



An Audit Report on

# **Financial Processes at the Department of Criminal Justice**

June 2018  
Report No. 18-035



An Audit Report on

# Financial Processes at the Department of Criminal Justice

SAO Report No. 18-035  
June 2018

## Overall Conclusion

The Department of Criminal Justice (Department) established processes and related controls to help ensure that it managed Texas Correctional Industries (TCI) sales and purchases, assets, and Hurricane Harvey expenditures in accordance with applicable statutes, rules, and Department policies and procedures. However, the Department should strengthen its processes for documenting the price of TCI products.

TCI. The Department oversees TCI, which manufactures goods and provides services for sale to certain city, county, state, and federal entities. It also uses TCI goods internally. The Department had processes and controls in place to ensure that TCI sales, purchases, and cost sheets complied with state laws and regulations and Department policies and procedures. However, the Department should strengthen its processes for recording sales transactions and documenting cost sheets.

Asset Management. The Department established processes and controls to help ensure that assets were (1) appropriately accounted for, (2) safeguarded, and (3) reported accurately in its accounting system, LONESTARS, and the State Property Accounting (SPA) system.

Hurricane Harvey. The Department established processes and controls to ensure that disaster recovery funds, such as those used for Hurricane Harvey, were managed in accordance with applicable statutes, rules, and Department policies and procedures.

Information Technology. The Department generally had appropriate information technology processes and controls related to the financial processes audited.

Auditors communicated other, less significant issues to the Department separately in writing.

### Background

The Department of Criminal Justice (Department) manages offenders in state prisons and jails and private correctional facilities that contract with the Department. The Department also provides funding and certain oversight of community supervision (previously known as adult probation) and is responsible for supervising offenders released from prison on parole or mandatory supervision. The nine member Texas Board of Criminal Justice oversees the Department.

For fiscal year 2018, the Department received \$3,323,032,859 in appropriations. The Department was authorized to have 39,453.8 full-time equivalent employees.

Sources: **The Department's** Web site and the General Appropriations Act (85th Legislature).

This audit was conducted in accordance with Texas Government Code, Sections 321.0131 and 321.0132.

For more information regarding this report, please contact Audrey O'Neill, Audit Manager, or Lisa Collier, First Assistant State Auditor, at (512) 936-9500.

Table 1 presents a summary of the findings in this report and the related issue ratings. (See Appendix 2 for more information about the issue rating classifications and descriptions.)

Table 1

Summary of Chapters/Subchapters and Related Issue Ratings		
Chapter/ Subchapter	Title	Issue Rating <sup>a</sup>
1	The Department Established Processes and Controls to Ensure That Texas Correctional Industries' Purchases and Sales Complied with Requirements; However, It Did Not Always Follow Those Processes	Medium
2	The Department Established Processes and Controls to Help Manage Its Assets	Low
3	The Department Established Processes and Related Controls for Hurricane Harvey Expenditures	Low
4	The Department Had Appropriate Information Technology Controls Over Its Financial Data	Low

<sup>a</sup> A subchapter is rated Priority if the issues identified present risks or effects that if not addressed could critically affect the audited **entity's ability to effectively administer the program(s)/function(s) audited**. Immediate action is required to address the noted concern and reduce risks to the audited entity.

A subchapter is rated High if the issues identified present risks or effects that if not addressed could substantially affect the audited **entity's ability to effectively administer the program(s)/function(s) audited**. Prompt action is essential to address the noted concern and reduce risks to the audited entity.

A subchapter is rated Medium if the issues identified present risks or effects that if not addressed could moderately affect the audited **entity's ability to effectively administer** program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

A subchapter is rated Low if the **audit identified strengths that support the audited entity's ability to administer the** program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the **audited entity's ability to effectively administer the program(s)/function(s) audited**.

## ***Summary of Management's Response***

At the end of certain chapters in this report, auditors made recommendations to address the issues identified during this audit. The Department agreed with the recommendations in this report.

## ***Audit Objective and Scope***

The objective of this audit was to determine whether the Department has processes and related controls to help ensure that it administers financial transactions in accordance with applicable statutes, rules, and agency policies and procedures.

**The scope of this audit covered the Department's activities** related to asset management; Hurricane Harvey expenditures; TCI sales, purchases, and cost determinations; and information systems from September 1, 2016, through January

31, 2018. In addition, auditors reviewed **the Department's Hurricane Harvey-** related project worksheets submitted to the Federal Emergency Management Agency through April 5, 2018.

# Contents

## *Detailed Results*

---

Chapter 1	
The Department Established Processes and Controls to <b>Ensure That Texas Correctional Industries' Purchases</b> and Sales Complied with Requirements; However, It Did Not Always Follow Those Processes.....	1
Chapter 2	
The Department Established Processes and Controls to Help Manage Its Assets.....	4
Chapter 3	
The Department Established Processes and Related Controls for Hurricane Harvey Expenditures .....	6
Chapter 4	
The Department Had Appropriate Information Technology Controls Over Its Financial Data .....	7

## *Appendices*

---

Appendix 1	
Objective, Scope, and Methodology .....	8
Appendix 2	
Issue Rating Classifications and Descriptions.....	12

# Detailed Results

Chapter 1

## **The Department Established Processes and Controls to Ensure That Texas Correctional Industries’ Purchases and Sales Complied with Requirements; However, It Did Not Always Follow Those Processes**

Chapter 1  
Rating:  
Medium<sup>1</sup>

The Department of Criminal Justice (Department) had processes and controls in place to ensure that Texas Correctional Industries (TCI) sales, purchases, and cost sheets complied with state laws and regulations and Department policies and procedures. However, the Department should strengthen its processes for recording sales transactions and documenting cost sheets.

For its sales of TCI products, the Department uses cost sheets. It calculates those cost sheets based on overhead, raw material, and other types of costs. The Department then uses those cost sheets to determine the sales prices for TCI’s finished products (see Figure 1).

Texas Correctional Industries (TCI)

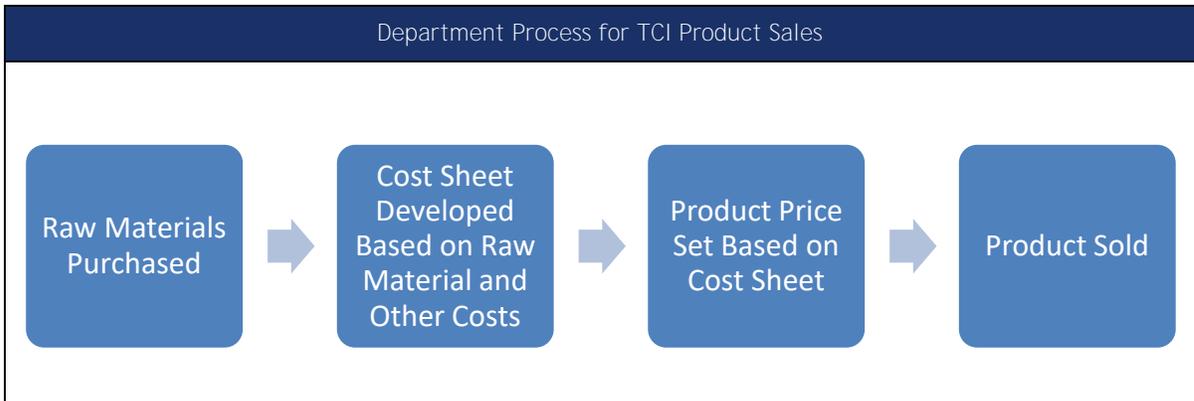
TCI’s objective (described in Texas Government Code, Section 497.002) is to provide work program participants with marketable job skills to help reduce recidivism, while also reducing costs by providing products to the Department of Criminal Justice (Department) and other eligible entities on a for-profit basis. The Department asserted that it offered more than 2,200 standard products.

TCI had external sales of approximately \$82 million from September 1, 2016, through January 31, 2018. In addition, the Department reported that it produced approximately \$35 million in products for internal consumption during that same time period.

TCI had expenditures of approximately \$75 million for raw materials and consumables from September 1, 2016, through January 31, 2018.

Source: The Department.

Figure 1



Source: Auditors created Figure 1 based on information from the Department.

<sup>1</sup> Chapter 1 is rated as Medium because the issues identified present risks or effects that if not addressed could moderately affect the audited entity’s ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern and reduce risks to a more desirable level.

The Department had processes and related controls to help ensure that it accurately processed purchases of raw materials in accordance with applicable statutes, rules, and Department policies and procedures.

**Specifically, the Department:**

- Purchased allowable materials.
- Accurately recorded transactions in the Uniform Statewide Accounting System (USAS).
- Used appropriate procurement methods.
- Ensured that internal purchasing and division staff approved the purchases.
- Made timely payments to vendors.

The Department had processes for developing cost sheets; however, it did not always follow those processes.

**The Department used cost sheets to document the standard cost for items it produced (see text box for more information about the cost sheets).**

**Most of the raw material and overhead costs used to calculate the cost sheets were supported; however, auditors identified some instances in which the Department should improve its documentation. Specifically, auditors tested cost sheets for five products the Department manufactured. Those products were comprised of 37 separate cost components. For 30 of those cost components, the Department had appropriate documentation to support the raw material and overhead costs. For the remaining seven cost components, the Department either (1) recorded inaccurate costs when compared to supporting documentation or (2) did not have supporting documentation. For example, auditors identified inaccurate cost components that resulted in product pricing differences ranging from one cent to six dollars per product. Not ensuring that cost sheets accurately reflect the raw material and overhead costs increases the risk that the Department could make decisions about price based on inaccurate information.**

**Additionally, the Department did not consistently document the review and approval of cost sheets in accordance with its policies and procedures. Specifically, one of the five cost sheets that auditors reviewed was not signed by any of the required Department staff or management. A lack of cost sheet**

<b>Cost Sheets</b>
For TCI products, the Department documents the standard cost of all standard items on a TCI-73 Cost Sheet. Those cost sheets capture items such as:
<ul style="list-style-type: none"><li>▪ Overhead costs.</li><li>▪ Raw material costs.</li><li>▪ Standard costs.</li><li>▪ Margins.</li><li>▪ Sales prices.</li></ul>
The cost sheets must be updated at least annually and managers at the facility and division level must approve them.
Source: The Department.

review and approval could lead to the inclusion of inaccurate component costs in the final cost sheets.

The Department established processes and controls to help ensure that TCI sales complied with requirements; however, its sales were not always supported by the product cost sheets.

The Department had processes and related controls to help ensure that all TCI sales were supported, reviewed, approved, and processed in accordance with applicable statutes, rules, and Department policies and procedures. However, the Department did not always ensure that the amount at which it sold TCI products was consistent with the product cost sheets. Specifically, auditors determined that 8 of 61 sales either (1) did not match the corresponding cost sheet or (2) did not have a current cost sheet available. Not ensuring that sales are supported by the cost sheets increases the risk that the Department, based on its process, may charge an incorrect price for a product.

#### Recommendations

The Department should:

- Develop processes to ensure that all costs on its TCI cost sheets are accurate and supported.
- Strengthen processes to ensure that managers review and approve product cost sheets whenever they are updated.
- Develop and implement a process to ensure that its TCI sales are consistently supported by the product cost sheets.

#### Management's Response

*The Texas Department of Criminal Justice agrees with the recommendations. The Director of the Manufacturing, Agribusiness, and Logistics (MAL) Division reviewed and updated the TCI Product Pricing Forms (TCI-73) for all Texas Correctional Industries (TCI) standard products to reflect current raw material costs, accurate overhead rates, and new calculated sales pricing. Policy 2.02.07 Pricing of TCI Products and Services was reviewed by MAL management and responsible staff received additional instruction on its processes and enforcement.*

**Target Date:** Complete

## The Department Established Processes and Controls to Help Manage Its Assets

---

Chapter 2  
Rating:  
Low<sup>2</sup>

The Department established processes and controls to help ensure that assets were (1) appropriately accounted for, (2) safeguarded, and (3) reported accurately in its accounting system, LONESTARS, and the State Property Accounting (SPA) system. However, the Department should ensure that it accurately accounts for interagency purchases of vehicles.

### Assets

The Department manages approximately \$3.74 billion in assets, which include the following categories:

**Capitalized assets:** The Department manages \$3.57 billion in capitalized assets. A capitalized asset has a value equal to or greater than the capitalization threshold for the asset type. Those assets are reported in **an agency's annual financial report**.

**Controlled assets:** The Department manages \$170 million in controlled assets. A controlled asset is a capital asset that has a value that is lower than the capitalization threshold established for that asset type; however, due to its high-risk nature, it is tracked and reported in the SPA system.

Controlled assets include guns, computers, mobile devices, and other equipment.

Sources: The Department and *SPA Process User's Guide*.

Specifically, for a sample of 70 assets tested, the Department generally ensured that the assets' locations matched the information recorded in SPA/LONESTARS and that it accurately documented key identifying information in LONESTARS. In addition, the Department had appropriate processes and controls to ensure that it properly accounted for the assets it added to its inventory and the disposals that it made from its inventory in LONESTARS and SPA, and it had controls to internally monitor compliance with its asset management policies.

**Interagency Purchases.** While the vehicles tested were located and appropriately safeguarded, for some interagency vehicle purchases, the Department had tagged vehicles with two different asset numbers. Specifically, auditors identified a total of 458 vehicles that the Department purchased from other state

entities that were assigned two different asset numbers. As a result, the vehicles were recorded twice in both LONESTARS and SPA: once for the interagency purchase amount and once for the historical acquisition cost. The Department asserted that this occurred to account for the interagency purchase costs for the vehicles, which were previously recorded at their historical acquisition cost by the originating agency. The *SPA Process User's Guide* requires an asset to be recorded in SPA at its historical acquisition cost. As a result, the asset value of those 458 vehicles was overstated by approximately \$2.2 million (or 0.06 percent of the Department's \$3.7 billion in assets).

---

<sup>2</sup> Chapter 2 is rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

## Recommendation

The Department should accurately account for all interagency purchases in SPA and LONESTARS as required.

### **Management's Response**

*The Texas Department of Criminal Justice agrees with the recommendation. On December 18, 2017, the Comptroller's Office created a Comptroller Object of Expense Code and guidelines related to interagency capital purchases. By March 31, 2018, the Accounting & Business Services Director ensured that all interagency-purchased vehicles had a single asset number and the appropriate adjusting entries had been made in LONESTARS and SPA. The TDCJ will continue to accurately account for all new interagency purchases in SPA and LONESTARS.*

**Target Date:** Complete

## The Department Established Processes and Related Controls for Hurricane Harvey Expenditures

---

Chapter 3  
Rating:  
Low<sup>3</sup>

The Department established processes and controls to ensure that disaster recovery funds used for Hurricane Harvey were managed in accordance with applicable statutes, rules, and Department policies and procedures.

### Hurricane Harvey

Hurricane Harvey, a federally declared Major Disaster, made landfall in Texas in August 2017. As a result of the Major Disaster Declaration, resources that Texas allocated to response and recovery could become federally reimbursable.

Twenty-nine Department units (including prisons, jails, and treatment facilities) were physically affected by the hurricane. The Office of Incident Management is the central oversight authority for the Department's emergency management preparedness and response.

At the time of this audit, the Department was still in the process of determining its total hurricane-related expenditures. However, the Department estimated that its hurricane-related costs would total approximately \$3.4 million, and it anticipated that approximately \$2.9 million of those costs may be reimbursable.

Sources: The Department and FEMA.

At the time of the audit, the Department had submitted 2 hurricane-related project worksheets<sup>4</sup> to the Federal Emergency Management Agency (FEMA) requesting approximately \$950,000 in federal reimbursements, and it anticipated that it would submit a total of 8 project worksheets to FEMA related to Hurricane Harvey. The Department ensured that the two project worksheets tested were reviewed and approved prior to submitting the worksheets to FEMA for reimbursement.<sup>5</sup>

The Department also established policies and reporting templates for tracking costs (such as payroll, materials, or vehicle usage) related to storm activities. In addition, for a sample of direct expenditures tested, the Department had support to demonstrate that each of those expenditures was related to Hurricane Harvey.

---

<sup>3</sup> The risk related to the issues discussed in Chapter 3 is rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

<sup>4</sup> Public Assistance awards from FEMA are based on project worksheets the requesting entity prepares. The project worksheets document the determination of the eligible scope of work and the cost estimate, which includes the total amount that is federally reimbursable. The project worksheets also include all relevant support for those costs.

<sup>5</sup> The audit work performed on the project worksheets for this report was not designed to address compliance with the audit requirements for federal awards in the Office of Management and Budget's Uniform Guidance.

## ***The Department Had Appropriate Information Technology Controls Over Its Financial Data***

---

Chapter 4  
Rating:  
Low <sup>6</sup>

The Department generally had appropriate automated processes and controls over the financial data related to this audit. For example, the Department established key application controls in its procurement system, ADPICS, that were operating effectively. In addition, the Department established adequate change management controls for its key information systems. The Department appropriately documented, tested, and approved all changes tested before it implemented those changes in ADPICS or its accounting system, LONESTARS.

However, while overall its controls were adequate, the Department should ensure that it (1) consistently restricts access to LONESTARS to current employees and (2) limits excessive access permissions to LONESTARS. Appropriately managing access to key information systems would help decrease the risk of inappropriate transactions being processed without proper review.

### Recommendation

The Department should ensure that it appropriately restricts access to its key information systems.

### Management's Response

*The Texas Department of Criminal Justice agrees with the recommendation. By the end of May 2018, all access and permissions were reviewed and limited to appropriate personnel by the Accounting and Business Services Director and Information Technology Division Enterprise Applications Director. Access and permissions will continue to be monitored by these individuals to ensure appropriate system controls are in place.*

**Target Date:** Complete

---

<sup>6</sup> The risk related to the issues discussed in Chapter 4 is rated as Low because the audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited or the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.

# Appendices

Appendix 1

## **Objective, Scope, and Methodology**

---

### Objective

The objective of this audit was to determine whether the Department of Criminal Justice (Department) has processes and related controls to help ensure that it administers financial transactions in accordance with applicable statutes, rules, and agency policies and procedures.

### Scope

The scope of this audit covered the Department's activities related to asset management; Hurricane Harvey expenditures; Texas Correctional Industries' (TCI) sales, purchases, and cost determinations; and information systems from September 1, 2016, through January 31, 2018. In addition, auditors reviewed the Department's Hurricane Harvey-related project worksheets submitted to the Federal Emergency Management Agency through April 5, 2018.

### Methodology

The audit methodology included collecting information and documentation; interviewing Department staff regarding financial and operational processes; physically inspecting assets; testing documentation related to TCI sales and purchases; reviewing cost sheets and supporting documentation; reviewing access to key financial systems; and analyzing and evaluating the results of audit tests.

### Data Reliability and Completeness

Auditors used expenditure data from the Department's financial system (LONESTARS) to test Hurricane Harvey expenditures; asset records; and TCI sales and purchases. Auditors compared data in LONESTARS to (1) the Uniform Statewide Accounting System (USAS) for expenditure and revenue data and (2) the State Property Accounting (SPA) system for asset data.

Auditors also tested logical access and change management for LONESTARS and the Advanced Purchasing and Inventory Control System (ADPICS). In

addition, auditors tested certain key application controls in the LONESTARS and ADPICS applications.

Auditors determined that expenditure, revenue, and asset data from LONESTARS was reliable for the purposes of this audit.

#### Sampling Methodology

Auditors selected nonstatistical samples of (1) transactions related to TCI sales and purchases, (2) Hurricane Harvey expenditures, and (3) current assets, asset additions, and asset dispositions. Those samples were selected primarily through random selection; in some cases, auditors also selected additional risk-based items for testing. The sample items were not necessarily representative of the populations; therefore, it would not be appropriate to project the test results to the populations.

Information collected and reviewed included the following:

- Department policies, procedures, and guidelines.
- Department expenditure and revenue data from USAS and LONESTARS and asset data from the SPA system.
- Invoices, purchase orders, cost sheets, and other supporting documentation for TCI sales.
- Invoices, purchase orders, purchase requisitions, receiving reports, and other supporting documentation for expenditures.
- The Department's Hurricane Harvey-related project worksheets and supporting documentation.
- Asset addition and deletion forms, asset tags, and other supporting documentation for capital assets.
- User access data and supporting documentation related to both general and application controls over the Department's financial process-related systems.

Procedures and tests conducted included the following:

- Interviewed Department staff to identify the Department's financial and operational processes, including financial and administrative internal controls, and the information systems that support those processes.
- Tested samples of the Department's TCI sales and purchases, Hurricane Harvey expenditures, and assets to determine compliance with the Department's policies and procedures and state laws and regulations.

- Physically observed assets.
- Reviewed project worksheets, supporting documentation, and evidence of reviews of the project worksheets.
- Reviewed supporting documentation related to both general and application controls over the Department's financial process-related systems.
- Reviewed user access information for the Department's financial process-related systems.

Criteria used included the following:

- Department policies and procedures.
- Department *Property Manual*.
- Texas Government Code, Chapters 403, 404, and 2251.
- Title 1, Texas Administrative Code, Chapter 202.
- *State of Texas Procurement Manual*.
- Office of the Comptroller of Public Accounts' eXpendit purchasing procedure.
- *SPA Process User's Guide*.
- Department of Information Resources' *Security Control Standards Catalog*.

#### Project Information

Audit fieldwork was conducted from December 2017 through May 2018. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The following members of the State Auditor's staff performed the audit:

- Thomas Andrew Mahoney, CGAP (Project Manager)
- Adam K. Ryan (Assistant Project Manager)

- Cody Bogan
- Jennifer Grant, MPA
- Kelley Ngaide, CIA, CFE
- Doug Stearns, CISA
- George D. Eure, CPA (Quality Control Reviewer)
- Audrey O’Neill, CIA, CFE, CGAP (Audit Manager)

## Issue Rating Classifications and Descriptions

Auditors used professional judgement and rated the audit findings identified in this report. Those issue ratings are summarized in the report chapters/sub-chapters. The issue ratings were determined based on the degree of risk or effect of the findings in relation to the audit objective(s).

In determining the ratings of audit findings, auditors considered factors such as financial impact; potential failure to meet program/function objectives; noncompliance with state statute(s), rules, regulations, and other requirements or criteria; and the inadequacy of the design and/or operating effectiveness of internal controls. In addition, evidence of potential fraud, waste, or abuse; significant control environment issues; and little to no corrective action for issues previously identified could increase the ratings for audit findings. Auditors also identified and considered other factors when appropriate.

Table 2 provides a description of the issue ratings presented in this report.

Table 2

Summary of Issue Ratings	
Issue Rating	Description of Rating
Low	The audit identified strengths that support the audited entity's ability to administer the program(s)/functions(s) audited <u>or</u> the issues identified do not present significant risks or effects that would negatively affect the audited entity's ability to effectively administer the program(s)/function(s) audited.
Medium	Issues identified present risks or effects that if not addressed could <u>moderately affect</u> the audited entity's ability to effectively administer program(s)/function(s) audited. Action is needed to address the noted concern(s) and reduce risks to a more desirable level.
High	Issues identified present risks or effects that if not addressed could <u>substantially affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Prompt action is essential to address the noted concern(s) and reduce risks to the audited entity.
Priority	Issues identified present risks or effects that if not addressed could <u>critically affect</u> the audited entity's ability to effectively administer the program(s)/function(s) audited. Immediate action is required to address the noted concern(s) and reduce risks to the audited entity.

Copies of this report have been distributed to the following:

### **Legislative Audit Committee**

The Honorable Dan Patrick, Lieutenant Governor, Joint Chair  
The Honorable Joe Straus III, Speaker of the House, Joint Chair  
The Honorable Jane Nelson, Senate Finance Committee  
The Honorable Robert Nichols, Member, Texas Senate  
The Honorable John Zerwas, House Appropriations Committee  
The Honorable Dennis Bonnen, House Ways and Means Committee

### **Office of the Governor**

The Honorable Greg Abbott, Governor

### **Department of Criminal Justice**

Members of the Board of Criminal Justice

Mr. Dale Wainwright, Chairman  
Mr. R. Terrell McCombs, Vice-Chairman  
Mr. E.F. "Mano" DeAyala  
Mr. Thomas G. Fordyce  
Mr. Eric Gambrell  
Mr. Larry Don Miles  
Mr. Patrick O'Daniel  
Ms. Derrelynn Perryman  
Mr. Thomas P. Wingate

Mr. Bryan Collier, Executive Director



This document is not copyrighted. Readers may make additional copies of this report as needed. In addition, most State Auditor's Office reports may be downloaded from our Web site: [www.sao.texas.gov](http://www.sao.texas.gov).

In compliance with the Americans with Disabilities Act, this document may also be requested in alternative formats. To do so, contact our report request line at (512) 936-9500 (Voice), (512) 936-9400 (FAX), 1-800-RELAY-TX (TDD), or visit the Robert E. Johnson Building, 1501 North Congress Avenue, Suite 4.224, Austin, Texas 78701.

The State Auditor's Office is an equal opportunity employer and does not discriminate on the basis of race, color, religion, sex, national origin, age, or disability in employment or in the provision of services, programs, or activities.

To report waste, fraud, or abuse in state government call the SAO Hotline: 1-800-TX-AUDIT.