



Office of the Inspector General

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# *Audit Report*

To the Senior Vice President,  
Procurement, and the Vice  
President and Controller

# RECEIVE AND INSPECT MATERIAL PROCESS INTERNAL CONTROL REVIEW

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Audit Team  
Ricky L. Taylor  
Gregory R. Stinson

Audit 2005-032F  
June 1, 2005



**Memorandum from the Office of the Inspector General**

June 1, 2005

Paul R. LaPointe, ET 5B-K  
Randy P. Trusley, WT 5C-K

**REQUEST FOR MANAGEMENT DECISION – AUDIT 2005-032F – RECEIVE AND INSPECT MATERIAL PROCESS INTERNAL CONTROL REVIEW**

Attached is the subject final report for your review and management decision. You are responsible for determining the necessary actions to take in response to our findings. Please advise us of your management decision within 60 days of the date of this report.

Information contained in this report may be subject to public disclosure. Please advise us of any sensitive information in this report that you recommend be withheld.

If you have any questions, please contact Rick L. Taylor, Senior Auditor, at (865) 632-7321 or Louise B. Beck, Manager, Financial and Operational Audits, at (865) 632-2622. We appreciate the courtesy and cooperation received from your staff during this review.

Ben R. Wagner  
Assistant Inspector General  
(Audits and Inspections)  
ET 3C-K

RLT:JP

Attachment

cc (Attachment):

Franklin E. Alford, SP 1A-C  
Tom D. Kilgore, ET 12A-K  
Richard W. Moore, ET 4C-K  
Ellen Robinson, ET 12A-K  
OIG File No. 2005-032F

## **SYNOPSIS**

The Office of the Inspector General (OIG) audit personnel conducted an audit to assess controls over Tennessee Valley Authority's (TVA) Receipt and Inspection (R&I) inventory<sup>1</sup> process. Our audit included the controls in place as of May 16, 2005. According to Procurement information, as of April 30, 2005, TVA's inventory of material was about \$319 million with typical annual inventory receipts of about \$150 million. TVA had 226 employees managing this inventory at 83 TVA locations.

In summary, we found TVA's control design for the R&I process was suitably designed to prevent or detect, on a timely basis, material misstatements in significant accounts and disclosures. More specifically, we determined (1) the policies and procedures accurately reflect the current practices described by management, and (2) the process includes the key control activities required to satisfy information processing objectives and the relevant financial statement assertions. However, we noted TVA's Risk Control Tracking System (RCTS) could be updated to more accurately reflect key financial controls of the R&I process.

## **BACKGROUND**

TVA's Materials Management group within the Procurement organization is responsible for managing TVA's material inventory. As of April 30, 2005, TVA's inventory of material was about \$319 million with typical annual inventory receipts of about \$150 million. TVA had 226 employees managing this inventory at 83 TVA locations.

The primary objectives of the R&I process are to ensure (1) inventory received is usable and recorded accurately and timely, (2) only goods ordered are received and recorded in the appropriate period, (3) all stored materials are adequately safeguarded, and (4) all defective or rejected products received and excessive inventories are returned to suppliers timely and the transactions are recorded in the appropriate period.

In order to meet these four primary objectives, Procurement's policies and procedures require personnel to (1) inspect and count the material when it is received, (2) match purchasing documentation to

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<sup>1</sup> For purposes of this report, inventory means material inventory.

material received, (3) restrict access to inventory, and (4) monitor and segregate rejected materials to ensure timely returns.

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

Our objective was to assess controls over the R&I process. The scope of the audit was R&I process controls as of May 16, 2005. We obtained an understanding of controls and processes relating to receiving and inspecting material inventory by:

- Accessing RCTS to obtain all the related information/documentation for the R&I process.
- Interviewing Procurement personnel to gain an understanding of the process and obtain additional control documentation.
- Using information obtained to document and flowchart the R&I process.
- Conducting a walkthrough of the process with Procurement personnel to (1) confirm our understanding of the process and key control activities, (2) identify areas where process and/or control documentation needs to be prepared or updated, and (3) identify any additional mitigating control activities.
- Participating in a Fraud Risk Assessment with Procurement and OIG investigative personnel to identify possible fraud schemes and weaknesses in internal controls related to material management.
- Using information obtained in the walkthrough and Fraud Risk Assessment to assess the control design and documentation.

This audit was performed in accordance with generally accepted government auditing standards. Although we did not test for compliance with laws and regulations, nothing came to our attention during the audit that indicated noncompliance with laws and regulations.

## **FINDINGS**

We found TVA's control design for the R&I process was suitably designed to prevent or detect, on a timely basis, material misstatements in significant accounts and disclosures. More specifically, we determined (1) the policies and procedures accurately reflect the current practices described by management, and (2) the process includes the key control activities required to satisfy

information processing objectives and the relevant financial statement assertions. However, we noted RCTS could be updated to more accurately reflect key financial controls of the R&I process.

## **RCTS ISSUES**

We identified two issues concerning the R&I process documentation in RCTS. Specifically:

- RCTS should be updated to delete the following control: "shipments are not received that are not on the receiving manifest or that cannot be otherwise documented" (RCTS Control Activity No. H.2.B.2). We discussed this control with Procurement management, and we mutually agreed this was not a key financial control but was an operational control.
- RCTS contained the following three controls that should be included in the Manage Site Material process instead of the R&I process. Procurement management agreed with our assessment of these controls.
  1. All issues and returns are accompanied by the appropriate documentation (RCTS Control Activity No. H.2.E.1).
  2. Pick Ticket quantities are entered into the system by authorized personnel (RCTS Control Activity No. H.2.E.3).
  3. Material is required to be issued to an order within an established time period after the material has been picked (RCTS Control Activity No. H.2.E.4).

We recommend Procurement take corrective action as discussed above.