



A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Management Letter

Department of Corrections

Arizona Correctional Industries
Year Ended June 30, 2003



Debra K. Davenport
Auditor General

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DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

**STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL**

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

September 10, 2004

Dora Schriro, Director
State of Arizona
Department of Corrections
1601 West Jefferson Street
Phoenix, AZ 85007

Dear Ms. Schriro:

In planning and conducting our audit of the State of Arizona, Department of Corrections—Arizona Correctional Industries (ACI) for the year ended June 30, 2003, we considered ACI's internal controls over financial reporting and tested its compliance with laws and regulations that could have a direct and material effect on ACI's financial statements as required by U.S. generally accepted auditing standards.

We noted no internal control weaknesses or instances of noncompliance that we consider to be material to the financial statements. However, our audit disclosed other matters involving internal controls that management should correct to ensure that it fulfills its responsibility to establish and maintain adequate internal controls. Our recommendations are described in the accompanying summary.

This letter is intended solely for the information of the Department of Corrections and is not intended to be and should not be used by anyone other than the specified party. However, this letter is a matter of public record, and its distribution is not limited.

Should you have any questions concerning its contents, please let us know.

Sincerely,

Dennis L. Mattheisen, CPA
Financial Audit Director

TABLE OF CONTENTS



Recommendation 1: ACI should ensure that inventories and cost of goods sold are properly valued	1
Recommendation 2: ACI should ensure that depreciation expense and capital assets are properly reported	2
Department Response	

ACI should ensure that inventories and cost of goods sold are properly valued

ACI's management depends on complete and accurate information to value its inventories and to appropriately price goods produced for sale. To achieve this objective, management should have appropriate procedures to value its inventory. ACI records inventories and cost of goods sold using standard costing techniques. Generally Accepted Accounting Principles allows inventory to be valued using standard costs if adjustments are made at reasonable intervals to reflect the actual costs. However, ACI did not adjust its accounting records for actual labor and material costs incurred.

To help ensure that inventories are properly valued and costs of goods sold are accurately reported, ACI should develop and implement policies and procedures to compare actual costs to standard costs on a regular basis and record any necessary adjusting entries. Specifically:

- Determine actual material usage and labor hours.
- Compare actual costs and usage of materials and labor to standards, noting any variances.
- Monitor variances to determine if standard costs should be adjusted because of large variances.
- Record differences between standard and actual cost accounts to the appropriate inventory and cost of good sold accounts.

A similiar recommendation was previously reported in our management letter to ACI dated August 8, 2003.

ACI should ensure that depreciation expense and capital assets are properly reported

ACI's capital assets represent a major investment of monies. Therefore, it is essential that ACI accurately reports these assets, net of accumulated depreciation, to the public and other interested parties. To accomplish this, it must maintain a reliable capital assets system and have procedures in place that accurately calculate depreciation. However, the auditors noted that the remaining useful lives used in calculating depreciation were not changed when the Arizona Department of Administration revised the useful life of capital assets in July 2001.

To help ensure the propriety and accuracy of ACI's capital assets records and ensure that capital assets and depreciation expense are properly reported in the financial statements, ACI should revise the estimated remaining useful lives of its capital assets to be in accordance with the Arizona Department of Administration's policies.



ARIZONA CORRECTIONAL INDUSTRIES

A DIVISION OF ARIZONA DEPARTMENT OF CORRECTIONS

September 15, 2004

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

Dear Ms. Davenport:

Arizona Correctional Industries (ACI) appreciates the insights shared in the Management Letter from your certified audit performed on our division for the year ending June 30, 2003. Attached is our response to your audit findings and related recommendations.

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

Sincerely, _

Bill Branson
Acting Assistant Director

BB:bs

Attachment

**ARIZONA CORRECTIONAL INDUSTRIES
AUDITOR GENERAL RESPONSE
FOR THE YEAR ENDED JUNE 30, 2003**

RECOMMENDATION 1: ACI should ensure that inventories and cost of goods sold are properly valued.

We concur. Our understanding is that this comment only applies to finished goods.

All standard product costs of manufacture are reviewed semi-annually and more often if necessary and adjusted as required. All non-standard products have a developed cost of manufacture before they are produced. For most of the divisions, labor and overhead are allocated to inventory based on a standard shop rate. This rate is tested against the actual financials on a quarterly basis and adjusted as necessary. ACI believes in aggregate the inventories are substantially accurate and will continue to practice procedures that clearly support the expressed inventory balances. ACI has implemented a cost accounting system for the furniture division, metal fabrication and wood/metal refurbishing, and is continuing efforts to implement and improve in the other divisions.

RECOMMENDATION 2: ACI should ensure that depreciation expense and capital assets are properly reported.

We concur. The useful lives of the capital assets have been adjusted to agree with the State of Arizona Accounting Manual published by the Arizona Department of Administration.