reasonable assurance that:
>
> (1) Obligations and costs are in compliance with applicable law;
>
> (2) Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
>
> (3) Revenues and expenditures are properly recorded and accounted for to permit the preparation of accurate and reliable financial and statistical reports and to maintain accountability over the assets.

<u>**Cause**</u>

This is TRICOR's first year to prepare external financial statements in conformity with generally accepted accounting principles. Previously, TRICOR had only prepared internal statements for use by management and its board. In a desire to provide management and the board with timely information, it has been TRICOR's practice to close its books for the year ending June 30 on or about July 15.

In addition, TRICOR uses two accounting systems, the TRICOR Information Management System and Edison (the state's central accounting system), to maintain its financial information. Because there can be as much as a one-month delay in the recording of transactions between the two systems, the practice of closing on July 15 does not allow time to ensure all transactions are reported in the correct fiscal year. Furthermore, management did not reconcile the two accounting systems. Adequate reconciliations are essential to fair presentation of the financial statements, as they help ensure that the information entered into both accounting systems is accurate and reported in the correct period.

In the first year of preparing external financial statements, management and staff appeared to lack complete knowledge of all necessary governmental accounting and reporting principles. TRICOR's previous reporting focus was to provide management and the board with internal statements, particularly profit and loss statements, to use in the decision-making process regarding TRICOR's various business units. This focus on profit and loss statements, meant that less attention was placed on the asset and liability accounts even when preparing external statements.

Effect

Because of the following issues noted, we were unable to obtain sufficient appropriate audit evidence on which to form an opinion, and we concluded the possible effects of undetected misstatements on the financial statements, if any, could be both material and pervasive:

- TRICOR uses two accounting systems to maintain its financial information: the TRICOR Information Management System (TIMS) and Edison, the state's central accounting system. TRICOR prepares its financial statements using the year-end account balances in TIMS. Payments are processed through Edison, and there can be as much as a one-month delay between when transactions are posted in Edison and TIMS. The accounts in TIMS and Edison are not reconciled and the delay between posting in the two systems is not accounted for when preparing the financial statements, resulting in year-end cut-off issues and material misstatements that are not detected. In addition to the adjustments specifically identified, as described in the following list of errors, most of the other accounts within the two systems also did not reconcile. Management was unable to explain the differences. Therefore, we were not able to determine whether the account balances or transaction classes were fairly stated at or for the year ended June 30, 2016. Our opinion was modified accordingly with respect to this matter.
    - The Chief Business Officer did not ensure the cash balances in TIMS and Edison reconciled. The Department of the Treasury maintains all TRICOR cash in the State Pooled Investment Fund (SPIF), which is recorded in Edison. The cash balance in TIMS includes an additional $500,805, which is not recorded in Edison. The Chief Business Officer explained that he and the Accounting Manager had begun a reconciliation process, but it was never completed and did not extend to the end of the fiscal year. Since TRICOR is an internal service fund of the State of Tennessee, the amount of cash recorded at TRICOR should reconcile to the cash held in the SPIF by the Department of the Treasury, as recorded in Edison.
    - Accounting staff did not record payments received from customers against TRICOR's accounts receivable balances in the correct fiscal year. The amounts received, totaling $993,642, were first recorded by accounting staff at the Department of Finance and Administration (F&A) in Edison with an effective date of June 30, 2016. F&A staff notified TRICOR management of the payments on July 18, 2016. However, TRICOR had closed TIMS on July 15,

2016; therefore, management recorded the entry in the subsequent fiscal year in TIMS. Because the statements are prepared from TIMS, this caused an understatement of cash and an overstatement of accounts receivable of $993,642 at June 30, 2016. The audited statements were corrected.

- Timing differences in recording transactions in TIMS and Edison caused an overstatement of $724,951 in both cash and accounts payable and accrued liabilities at June 30, 2016. Payments were made and recorded in Edison prior to June 30, 2016; however, TRICOR staff recorded the entries in TIMS in the subsequent fiscal year. The audited statements were corrected.

- We noted numerous errors in our capital assets testing. Specifically, our testwork noted incorrect state tag numbers, serial numbers, locations, and descriptions of the items. In several instances, we could not physically locate items based on the information on the capital asset list (see finding 2). As a result, we were unable to determine whether the capital assets account was fairly stated.

- The amounts reported in the capital assets note in the notes to the financial statements did not agree to the amounts reported on the statements of net position at June 30, 2016, and June 30, 2015. Management provided us with a revised version of the note, which also did not agree to the financial statements. Because of the errors noted as a result of our capital assets testwork, we were also unable to determine the correct amounts for the capital assets note.

- The Chief Business Officer incorrectly included the balance of the unbilled shipments account in inventories, rather than accounts receivable, in the financial statements. The unbilled shipments account should have a debit balance; however, at year-end, the account had a credit balance of $62,367, which management was unable to explain. Because management was unable to determine the reason for the incorrect balance, we were not able to determine the adjusting entry to correct the errors associated with this account, nor were we able to determine whether the account was fairly stated.

- On several occasions throughout the audit, management expressed concerns with the balance of the unvouchered receipts account. The account is intended to be used to indicate the receipt of goods and inventory by TRICOR when an invoice has not yet been received. Management is continuing to investigate transactions recorded in the account, but we could not obtain appropriate audit evidence to substantiate the correct account balance for unvouchered receipts.

In addition, we noted the following errors:

- Management did not implement Governmental Accounting Standards Board (GASB) Statement 68, *Accounting and Financial Reporting for Pensions*, and Statement 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, which was effective for fiscal years beginning after June 15, 2014. As a result, TRICOR did not report the net pension asset, net pension liability, pension expense, related deferred outflows and deferred inflows of resources, or related notes and required supplementary information (RSI) at and for the year ended June 30, 2016.

Management provided the related notes and RSI after the beginning of fieldwork. The audited statements were corrected.

- TRICOR did not adequately reconcile the mail log and the cash receipts recorded in the systems. Checks received in the mail are scanned into a program called iNovah, which ultimately records the receipt in Edison. The Accounting Manager informally compared the receipts per the mail log with the iNovah list, but did not document the reconciliation. The Accounting Manager also reconciled the iNovah receipts to Edison monthly; however, the reconciliation was not signed or dated by the preparer or reviewer. In addition, there is not a reconciliation performed between the mail log, iNovah, or the receipts per Edison to the cash receipts recorded in the TIMS system. Proper internal control and reconciliations ensure that all cash receipts are entered into the accounting system and are for the correct amount.
- We noted 31 accounts, totaling $28,575, on TRICOR's accounts receivable list with negative (credit) balances, and 22 accounts, totaling $73,366, on the accounts payable list with negative (debit) balances. Management should ensure procedures are in place to periodically investigate and correct these errors in a timely manner.
- TRICOR did not follow Department of Finance and Administration Policy 23, "Accounts Receivable – Recording, Collection, and Write-Offs," when writing off $320,999 of accounts receivable. Management did not obtain the proper approvals from either the Commissioner of the Department of Finance and Administration or the Comptroller of the Treasury before writing off the balances in TIMS.
- Management made an error in a previous year when recording building improvements and incorrectly recorded them twice, causing an overstatement of $428,744 in building and building improvements and net investment of plant. The audited statements were corrected.

Recommendation

The Chief Business Officer and the Department of Finance and Administration Controller for TRICOR (Controller) should ensure that a complete reconciliation is performed between TIMS and Edison, including the cash account, and should investigate the propriety of all reconciling items. In addition, the Chief Business Officer and the Controller should research each account to ensure that the recorded amounts are proper and that management is able to substantiate the balance. Management should also develop policies and procedures for reconciling daily cash receipts to ensure proper accountability and recording of cash.

The Chief Business Officer and the Controller should also ensure that current staff members who prepare daily accounting transactions and those who prepare and/or review the financial statements have adequate knowledge of governmental accounting and reporting requirements to properly perform their responsibilities. Furthermore, the Chief Business Officer and the Controller should ensure the books remain open for an adequate time after year-end to allow all required entries to be made.

Management's Comment

We concur. Prior to the time of the significant turnover in the leadership group, there were many significant deficiencies that required improvements in multiple areas. Since that time, the Department of Finance and Administration (F&A) has taken responsibility for transactional and general ledger accounting for TRICOR. As a result, a controller has been hired permanently as of February 2017; accounting personnel have improved their skills through coaching and training, and a general broader knowledge base over policies and procedures surrounding fiscal matters has been established.

Reconciliation of TRICOR financial statements to the state's CAFR has been a priority during the current year, but was not completed during the field work of this audit. Since the field work ended, much progress has been made by F&A accountants assigned to TRICOR. There is now a process in place to ensure routine reconciliation of all TIMS and EDISON balance sheet accounts, following up on significant reconciling items, and substantiating all balances.

F&A and TRICOR management are committed to:

- strengthening the financial control environment,
- continued GASB instruction and development of staff who prepare daily accounting transactions and those reviewing financial statements, and
- scrutinizing all aspects of the financial control environment.

These efforts will enhance effectiveness and efficiency and the reliability of financial reporting and compliance to applicable laws and regulations.

Finally, the timing of closing year end was extended for the 2017 fiscal year allowing all required entries to be made.

2. Management did not ensure staff followed procedures to account for capital assets

Condition

Management did not ensure staff followed TRICOR's property management policies and procedures.

Criteria

Management is responsible for maintaining records to support the preparation and fair presentation of the entity's financial statements and accompanying notes in accordance with accounting principles generally accepted in the United States of America. This includes accurate and detailed information supporting the capital asset and related depreciation amounts reported on the statement of net position.

Section 9-18-102, *Tennessee Code Annotated*, states:

> (a) Each agency of state government and institution of higher education . . . shall establish and maintain internal controls, which shall provide reasonable assurance that:
>
> (1) Obligations and costs are in compliance with applicable law;
>
> (2) Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
>
> (3) Revenues and expenditures are properly recorded and accounted for to permit the preparation of accurate and reliable financial and statistical reports and to maintain accountability over the assets.

TRICOR Property Management Standard Operating Procedure 330-1 states:

> (5.3) The site manager of each location where property is purchased, transferred to, or assigned shall be responsible for daily management and accountability of the assets. The site manager will contact the TRICOR Property Officer when new items are received. All site managers will maintain an accurate listing of their equipment items and coordinate with the property officer to reconcile any differences.
>
> (5.4) Transfers of TRICOR state property shall be accomplished in the following manner. (a) When equipment is permanently transferred from one TRICOR work site to another, a Property Management Report, TO-0006, will be completed by the sending site manager and submitted to the property officer.

Cause

Based on discussions with TRICOR personnel, problems with the capital asset list go back several years. Some assets may have been transferred to other facilities, traded in for newer items, or scrapped and repurposed by combining them with other items without notifying the Property Manager, whose responsibility is to properly maintain the records. In other instances, specifically issues related to the Tennessee Cook Chill facility, equipment records may have been incomplete when the items were transferred from the Department of Correction to TRICOR.

Effect

We could not determine the total value of TRICOR's capital assets due to inaccurate records. Specifically, our testwork noted incorrect state tag numbers, serial numbers, locations, and item descriptions that did not allow us to match items on the capital asset list with actual pieces of equipment or vice versa.

We visited three of TRICOR's operating locations, where we inspected each piece of equipment on the premises and attempted to locate it on the capital asset list. Our objective was to determine if the equipment list was complete. By observing all equipment items, our test should also ensure each equipment item on the list existed. We noted the following errors:

- A total of 50 equipment items, with a book value of $120,026 at June 30, 2016, were on the capital asset list with a location code of BCCX (Bledsoe County Correctional Complex). We could not physically locate 8 of the 50 items (16%). We also observed an additional 10 items with a state inventory tag not assigned to BCCX. Four of the 10 items were located on the list under other TRICOR cost centers, while the remaining 6 items did not appear on the list.
- A total of 10 equipment items, with a value of $382,553.24, were on the capital asset list with a location code of TLC (TRICOR Logistic Center). We could not locate 3 of the 10 items (30%). Additionally, we observed another eight items with a state inventory tag not assigned to TLC, but to other cost centers within TRICOR.
- A total of 99 equipment items, totaling $1,161,707.05, were on the capital asset list assigned to the Tennessee Cook Chill facility. We could not locate 53 of the 99 items (54%) based on the information documented on the list.

We also visited the West Tennessee State Prison field crops, where we physically located 10 random equipment items. Our objective was to determine if the equipment observed was properly included on the equipment list. Based on our testwork, each piece of equipment was properly recorded on the list where appropriate.

We also selected a random sample of 16 equipment items from all cost centers, excluding BCCX, TLC, and Cook Chill, listed on TRICOR's master capital asset list. For 2 of the 16 items tested (13%), we could not physically locate the capital asset.

The errors noted above resulted in a combined known overstatement of capital assets of $554,310. However, we observed additional items not on the list of which we were unable to determine the value; therefore, we were not able to determine the correct balance of capital assets or whether capital assets were fairly stated at June 30, 2016.

In addition, we selected a random sample of 30 equipment items from all cost centers on the capital asset list to test the accuracy of other attributes recorded for equipment items, and we noted the following problems:

- For 3 of 30 items tested (30%), there was not an adequate description of the item on the list.
- For 15 of 30 items tested (50%), the state identification tag was missing or did not match the list.
- For 10 of 30 items tested (33%), the serial number on the asset did not match the list.

Recommendation

The Chief Executive Officer (CEO) should ensure that the current capital asset list is updated to reflect current and accurate information, including state tag numbers, serial numbers, locations, and item descriptions. Any obsolete items should be properly disposed of and removed from the list. The CEO should also ensure that staff accurately enter all information on the list when new assets are purchased. The CEO should ensure that TRICOR personnel responsible for capital assets notify the central office of any transfers, trade-ins, or disposals of capital assets to allow for accurate and updated information on the capital asset list.

Management's Comment

We concur. The fixed asset list at the time of the audit was inaccurate, especially with regards to Cook Chill.

In recent months, we have done the following in order to improve the accuracy of fixed asset records:

- Completed a sample review of 85 items, administered by F&A and resolved all differences.
- Visited all TRICOR locations (with the exception of one) and physically located and observed all fixed assets. Based upon the review, we have sought and obtained approval to correct the records in Edison.

In the coming months we will again visit all TRICOR locations, ensure that all fixed asset descriptions are accurate and update, and retag all fixed assets whose tags are missing or no longer legible. At that time, Edison fixed asset records will be updated as necessary.

Finally, during each visit, we will coach and train the employees at the TRICOR locations who are responsible for transfers, trade-ins, and disposals to ensure that these functions that only happen occasionally are done timely and accurately.