LEGISLATIVE AUDIT COMMISSION

Review of
Department of Corrections
Correctional Industries
Two Years Ended June 30, 2008

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REVIEW: 4328
DEPARTMENT OF CORRECTIONS
CORRECTIONAL INDUSTRIES
TWO YEARS ENDED JUNE 30, 2008

FINDINGS/RECOMMENDATIONS - 12

ACCEPTED - 6
IMPLEMENTED - 6

REPEATED RECOMMENDATIONS - 5
PRIOR AUDIT FINDINGS/RECOMMENDATIONS - 7

This review summarizes the reports on the Department of Corrections, Correctional Industries (ICI), filed with the Legislative Audit Commission August 6, 2009. The auditors performed a compliance examination for the two years ended June 30, 2008, and a financial audit for the one-year ended June 30, 2008. The auditors stated that the financial statements were fairly presented.

Correctional Industries operates as a productive enterprise employing prisoners from institutions under the jurisdiction of the Department of Corrections. ICI programs are supported by revenues derived from the sale of its products and services. Tax-supported institutions and non-profit organizations comprise the majority of the market. The Director of the Department of Corrections during the audit period was Roger E. Walker Jr. Mr. Walker resigned effective June 7, 2009 and Mr. Michael P. Randle became Director on June 8, 2009. The Chief Executive Officer of Correctional Industries during the audit period was James Underwood. Effective September 1, 2008, Ms. Donna Lindemulder began serving as CEO. She served previously as Marketing Manager at ICI.

Following is the average number of employees (excluding inmates) in the Correctional Industries Division:

FY08 -151; FY07 - 158; FY06 - 164.

Expenditures From Appropriations

The General Assembly appropriated $41,783,200 from the Working Capital Revolving Fund to Correctional Industries for FY08. Appendix A summarizes the appropriations and expenditures for the period under review. Correctional Industries' operations are financed by sales of its products. All appropriations are made from the Working Capital Revolving Fund, which receives all proceeds from the sale of products and services. Total expenditures for the Working Capital Revolving Fund increased from $35.9 million in FY06 to $38,481,788 in FY07, and $40,181,754 in FY08. Expenditures increased primarily due to an increase in the State contribution to the retirement system, and a rise in the cost of commodities. Lapse period spending was approximately $4.1 million, or 10.1%.

Working Capital Revolving Fund

Appendix B provides a balance sheet for the Working Capital Revolving Fund at June 30, 2008. The Working Capital Revolving Fund accounts for the activities of the Correctional Industries program. Net income for the Fund for FY08 was $1,223,000.

Summary of Operations by Industry

Appendix C presents a summary of Correctional Industries' net income for each industry in FY08 and FY07. During FY08, Correctional Industries operated 36 separate industries, of which 19 were found to be profitable and 17 experienced losses. During FY2008, the following industries had the largest losses: Pana Trucking (-$1,423,102) and Jacksonville Modular Furniture (-$438,232) and Lincoln Asbestos Abatement (-$407,654). The industry with the greatest profit was Dixon Optical, $3,892,061.

Accounts Receivable

Accounts receivable as shown in Appendix D amounted to $5,100,530 at June 30, 2008. A receivable of almost $3.2 million is due from the Department of Corrections. Accounts receivable represent amounts due from sale of goods and services to State agencies, local governments, and others. Most receivables were current. Accounts over 180 days old totaled $447,646. The Department considers all accounts fully collectible.

Inventories and Property and Equipment

Inventories at June 30, 2002 are shown in Appendix E. Inventories at June 30, 2008 totaled $10,514,944. Appendix F contains a summary of property and equipment. The sum of equipment, buildings and livestock at June 30, 2008 was $27,471,364. The capitalization policy in the Code is different than the policy established by ICI in conjunction with the Comptroller's guidelines for financial reporting. This schedule is unaudited because of the significance of the exceptions as noted in Finding No. 2.

Number of Inmates Employed by Industry

Appendix G indicates the number of inmates employed by each industry for FY08 and FY07. During FY08, the average number of inmates working was 1,016, which was 21 fewer than FY07 when 1,037 were employed at Correctional Industries.

Accountants' Findings and Recommendations

Condensed below are the 12 findings and recommendations included in the audit report. Five recommendations were repeated from prior audits. The following recommendations are classified on the basis of information provided by Mary Ann Bohlen, Assistant Deputy Director, Fiscal Accounting Compliance, Department of Corrections, in a memo received on January 18, 2010 via electronic mail. Further updates were received on February 4, 2010.

Accepted and Implemented

1. Devote sufficient resources to the financial accounting function so that financial information for the Working Capital Revolving Fund (fund 301) is properly recorded and accounted for thus permitting the preparation of reliable financial statements and Comptroller GAAP packages. Also, provide accounting personnel sufficient technical resources and training to ensure generally accepted accounting principles are followed in the preparation of year-end financial information. (Repeated-2006)

Finding: The Department of Corrections did not ensure financial records used to prepare the year-end financial statements and the Generally Accepted Accounting Principles (GAAP) package were accurate for fund 301 Working Capital Revolving Fund. During testing, auditors noted the following:

- The amount reported as accounts payable and accrued expenses as of June 30, 2008 in the financial statements and Comptroller's GAAP package was overstated by $861,626. Lapse period invoice vouchers included payments for goods ordered before year end but received after 6/30/08. These types of payments should not have been accrued as of 6/30/08 because the liabilities would not be incurred until the goods were received which was subsequent to 6/30/08.
- There were no monthly reconciliations performed between the cash balance per fund 301 accounting records and the cash balance per the Comptroller's records.
- The total compensated absences balances reported in the financial statements and Comptroller's GAAP package did not include compensable holiday hours earned by employees totaling $85,910 and the related cost of benefits for the holiday hours of $6,572.

Management indicated the current exceptions were due to miscommunication and misunderstanding of the status of lapse payments, limited staffing, and oversight. This finding has been reported in the previous two audits of which management indicated the exceptions were due to staff shortages.

Accepted or Implemented – continued

Response: Accepted. The Agency will make every effort to ensure financial reporting is accurate and timely. Sufficient resources are planned to be devoted to the project.

Updated Response: Implemented. During FY09, the Agency contracted with a CPA firm to compile and reconcile the financial statements and information for Correctional Industries.

2. Provide adequate resources to ensure State property is accurately recorded in the property records and required reports are timely and accurately submitted to the Comptroller's Office.

Finding: The Department did not have internal controls in place to ensure fund 301 property additions and deletions were properly recorded and quarterly property reports due to the Office of the Comptroller are accurate and adequately supported. During testing of fund 301 property and equipment, auditors noted the following:

- The Agency did not maintain a detailed listing of property additions and deletions to support the quarterly additions and deletions reported to the Comptroller for FY07 and FY08 for fund 301. Without detailed support auditors cannot perform testing to determine whether additions or deletions to State Property as reported in the quarterly C-15 reports were accurate.

- The total State property on the fund 301 C-15 reports for June 30, 2007 and June 30, 2008 did not agree to ICI supporting documentation. The quarterly reports overstated State property by $103,389 and $ 91,258 respectively for fiscal years 2007 and 2008 compared to the supporting documentation.

- During testing, all seven of the State property deletions tested in fiscal year 2007 totaling $65,428 were not timely removed from the property control records.

- During testing auditors identified $101,798 and $1,579 of expenditures for fiscal years 2008 and 2007 respectively, charged to the telecommunications and equipment appropriations that should have been recorded in the property control system, but were not.

According to management, the above problems were due to staffing limitations. Staff assigned to maintain the property control records and compile information for C-15 reporting had left and were not replaced during the audit period.

Updated Response: Implemented. The errors identified by the auditors were researched and entries posted as appropriate to the property control system. The entries and statements were verified by the CPA firm.

3. Implement a process to have a person independent of the preparation of the quarterly accounts receivable reports compare the reports to supporting documentation prior to submission to the Comptroller to ensure accurate information is reported.

Finding: The Department of Corrections did not file accurate quarterly accounts receivable reports with the Office of the Comptroller for fund 301. During testing, auditors identified the following exceptions:

- The Agency was unable to provide the 06/30/07 Accounts Receivable Activity Report (C-97) for our testing.

- For the quarters ended 9/30/07, 12/31/07, and 3/31/08, information such as net receivables and number of accounts in the reports submitted to the Comptroller's Office did not agree to the supporting information generated by the general ledger system.

According to management, errors noted above on quarterly reporting of accounts receivable were due to multiple iterations of general ledger reports used for the testing and the reporting.

Response: Implemented. The Agency has implemented procedures to ensure accurate accounts receivable reporting.

4. Stress the importance of maintaining accurate time sheets to those employees responsible for maintaining them. Also, automate the timekeeping system to provide greater efficiency and prevent these errors from occurring.

Finding: Correctional Industries (ICI) did not maintain accurate employee timekeeping records. During testing, auditors noted errors in the reporting and accounting for sick, personal and vacation leave time as follows:

- The timekeeper posted an incorrect number of leave hours taken for 9 of 30 (30%) employees tested.
- One employee's time sheet was erroneously deducted with 15 hours of vacation leave which should have been deducted from another employee's timesheet.
- Two employees miscalculated the proper number of overtime hours worked; the error was not caught by the timekeeper and was subsequently posted to the employees time sheets.
- The sick leave balance brought forward to an employee's FY07 timesheet was erroneously computed.
- Two employees took time off which was not deducted from their leave time balances. In addition, the same employees' timesheets indicated 22.5 hours of

Accepted or Implemented – continued

leave at various dates during FY07 and FY08, but supporting documentation indicated the employee was not on leave during the time periods indicated.

According to ICI management, these errors were due to staffing limitations and also limitations that are inherent in maintaining manual timekeeping records. This finding has been reported in the previous two audits of which management indicated the exceptions were due to staff shortages and accounting functions being centralized within the Department of Corrections.

Updated Response: Accepted. The timekeeping duties were reassigned to a staff person more familiar with the requirements of manual timekeeping.

5. Re-evaluate the propriety of the continued use of temporary assignments for long-term employment positions. Comply with administrative rules and the AFSCME agreement, where applicable, for those employees on temporary assignment. Also complete all the required documentation for employees that are temporarily assigned. (Repeated-1998)

Finding: Correctional Industries (ICI) continues to place employees on temporary assignment for periods beyond the time limit specified by State administrative rules as well as the union agreement.

During testing, auditors noted nine employees working in temporarily assigned positions during FY08 and FY07. Four of nine employees had been working in temporarily assigned positions from two to six years. Another four of the nine employees had stopped working on temporary assigned positions during FY08 after working four months to six years on temporary assignment. The other employee had just recently been assigned to the temporary position in May 2008. According to the Code, no position shall be filled by temporary assignment for more than six months out of a 12-month period. According to the union agreement, an employee is allowed to be temporarily assigned for up to 60 working days in a 12-month period, or up to six months while the regular employee is on leave.

According to ICI management, lengthy temporary assignments of employees were due to staffing limitations. This finding was first reported in 1998. In the previous reports management also indicated the exceptions were due to staff limitations.

Response: ICI has developed plans that would help address these issues, including reorganizations and hiring of staff.

Updated Response: Partially Implemented. ICI was able to fill some positions (6) that were critical to resolving the temporary assignment issues; there are other positions that are pending the final decision of the legal outcome of the layoff.

6. **Direct the Correctional Industries Training Coordinator to follow the Administrative Directive and only record employee training upon the submission of proper documentation such as certificates, attendance sheets or other official forms of verification for training attended. Also, keep verification documentation in each employee's training record.**

Finding: Correctional Industries did not obtain or retain documentation to support training events employees attended. Auditors reviewed the summary of training hours of 15 employees and noted that all employees meet the required training hours for both FY07 and FY08. However, most of the training events indicated on the summary were not supported by certificates, attendance sheets or any other form of verification for the training.

According to ICI personnel, it is ICI practice to accept any document submitted by the employees attesting they have attended the training. In some instances verbal or email notifications from employees were used to document training attended.

Updated Response: Partially Implemented. ICI has established a training coordinator for their staff. Staff have been instructed to turn in training documents to the coordinator. The documents must be complete and signed.

7. **Critically re-examine the need for the Management Information System and determine if the current limited implementation is cost-effective and meets the Agency's needs. In addition, conduct a thorough assessment to determine if the full implementation of all modules at all sites will provide a cost-beneficial solution. (Repeated-2000)**

Finding: Correctional Industries (ICI) has taken no further progress in its plan to completely install an automated management information system (system).

ICI initiated a project in 1998 to install the system for the purpose of connecting the ICI Central Office to 19 remote operation locations to enable management to gather timely data. The project was expected to have been fully implemented in fiscal year 2000. Since fiscal year 2000, ICI has only been using 3 modules and these modules were only used in the Central Office.

ICI paid the vendor $340,000 of a $420,000 contract that was to include software plus training and installation at the time of implementation. Since the installation of the system in 2000, ICI has continued to use and pay the vendor for technical support of the 3 modules utilized. During the fiscal years 2007 and 2008, ICI paid the vendor $54,067 and $4,612, respectively for technical support, for a total of almost $1.3 million.

According to ICI management, the need to further utilize the system for its intended purpose was not re-examined during the current engagement period because other priorities took precedence. ICI had previously indicated they were not able to initiate

planning for the other modules because of fiscal constraints, retirement of key staff along with delays regarding the installation of fiber optic cable to connect the remote locations.

Response: Accepted. The Agency will evaluate the need and practicality of the MACOLA system.

8. Properly perform the required monthly reconciliation of receipts. Record all receipts including automatic payments in receipts records and reconcile the total receipts with the Comptroller's receipt records and promptly report any discrepancies.

Finding: The Department of Corrections did not adequately perform a monthly reconciliation of receipt records to receipt records maintained by the Comptroller for fund 301.

During testing, the auditors noted the Agency did not always record in their receipt records certain automatic transfers from a purchasing agency's account to fund 301 for sales made to the fund. The Agency did not ensure all of these receipt transactions were properly recorded in its receipts records because they did not perform a monthly reconciliation of this specific revenue source against the Comptroller's records. The Agency did not communicate any of the reconciliation variances to the Comptroller as required.

According to management, the Department of Corrections had made steps to record automatic payments in the receipts records to properly reconcile with the Comptroller's receipt records. This will be fully addressed in fiscal year 2009.

Response: Implemented. The Agency has developed procedures to ensure reconciliations are completed for the automatic transfers.

Updated Response: Implemented. The Agency in cooperation with CMS and the Comptroller is automating the reconciliation of the cash balance of the 301 fund.

9. Maintain detailed records of asset deletions and transfers to ensure proceeds from any sale of these assets are collected and deposited into ICI Working Capital Revolving Fund. (Repeated-2006)

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Finding: The Department of Corrections did not maintain records of assets transferred to CMS and other State agencies to ensure that subsequent sale of these assets, if any, are monitored and proceeds deposited into the Working Capital Revolving Fund.

According to the Department of Corrections management, detailed records were not maintained due to staffing limitations.

<u>Response:</u> Implemented. The Agency has implemented procedures to ensure tracking of surplus assets.

10. Work with the Department of Corrections Central Office to identify and include occupancy costs relating to Center manufacturing facilities to provide a good estimate of the total cost of a product. In addition, include guidelines in policies and procedures for the basis of valuation/estimate of these costs and their inclusion in the computation of product costs as a basis of setting a selling price. (Repeated-2006)

<u>Finding:</u> The Department of Corrections does not include any occupancy costs for the production facilities they use at the Correctional Centers in their computation of the manufacturing cost of its products for fund 301.

In the previous compliance report ICI management indicated with the assistance of the Fiscal Services Unit of the Department of Corrections they will review the occupancy costs to determine the estimated cost to produce certain products. During testing, auditors noted there were no changes made in the costing procedures, specifically, occupancy costs were not considered in the computation of manufacturing costs. According to ICI management, their plan to integrate occupancy costs in the computation of the manufacturing costs of ICI products was put on hold as other projects took precedence.

<u>Response:</u> Accepted. The Agency will work to determine the value of the excluded costs and perform cost benefit analysis of the inclusion of the cost in the price of the items.

11. Adopt and implement a formal written inventory policy. Define criteria for identifying obsolete, surplus or scrap inventories and address how often inventories are reviewed. Establish inventory reserves in accordance with the written policy and Generally Accepted Accounting Principles, and review regularly for reasonableness.

<u>Finding:</u> Correctional Industries (ICI) does not have a formal written policy in place to address inventory obsolescence. During testing of the ICI inventories, auditors identified slow moving finished goods inventories valued at $334,376 and noted there is no formal policy and procedure for the periodic review of inventories for obsolescence,

Accepted or Implemented – concluded

scrap or surplus. Auditors also noted there were raw materials valued at $35,539 with no usage for several years but they continued to be maintained at various locations.

According to ICI management, some of the slow moving inventories were produced for the Department of Corrections (DOC) and other Illinois State agencies. DOC discontinued the use of some of the institutional garments produced for them but ICI management is confident the inventories can be sold to customers other than DOC. Site Superintendents and personnel are instructed on an annual basis to identify obsolete inventories and report these items to ICI Central Office for write off. However, testing noted this was not followed on a consistent basis.

Updated Response: Implemented. ICI formulated and implemented the policy.

12. Develop and submit administrative rules to the Joint Committee on Administrative Rules (JCAR) regarding billing user agencies in advance, issuing credits or refunds and issuing bills to user agencies for amounts owed from the prior fiscal year as allowed by the State Finance Act. Also, develop a written administrative directive to address issues with these transactions.

Finding: Correctional Industries (ICI) has not issued administrative rules outlining how they can bill user agencies in advance, issue credits or refunds or issue bills to user agencies for amounts owed from the prior fiscal year (catch-up billings). In addition, ICI does not have any written administrative directives to guide them in these areas.

During our testing, ICI issued 6 catch-up billings totaling $1,698 in FY 2008 to State agencies for amounts owed from FY 2007. In addition, ICI issued 11 catch-up billings totaling $129,553 in FY 2009 to State agencies for amounts owed from FY 2008.

ICI management indicated they believed the statute alone was sufficient for the issuance of the catch-up billings and subsequent payment by the user agencies.

Updated Response: Partially Implemented. ICI is working to establish JCAR rules for utilization of catch up billings by Fund 301.

Emergency Purchases

The Illinois Purchasing Act (30 ILCS 505/1) states, “The principle of competitive bidding and economical procurement practices shall be applicable to all purchases and contracts...” The law also recognizes that there will be emergency situations when it will be impossible to conduct bidding. It provides a general exemption for emergencies “involving public health, public safety, or where immediate expenditure is necessary for repairs to State property in order to protect against further loss of or damage ... prevent or minimize serious disruption in State services, to insure the integrity of State records, or to avoid lapsing or loss of federal or donated funds. The Chief procurement officer may promulgate rules extending the circumstances by which a purchasing agency may make ‘quick purchases’, including but not limited to items available at a discount for a limited period of time.”

State agencies are required to file an affidavit with the Auditor General for emergency procurements that are an exception to the competitive bidding requirements per the Illinois Purchasing Act. The affidavit is to set forth the circumstance requiring the emergency purchase. The Commission receives quarterly reports of all emergency purchases from the Office of the Auditor General. The Legislative Audit Commission is directed to review the purchases and to comment on abuses of the exemption.

During FY07 and FY08, Correctional Industries filed two affidavits for emergency purchases totaling $93,344.82 for the following items:

- $47,025.00 for commodities; and
- $46,320.00 for equipment repairs.

In FY08 there was an additional affidavit filed using $81,465.00 in federal funds to purchase furniture for inmate computer work stations.