



A REPORT  
TO THE  
ARIZONA LEGISLATURE

Financial Audit Division

---

Management Letter

# State Department of Corrections

Arizona Correctional Industries

Year Ended June 30, 2005

---



---

**Debra K. Davenport**  
Auditor General

The **Auditor General** is appointed by the Joint Legislative Audit Committee, a bipartisan committee composed of five senators and five representatives. Her mission is to provide independent and impartial information and specific recommendations to improve the operations of state and local government entities. To this end, she provides financial audits and accounting services to the State and political subdivisions, investigates possible misuse of public monies, and conducts performance audits of school districts, state agencies, and the programs they administer.



Copies of the Auditor General's reports are free.  
You may request them by contacting us at:

**Office of the Auditor General**

2910 N. 44th Street, Suite 410 • Phoenix, AZ 85018 • (602) 553-0333

Additionally, many of our reports can be found in electronic format at:

**[www.azauditor.gov](http://www.azauditor.gov)**

# TABLE OF CONTENTS

---



Recommendation 1: ACI should investigate and correct all reconciling items identified on its bank reconciliations	1
Recommendation 2: ACI should ensure that inventories are properly valued	1
Recommendation 3: ACI should ensure that its capital assets are properly reported	2
Department Response	

## ACI should investigate and correct all reconciling items identified on its bank reconciliations

ACI maintains several bank accounts with activity totaling over \$25 million in fiscal year 2005 in addition to its cash held by the State Treasurer's Office. Therefore, it is essential that ACI ensures that its cash balance is accurate and current. ACI reconciled its general ledger cash balances to the bank statements; however, it did not promptly investigate and resolve all reconciling items identified on these reconciliations. As of June 30, 2005, auditors noted unrecorded transactions and uncorrected differences on its reconciliations that were over 1 year old.

To help ensure that all cash transactions are properly recorded on its general ledger, ACI should add the following procedures when employees reconcile the bank statements to ACI's cash balances:

- Investigate checks outstanding for more than 1 month and determine whether they will be cashed or whether ACI should add the amounts back to cash.
- Investigate all reconciling items identified on the bank reconciliations and propose any adjustments necessary to correct ACI's cash balance.
- Require a supervisor to review and approve all bank reconciliations as well as all proposed adjustments.

## ACI should ensure that inventories are properly valued

ACI inventories consist of raw materials that are used in the manufacturing process as well as finished goods that are available for sale and ACI's management depends on complete, accurate, and current information to value its inventories and appropriately price finished goods for sale. To verify the quantity of its inventories, ACI performs an annual physical count of its inventories and records the information in its inventory management system. However, at June 30, 2005, ACI recorded counts in its inventory management system that differed from those recorded on the actual physical inventory count sheets at that date. For example, one of ACI's divisions had 11 such inventory count differences that resulted in almost \$66,000 overstatement of inventory. ACI corrected its accounting records and financial statements for all errors noted.

Further, to accurately value its inventory and cost of goods sold, ACI needs to ensure that the unit cost assigned to each inventory item is accurate. However, this was not accomplished since ACI did not follow its policies and procedures for regularly adjusting its accounting records for raw material price changes, and actual labor and material costs incurred. For example, ACI's policy is to update and document the value of inventory semiannually; however, as of June 2005, the value of finished goods at several divisions had not been updated in over a year.

To help ensure that inventories are accurately counted and recorded in the inventory management system, ACI should review the counts in the system to ensure that they agree to the physical inventory count sheets and document reasons for any adjustments. Further, to help ensure that inventories are properly valued and costs of goods sold are accurately reported, ACI should follow its policy and update its inventory costs every 6 months.

## ACI should ensure that its capital assets are properly reported

ACI's capital assets represent a major investment of monies. Therefore, it is essential that ACI establish and maintain effective stewardship over these assets. Effective stewardship requires ACI to maintain accurate and complete listings of these assets and ensure that they are properly accounted for and accurately reported in its financial statements. However, ACI did not establish adequate internal control policies that would ensure that capital assets and depreciation expense are properly reported. Specifically, ACI's capital assets listing contained numerous errors and inconsistencies, including capital asset items that were not listed individually, assets that had been disposed of, assets with incorrect costs, assets that were incorrectly classified, and assets that were inaccurately depreciated.

The following procedures can help the District improve control over its capital assets and ensure that its capital assets listing, including accumulated depreciation, is accurate and complete:

- Reconcile the current year's capital assets listing to the previous year's capital assets listing to ensure that the current listing includes all items acquired during the year and excludes all items disposed of during the year and excludes all items disposed of during the year.
- Have a supervisor review the capital assets listing and supporting schedules to determine that each asset's cost, classification, useful life, and annual depreciation are accurate and in accordance with ACI's policy.
- Have a second employee recalculate depreciation expense and accumulated depreciation each year to ensure accuracy.



## **ARIZONA CORRECTIONAL INDUSTRIES**

A DIVISION OF ARIZONA DEPARTMENT OF CORRECTIONS

January 12, 2007

Debra Davenport, CPA  
Auditor General  
Office of the Auditor General  
2910 N. 44<sup>th</sup> Street, Suite 410  
Phoenix, AZ 85018

Dear Ms. Davenport:

Arizona Correctional Industries (ACI) appreciates the effort regarding the ACI June 30, 2005 certified audit. The comments and insights provide benefit necessary to performing our jobs effectively. Attached is our response to your audit findings and related recommendations.

If you have any questions, please contact me or Dale Beatty CPA, ACI Controller, at 272-7600.

Sincerely,

Bill Branson  
General Manager

DRB:bm

Attachment

**ARIZONA CORRECTIONAL INDUSTRIES  
AUDITOR GENERAL RESPONSE  
FOR THE YEAR ENDED JUNE 30, 2005**

**RECOMMENDATION 1: ACI should investigate and correct all reconciling items identified on its bank reconciliations.**

We concur. Timely and accurate bank reconciliations are an integral part in providing accurate financial information. Because of staff turnover, this process was not monitored as well as it should have been. One of the biggest challenges is adjustments made to our accounts by the Treasury department without providing adequate information. Additional work is required to determine how to properly account for these adjustments. These adjustments need to be resolved more quickly and have not always been completed in a timely manner. ACI has implemented all recommendations. Unresolved items amounted to \$2,600.

**RECOMMENDATION 2: ACI should ensure that inventories are properly valued.**

We concur. Accurate financial statements require accurate inventories, especially at year-end. Some count tags were modified and the reasons were not documented. The documentation may have been lost when the roof collapsed, but we have no way of determining it at this time. The policy is to update material costs at least every six months or earlier, this is based on materiality and is determined on a product-by-product basis. All recommendations have been implemented.

**RECOMMENDATION 3: ACI should ensure that its capital assets are properly reported.**

We concur. Effective stewardship is necessary regarding the maintenance of the fixed asset accounts. There are numerous internal controls in place and ACI believes the errors were not material. Although some of the subsidiary accounts had issues, overall the fixed assets were correct. A substantial amount of effort is expended to maintain accurate data. All of the recommendations are implemented.