DEPARTMENT OF FINANCE

EDMUND G. BROWN JR., GOVERNOR

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Transmitted via e-mail

January 28, 2011

Mr. Blake Baras, Managing Director of Finance
Adult Secure Institutions
Cornell Companies, Inc.
1700 West Loop South, Suite 1500
Houston, TX 77027

Dear Mr. Baras:

Final Audit Report—Mesa Verde Community Correctional Facility, Contract R05.003

The Department of Finance, Office of State Audits and Evaluations, has completed its fiscal compliance audit and close-out review of the Mesa Verde Community Correctional Facility (Facility) for the period July 1, 2007 through December 31, 2009.

The enclosed report is for your information and use. The Geo Group, Inc.'s response to the report findings and our evaluation of the response are incorporated into this final report.

This report will be placed on our website. Additionally, pursuant to Executive Order S-20-09, the California Department of Corrections and Rehabilitation should post this report in its entirety to the Reporting Government Transparency website at http://www.reportingtransparency.ca.gov/ within five working days of this transmittal.

We appreciate the assistance and cooperation of the Facility. If you have any questions regarding this report, please contact Cheryl Lyon McCormick, Manager, or Osman Sanneh, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

David Botelho, CPA
Chief, Office of State Audits and Evaluations

Enclosure

cc: On following page

cc: Mr. Paul Haberling, Facility Director, Mesa Verde Community Correctional Facility
Mr. Matthew Hecktor, Division Controller, Adult Secure Division, Cornell Companies, Inc.
Ms. Dalinda Harman, Chief, Community Correctional Facilities Administration, California Department of Corrections and Rehabilitation
Mr. Terry Dickinson, Correctional Administrator, Community Correctional Facilities Administration, California Department of Corrections and Rehabilitation
Mr. Robert Logan, Staff Services Manager I, Community Correctional Facilities Administration, California Department of Corrections and Rehabilitation
Ms. Flordeliza Ligaya, Staff Services Manager I, Community Correctional Facilities Administration, California Department of Corrections and Rehabilitation
Mr. Renato Araza, Program Analyst, Community Correctional Facilities Administration, California Department of Corrections and Rehabilitation

A Fiscal Compliance Audit

Mesa Verde Community Correctional Facility
Contract R05.003
For the Period July 1, 2007
through December 31, 2009

Prepared By:
Office of State Audits and Evaluations
Department of Finance

105225071 DDR

September 2010

MEMBERS OF THE TEAM

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Final reports are available on our website at http://www.dof.ca.gov

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Executive Summary

The California Department of Corrections and Rehabilitation (Corrections) contracted with Cornell Companies, Inc. (Cornell), to operate the Mesa Verde Community Correctional Facility (Facility). Cornell is responsible for providing inmate housing, sustenance, and coordinating inmate activities within the Facility. Under the direction of on-site Corrections staff, Cornell also assists with inmate custody and Facility security. The Facility is located in Bakersfield, California, and is designed to accommodate an average daily population of 360 male inmates. On October 26, 2009, Corrections provided Cornell the required 60 day notice of intent to terminate contract R05.003 under which the Facility is administered. Accordingly, the contract was terminated and the Facility closed effective December 25, 2009.

Corrections requested the Department of Finance, Office of State Audits and Evaluations (Finance), to perform a fiscal compliance and close-out audit of contract R05.003 for the period July 1, 2007 through December 31, 2009.

Review Results:

- The per diem rate paid to Cornell was inflated resulting in $588,308 of questionable revenue received by the Facility. Included in its budget estimates were duplicate food service costs and unexpended funds for consultant services. We recommend Cornell refund Corrections $588,308. Further, in future contracts, ensure duplicative costs are not included in per diem contract rates, and compensated services are satisfactorily rendered.

- Questioned operating expenses totaling $721,042 were identified in the Quarterly Cost Reports (QCR). The questioned amounts consist of unallowable Intercompany Rent totaling $700,503 and incorrectly reported Other Insurance totaling $20,539. We recommend Cornell revise and resubmit its QCRs to properly present allowable Operating Expenses.

- The Facility transferred budgeted funds from one line item to another by more than $10,000 or more than 10 percent without Corrections' prior approval. We recommend Cornell request and receive Corrections' approval prior to transferring funds among line item categories that exceed established limits on any future contracts.

- The Facility overstated payroll and understated operating expenses in the QCR due to the misclassification of wages paid from the Inmate Welfare Fund (IWF). We recommend Cornell revise and resubmit its QCRs to properly present IWF salaries and operating expenses.

- The Corporate Fee reported in the QCR incorrectly included the Facility operating profit/loss. We recommend Cornell revise and resubmit its QCRs to properly present the Corporate Fee.

- Cornell is to remit to Corrections the December 31, 2009 combined residual IWF and Inmate Trust Fund (ITF) cash balances totaling $24,756 to effectively close the Facility.

BACKGROUND, SCOPE, AND METHODOLOGY

BACKGROUND

Corrections administers the Community Correctional Facility Program (Program). The Program is intended to ease overcrowding in state institutions, reduce the need for building new state correctional institutions, and provide a financial benefit for the local community in which the facility is located. The Community Correctional Facilities Administration within Corrections is responsible for the on-site administration of the Program.

Penal Code section 6256 authorizes Corrections to enter into contracts with appropriate public and private entities to provide housing, sustenance, supervision, inmate work incentive programs, education, vocational training, pre-release program assessment planning, and other services, as stipulated. Corrections contracted with Cornell Companies, Inc. (Cornell), for the operation of the Mesa Verde Community Correctional Facility (Facility). However, on October 26, 2009, Corrections provided Cornell the required 60 day notice of intent to terminate contract R05.003 under which the facility is administered. Accordingly, the contract was terminated and the Facility closed effective December 25, 2009.

As stipulated by contract R05.003, the Facility's funding is a combination of flat rate expenditure reimbursement and per diem funding. The combined funding was $7,333,186, $7,318,221, and $7,318,221 in fiscal years 2007-08, 2008-09, and 2009-10, respectively. Contract funds are used for the expenditure categories as shown in Appendix A.

The Facility is required to account for its funds separately from its general operations. Below is a description of each fund held by the Facility:

- *Inmate Welfare Fund*—A fund operated for the benefit and welfare of inmates who are under the jurisdiction of Corrections.
- *Inmate Trust Fund*—A fund that accounts for moneys belonging to inmates through work performed or money received from family or friends.

SCOPE AND OBJECTIVES

In accordance with an interagency agreement with Corrections, Finance conducted a fiscal compliance audit and close-out review of contract R05.003 between Cornell and Corrections. The audit objectives were to:

- Determine whether the Facility's cost reports accurately represent revenue received and expenditures incurred for the period July 1, 2007 through December 31, 2009.
- Determine whether the Facility's internal control allows for the accurate and timely development of cost reporting data and adequate safeguarding of state assets.

- Determine the Facility's compliance with the contract's fiscal and reporting requirements.
- Review the activities and contract compliance of the Inmate Welfare Fund and Inmate Trust Fund for the period July 1, 2007 through December 31, 2009.
- Determine the December 31, 2009 ending balances of the Inmate Welfare Fund and Inmate Trust Fund and verify if the remaining funds were reimbursed to the state.

METHODOLOGY

In order to determine whether the Facility's cost reports are accurate, information reported on the cost reports was traced to the Facility's general ledger and subsidiary ledgers. Revenue and expenditures reported in the Facility's general ledger were assessed for reasonableness. Additionally, a sample of receipts and disbursements was selected and traced to supporting documentation.

To ensure the Facility maintains an effective internal control system, an understanding of the Facility's internal control was obtained through inquiries of Facility staff. A selected sample of receipts and disbursements was traced to supporting documentation to determine the Facility's compliance with the contract's fiscal and reporting requirements. A review of the contract agreement, Corrections' *Department Operations Manual*, and the Financial Management Requirements for Community Correctional Facilities dated November 4, 2005 (Handbook) was performed to determine if selected items met eligibility requirements.

The funds (Inmate Welfare Fund and Inmate Trust Fund) were reviewed for completeness and propriety. Our review included the following:

- General internal control assessment.
- Review of the Facility's general ledger and/or subsidiary ledgers.
- Identification of fund transfers.
- Determination of whether transfers met eligibility requirements.
- Assessment of fund disbursements.
- Investigations of unusual transactions.
- Verification that the Facility maintained the funds in accordance with contract requirements.

Findings are presented in the *Findings and Recommendations* section of this report. Immaterial, non-reportable issues and observations were discussed with Facility representatives. The Appendices include schedules of financial related information that is presented for additional information and analysis.

Recommendations were developed based on contract requirements and guidelines set forth in the Handbook. Fieldwork was conducted during January 2010 and February 2010.

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to provide an independent assessment of compliance with contract R05.003, to provide information to improve accountability, and to facilitate decision-making by parties with responsibility to oversee or initiate corrective action. Because our objective was not to perform a financial statement audit, we do not express an opinion on the financial information presented in the Appendices. Furthermore, our evaluation of the Facility's internal control and tests of compliance was not to provide assurance on the Facility's internal control as a whole, or to provide an opinion on compliance. Accordingly, we do not provide such assurance or express such an opinion.

This report is intended solely for the information and use of Facility, Cornell, and Corrections management, and is not intended to be and should not be used by anyone other than these specified parties. However, this restriction is not intended to limit the distribution of this report, which is a matter of public record.

FINDING 1 Inflated Per Diem Rate

Condition: The per diem rate paid to Cornell was inflated by $2.08, resulting in $588,308 of questionable revenue received by the Facility. Included in its budget estimates were duplicate food service personnel costs and funds for consultant services that were not provided.

During the period reviewed, Cornell invoiced and Corrections paid $336,580 in duplicate food service personnel costs. The duplicate payment was a result of Cornell including the food service personnel costs as a component of its budgeted Staff Salaries and Benefits and Food expenditure line items. The duplication of budgeted costs results in an overstatement of the per diem rate by $1.19. See Table 1.

Additionally, Cornell invoiced and Corrections paid $251,728 for consultant services that were not provided, resulting in a per diem rate overstatement of $0.89. See Table 1.

Because the contracted per diem rate is determined by budget estimates, the duplicate costs and unexpended funds inflated the per diem rate paid, resulting in Facility revenue that is not justified.

Table 1: Inflated Per Diem Rate

Program	2007-08	2008-09	2009-10	Total	
Food Service					
Total Budgeted Expenditures	$5,576,368	$5,561,403	$5,561,403		
Less: Duplicate Food Service Costs	(157,470)	(157,470)	(157,470)		
Adjusted Budgeted Expenditures	$5,418,898	$5,403,933	$5,403,933		
Recalculated Per Diem Rate[1]	$ 41.13	$ 41.13	$ 41.13		
Less: Contracted Per Diem Rate	42.32	42.32	42.32		
Per Diem Overstatement	**$ 1.19**	**$ 1.19**	**$ 1.19**		**$1.19**
Annual Per Diem Bed Count	127,867	110,117	44,856		
Questioned Revenue[2]	**$ 152,162**	**$ 131,039**	**$ 53,379**	**$336,580**	
Consultant Services					
Total Budgeted Expenditures	$5,576,368	$5,561,403	$5,561,403		
Less: Unexpended Consultant Services	(118,192)	(117,869)	(117,869)		
Adjusted Budgeted Expenditures	$5,458,176	$5,443,534	$5,443,534		
Recalculated Per Diem Rate	$ 41.43	$ 41.43	$ 41.43		
Less: Contracted Per Diem Rate	42.32	42.32	42.32		**$ 0.89**
Per Diem Overstatement	**$ 0.89**	**$ 0.89**	**$ 0.89**		
Annual Per Diem Bed Count	127,867	110,117	44,856		
Questioned Revenue[2]	**$ 113,802**	**$ 98,004**	**$ 39,922**	**$251,728**	
Grand Total	**$ 265,964**	**$ 229,043**	**$ 93,301**	**$588,308**	**$2.08**

[1] Per Diem Rate calculation: (Total Budgeted Expenditures / 360 Beds)/365 days per year (366 for fiscal year 07-08 – leap year).
[2] Questioned Revenue = Per Diem Overstatement x Annual Bed Count.

Criteria: *Financial Management Requirements for Community Correctional Facilities, November 2005* (Handbook), section III.A, states Cornell agrees to provide services as specified in the Contract. Corrections will compensate Cornell in accordance with the rates specified for services satisfactorily rendered.

Handbook, section III.A.1.h.ii, states the food cost category must only include food items used in the preparation of a meal.

Recommendations:

A. Refund to Corrections $588,308:

   a. $336,580 in duplicated food service personnel payments received.

   b. $251,728 in invoiced program consultant services not provided.

B. Ensure duplicative costs are not included in future budget per diem contract rates.

C. Ensure compensated services are satisfactorily rendered in conformance with the contract budget in future contracts. Should revisions be necessary, follow the budget revision procedures detailed in the Handbook.

FINDING 2 Questioned Expenses

Condition: Questioned Operating Expenses totaling $721,042 were identified in the Quarterly Cost Report (QCR). The questioned amounts consist of unallowable Intercompany Rent totaling $700,503 and the erroneous reporting of Other Insurance totaling $20,539. See Table 2 for details.

Table 2: Summary of Questioned Expenses

Operating Expenses	2007-08	2008-09	2009-10	Total
Intercompany Rent	$ 268,175	$ 288,577	$ 143,751	**$ 700,503**
Other Insurance	(18,066)	26,866	11,739	**20,539**
Total Questioned	**$ 250,109**	**$ 315,443**	**$ 155,490**	**$ 721,042**

Intercompany Rent
Cornell reported $700,503 of unallowable Operating Expenses in its QCRs. The unallowable expenditures included: Intercompany Rent for Buildings, and Improvements, Furniture, Fixtures, and Equipment reported within the Maintenance, Repair, and Rentals subcategory of the QCR's Operating Expenses.

The unallowable expenditures consisted of leased equipment depreciation expenses and $308,254 (44 percent) in capital charges levied by Cornell's wholly owned subsidiary, WPB (lessor).

Contract R05.003 between Cornell and Corrections and the Handbook prohibits all such equipment charges. Consequently, we question the $700,503 Intercompany Rent expenditures reported in the QCRs.

Other Insurance
Cornell incorrectly reported its Other Insurance costs within the QCR's Operating Expenses category. We identified an understatement for 2007-08 of $18,066 and overstatements for 2008-09 and 2009-10 of $26,866 and $11,739 respectively. See Table 3 for calculations.

Per Cornell Management, the overstatements were made in current reports to correct prior year errors rather than reissue prior year reports. This inconsistent and incorrect reporting merely compounds the errors and renders the QCR incomparable between fiscal years and among CCF facilities.

Table 3: Other Insurance Misstatements

Expense per Calendar Year	**2007**	**2008**	**2009**
Other Insurance:			
Performance Bond	$ 63,000	$ 36,133	$ 36,133
Employee Fiduciary, Crime	8,797	4,611	4,609
Earthquake, Flood & DIC	16,679	52,000	37,415
Total Insurance Expense Incurred	**$ 88,476**	**$ 92,744**	**$ 78,157**
Fiscal Year Allocation[3]	**2007-08**	**2008-09**	**2009-10**
Expenses Incurred	$ 90,610	$ 85,451	$ 39,079
Expenses Reported in QCR	72,544	112,317	50,818
Over / (Under) statement	**$(18,066)**	**$ 26,866**	**$ 11,739**

Criteria:

Handbook, section II, states Cornell is responsible for complying with the reporting requirements of the Contract, including accuracy of expenditures claimed.

Handbook, section III.A.1.e states that the Cornell is responsible for the identification, procurement, installation, removal, repair, maintenance and/or replacement of all furniture, fixtures, and equipment that are necessary for the operation of the facility.

Handbook, section III.A.1.e states that a complete inventory of all furniture, fixtures, and equipment shall be submitted to Corrections on an annual basis. Any changes shall be reported quarterly. Corrections will not be responsible for any increase in equipment or related costs.

Handbook, section III.A.2, states costs not supported by source documentation (regardless of the type of costs) are not allowable.

Handbook, section IV.B, states Corrections will consider QCRs received to be accurate and will be used to monitor use of funds.

Handbook, section III.A.1 provides that Corrections or its designee reserves the right to question any and all costs.

[3] Fiscal Year Allocation equals half the expenses of the respective calendar years added together. For 2009-10, only half the 2009 expenses are allocated due to Facility closure prior to 2010.

Contract R05.003, General Scope of Work item 11 deleted the 1995 Handbook Section IV.C.5.b which allowed for equipment depreciation charges; and replaced the language with the following:

> "The contractor shall be responsible for the procurement, installation/removal, repair, maintenance, and or replacement of all furniture, fixtures, and equipment deemed necessary to operate the facility pursuant to the terms of the contract. Corrections will provide its own on-site staff with office furniture and equipment…."

Contract R05.003, General Scope of Work item 12 states "The contractor shall prepare and maintain an inventory of all equipment utilized in the operation of the facility…Changes, if any shall be made by the Contractor…Corrections shall have no obligation to increase payments to the Contractor for potential increases to furniture, fixtures, and equipment costs."

Recommendations:

A. Revise and resubmit the fiscal year 2007-08, 2008-09, and 2009-10 QCRs to properly reflect allowable Operating Expenses.

B. Ensure costs reported in the QCRs are allowable under the terms of the Contract agreement and Handbook.

C. Ensure adequate supporting documentation is retained and provided for audit in accordance with the Handbook.

FINDING 3 Reported Expenditures Are Not Consistent With Contract Budget

Condition: During the contract periods reviewed, Cornell reported Facility expenditures that significantly deviated from the contracted line item budgets. Table 4 details the line item deviations by fiscal year.

Cornell did not request Corrections' prior approval for line item transfers exceeding $10,000 or more than 10 percent of the related budget category, as required in the Handbook. The Handbook provision helps minimize the potential risks of reducing services to inmates in order to maximize the corporate fee. See Appendix A.

Table 4: Expenditures Significantly Deviating From Contract Budget

Fiscal Year 2007-08

Category	Contract Budget	Reported	Over/(Under)	Percentage
Food	$ 546,394	$ 533,054	$ (13,340)	(2%)
Transportation	23,371	31,068	7,697	33%
Consultant Services	118,192	(2,846)	(121,038)	(102%)
Operating Expenses	1,487,180	1,329,609	(157,571)	(11%)
Administrative Overhead	685,335	404,966	(280,369)	(41%)
Facility Lease/Use	1,708,200	1,841,200	133,000	8%
General Liability Insurance	48,618	54,998	6,380	13%
Total	$4,617,290	$4,192,049	$ (425,241)	(9%)

Fiscal Year 2008-09

Category	Contract Budget	Reported	Over/(Under)	Percentage
Staff Salaries and Benefits	$2,405,703	$2,607,152	$ 201,449	8%
Food	544,945	513,073	(31,872)	(6%)
Consultant Services	117,869	0	(117,869)	(100%)
Operating Expenses	1,483,184	1,125,194	(357,990)	(24%)
Facility Lease/ Use	1,708,200	1,841,200	133,000	8%
General Liability Insurance	48,618	56,957	8,339	17%
Total	$6,308,519	$6,143,576	$ (164,943)	(3%)

Fiscal Year 2009-10 (July 1, 2009 through December 31, 2009)

Category	Contract Budget*	Reported	Over/(Under)	Percentage
Staff Salaries and Benefits	$1,202,852	$1,097,500	$ (105,352)	(9%)
Food	272,473	196,143	(76,330)	(28%)
Consultant Services	58,935	0	(58,935)	(100%)
Operating Expenses	741,592	476,826	(264,766)	(36%)
Administrative Overhead	341,731	209,681	(132,050)	(39%)
Facility Lease/Use	854,100	890,903	36,803	4%
General Liability Insurance	24,309	31,205	6,896	28%
Total	$3,495,992	$2,902,258	$ (593,734)	(17%)

* *Budgeted expenditures are reported as 50 percent of the annual Contract budget amounts.*

Criteria: Handbook, section D, requires Cornell to obtain prior written approval from Corrections for "any change(s) to a budget line item funding that exceeds $10,000 or 10 percent of any line item in the contract allotment…before implementation." The Budget Revision Form is to be used when the contractor wishes to adjust funding or staffing based on actual spending patterns by increasing or decreasing the budget from one line item to another.

Recommendation:
Obtain Corrections' advance approval prior to transferring funds in excess of $10,000 or more than 10 percent among line item categories in future contracts.

FINDING 4 Inmate Welfare Fund Misstatements

Condition: Cornell misstated its Inmate Welfare Fund (IWF) Staff Salaries and Benefits and Operating Expenses by $112,274 for the periods reviewed (as shown in Table 5 below). Cornell paid IWF salaries from the Facility's Operating Fund but erroneously recorded the subsequent reimbursement as a reduction of its Operating Expenses rather than Staff Salaries and Benefits. Consequently, the reported Staff Salaries and Benefits is overstated and Operating Expenses is understated. However, the overall net effect to the QCR is zero.

Table 5: Schedule of IWF Misstatements

	2007-08	2008-09	2009-10	Total
IWF Salaries claimed as Operating Expenses	$ 25,998	$ 60,456	$ 25,820	**$112,274**

Criteria: Handbook, section III.C, states Cornell's accounting system must ensure the accounting records will provide information necessary to identify all receipts and expenditures of program funds.

Handbook, section IV.B, states Corrections will consider QCRs received to be accurate and will be used to monitor use of funds.

Recommendation: Revise and resubmit fiscal year 2007-08, 2008-09, and 2009-10 QCRs to properly present the IWF salaries and operating expenses.

FINDING 5 **Incorrect Corporate Fee Reporting**

Condition: Cornell incorrectly included the Facility's operating profit/loss in the Corporate Fee reported on the QCR. We identified an overstatement for 2007-08 of $296,319 and understatements for 2008-09 and 2009-10 of $735,485 and $317,061, respectively. See Table 6 for calculations.

Table 6: Schedule of Corporate Fee Misstatements

	2007-08	2008-09	2009-10
Reported Revenue	$7,201,666	$ 6,417,765	$ 2,748,835
Less: Reported Expenditures	6,601,584	6,850,317	2,914,429
Contracted Corporate Fee	303,763	302,933	151,467
Corporate Fee Over/(Under)statement	**$ 296,319**	**$ (735,485)**	**$ (317,061)**

Criteria: Handbook, section B, states the Contractor Fee shall be reported as a stand-alone item below the profit/loss line item.

Recommendation: Revise and resubmit fiscal year 2007-08, 2008-09, and 2009-10 QCRs to properly present the Corporate Fee.

OBSERVATION 1 Inmate Trust and Inmate Welfare Funds Cash Balance Close-Out

The Inmate Trust Fund (ITF) and Inmate Welfare Fund (IWF) reported closing cash balances at December 31, 2009 as follows:

FUND	Closing Cash Balance
ITF	$ 15,566
IWF	$ 9,190
Total	**$ 24,756**

See Appendices B and C, respectively, for a detailed summary.

Recommendation: Remit the closing ITF and IWF cash balance of $24,756 to Corrections.

Appendix A

Schedule of Reported and Audited Revenue and Expenditures

Mesa Verde Community Correctional Facility Contract R05.003 Schedule of Reported and Audited Revenue and Expenditures For the Period July 1, 2007 through June 30, 2008				
Category	**Contract Budget**	**Reported**	**Questioned**	**Audited**
Revenue	$7,333,186	$7,201,666	$ (265,964)[4]	$6,935,702
Expenditures:				
Staff Salaries and Benefits	2,412,133	2,409,535	(25,998)[5]	2,383,537
Food	546,394	533,054	0	533,054
Transportation	23,371	31,068	0	31,068
Consulting/Contracted Services	118,192	(2,846)[6]	0	(2,846)
Operating Expenses	1,487,180	1,329,609	(224,111)[7]	1,105,498
Administrative Overhead	685,335	404,966	0	404,966
Facility Lease/Use	1,708,200	1,841,200	0	1,841,200
General Liability Insurance	48,618	54,998	0	54,998
Total Expenditures	$7,029,423	$6,601,584	$ (250,109)	$6,351,475
Profit/(Loss)				$ 584,227
Corporate Fee	$ 303,763	$ 600,082	$ (296,319)[8]	$ 303,763

[4] See Finding 1
[5] See Finding 4
[6] Negative expenditure due to reversal of prior year accrual.
[7] See Findings 2 and 4
[8] See Finding 5

Mesa Verde Community Correctional Facility Contract R05.003 Schedule of Reported and Audited Revenue and Expenditures For the Period July 1, 2008 through June 30, 2009				
Category	**Contract Budget**	**Reported**	**Questioned**	**Audited**
Revenue	$7,318,221	$6,417,765	$(229,043)[9]	$6,188,722
Expenditures:				
Staff Salaries and Benefits	2,405,703	2,607,152	(60,456)[10]	2,546,696
Food	544,945	513,073	0	513,073
Transportation	23,307	23,279	0	23,279
Consulting/Contracted Services	117,869	0	0	0
Operating Expenses	1,483,184	1,125,194	(254,987)[11]	870,207
Administrative Overhead	683,462	683,462	0	683,462
Facility Lease/Use	1,708,200	1,841,200	0	1,841,200
General Liability Insurance	48,618	56,957	0	56,957
Total Expenditures	$7,015,288	$6,850,317	$ (315,443)	$6,534,874
Profit/(Loss)				$ (346,152)
Corporate Fee	$ 302,933	$ (432,552)	$ 735,485[12]	$ 302,933

[9] See Finding 1
[10] See Finding 4
[11] See Findings 2 and 4
[12] See Finding 5

SCHEDULE OF REPORTED AND AUDITED REVENUE AND EXPENDITURES

Mesa Verde Community Correctional Facility Contract R05.003 Schedule of Reported and Audited Revenue and Expenditures For the Period July 1, 2009 through December 31, 2009				
Category	**Contract Budget**[13]	**Reported**	**Questioned**	**Audited**
Revenue	$ 3,659,111	$2,748,835	$(93,301) [14]	$2,655,534
Expenditures:				
Staff Salaries and Benefits	1,202,852	1,097,500	(25,820) [15]	1,071,680
Food	272,472	196,143	0	196,143
Transportation	11,653	12,171	0	12,171
Consulting/Contracted Services	58,935	0	0	0
Operating Expenses	741,592	476,826	(129,670) [16]	347,156
Administrative Overhead	341,731	209,681	0	209,681
Facility Lease/Use	854,100	890,903	0	890,903
General Liability Insurance	24,309	31,205	0	31,205
Total Expenditures	$ 3,507,644	$2,914,429	$(155,490)	$2,758,939
Profit/(Loss)				$ (103,405)
Corporate Fee	$ 151,467	$ (165,594)	$317,061 [17]	$ 151,467

[13] Contract Budget reported at 50 percent as the schedule represents half the fiscal year due to Facility closure.
[14] See Finding 1
[15] See Finding 4
[16] See Findings 2 and 4
[17] See Finding 5

Appendix B
Inmate Trust Fund Balances

Mesa Verde Community Correctional Facility Contract R05.003 Inmate Trust Fund Balances For the Period July 1, 2007 through December 31, 2009			
	July 1, 2007 through June 30, 2008	**July 1, 2008 through June 30, 2009**	**July 1, 2009 through December 31, 2009**[18]
Beginning Balance	$60,613	$58,037	$43,303
Deposits	299,852	248,937	66,322
Disbursements	(302,428)	(263,671)	(94,059)
Ending Balance	**$58,037**	**$43,303**	**$15,566**[19]

[18] Balance includes activity occurring during January and February, 2010.
[19] Refer to Other Observations, Observation 1, for disposition of the ITF ending cash balance at closure.

APPENDIX C
INMATE WELFARE FUND BALANCES

Mesa Verde Community Correctional Facility Contract R05.003 Inmate Welfare Fund Balances For the Period July 1, 2007 through December 31, 2009			
	July 1, 2007 through June 30, 2008	**July 1, 2008 through June 30, 2009**	**July 1, 2009 through December 31, 2009**[20]
Beginning Balance	$43,867	$74,268	$30,829
Deposits	175,830	78,868	44,281
Disbursements	(145,429)	(122,307)	(65,920)
Ending Balance	**$74,268**	**$30,829**	**$ 9,190**[21]

[20] Balance includes activity occurring during January and February, 2010.
[21] Refer to Other Observations, Observation 1, for disposition of the IWF ending cash balance at closure.

The GEO Group, Inc.

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November 30, 2010

Mr. David Botelho, CPA
Department of Finance
Chief, Office of State Audits and Evaluations
300 Capitol Mall, Suite 801
Sacramento, CA 05814

Dear Mr. Botelho:

I am writing to you in response to your communication dated October 11, 2010 regarding the Draft Audit Report – Mesa Verde Community Correctional Facility, Contract R05.003 (Report).

In the Report there were various findings (summarized below) to which we have provided initial comments for each on an individual basis as noted:

Finding 1 - Inflated Per Diem Rate

The per diem rate paid to Cornell was inflated resulting in $588,308 of questionable revenue received by the Facility. Included in budget estimates were duplicate food service costs of $336,580 and unexpended funds for consultant services of $251,728. We recommend Cornell refund Corrections $588,308.

Management Response

Cornell believes that food costs of $336,580 were not duplicated and this is an issue related to the allocation within budget allotment categories. In this case, food services staff costs and food cost per meal were budgeted separately on the Contract Budget Allotment at the request of Corrections. Subsequent to the contract award, Cornell contracted food service operations to an independent third party. As a result, the actual costs incurred with the food service contractor were reported on the Quarterly Cost Reports (QCRs) under the Food Services line item. Costs reported in the Staff Salaries & Benefits line item do not reflect any food service staff costs as these were included in the costs for the food service contractor. A Budget Revision Form to move the food service staff salaries from the personnel category to the food category was not submitted because:

1. All services were provided as required by the contract.
2. All personnel were provided as per the staffing plan - food service personnel were provided by the food service contractor.

3. Actual costs incurred per the QCRs for both Food Services and Staff Salaries & Benefits were in line with the Contract Budget Allotment and within the established 10%/$10,000 threshold.

Only during the period July 1, 2009 to December 31, 2009 was the variance in excess of 10% primarily due to the closeout of the contract and related reduction in population to zero.

The remaining amount in question of $251,728 relates to Consultant Services. During the procurement process it was anticipated that certain facility services would be provided by outside consultants, however, during actual operations it was determined that these services could be more effectively rendered in-house. In an effort to align the actual operations with the Contract Budget Allotment a Budget Revision Form was sent to Corrections, which included the appropriate adjustment to Consultant Services. However, a signed copy was never received back from Corrections. A copy of the submission was provided to the auditors.

It is important to note that the Contract Budget Allotment was an estimate of a number of expense categories that were rolled up into a per diem and competitively bid during the procurement process. Contract invoices were based on a per diem, not a cost-plus format. The budget allotment and subsequent per diem were based on 100% occupancy. However, during the audit period in question the actual inmate population was approximately 87% resulting in a shortfall of revenue of approximately $1.8 million, much of which could not be mitigated due to the predominately fixed nature of the operating costs. Therefore, the per diem is not inflated, rather it is significantly deflated. Furthermore, this shortfall in revenue resulted in actual Corporate Fee (profit/loss) of $1,936 as opposed to the Contract Budget Allotment amount of $758,163 - this is a loss to Cornell of over three quarters of a million dollars as reported. Therefore, a "refund" of any expense line funds is neither warranted nor justified.

Cornell believes all compensated services were performed in accordance with the contract and is confused by *Recommendation C* which implies Mesa Verde CCF did not provide satisfactory services. Cornell seeks clarification of this recommendation including any formal documentation the auditor received from Corrections indicating compensated services were less than satisfactory.

Finding 2 – Questioned Expenses

Questioned operating expenses totaling $721,042 were identified in the Quarterly Cost Report. The questioned amount consists of unsupported Intercompany Rent totaling $700,503 and incorrectly reported Other Insurance totaling $20,539. We recommend Cornell refund Corrections $549,619 for unjustified per diem payments and revise and resubmit its QCRs to properly present supported Operating Expenses.

Management Response

Intercompany Rent is the result of a sale-leaseback of capital expenditures provided to the facility. This expense was calculated using depreciation expense and an allocated cost of capital (i.e., interest at 10% of asset value). Attached to this report are detailed asset listings supporting the assets underlying the calculation of the rent charge. The table below summarizes this support:

Period	Rent Charge Per QCR	WBP Depreciation	WBP Capital Charge	Total Charge	Difference
7/07 - 6/08	$268,175	$141,833	$117,232	$259,065	$(9,110)
7/08 - 6/09	$288,577	$168,238	$142,844	$311,082	$22,505
7/09 - 12/09	$143,751	$82,178	$69,440	$151,618	$7,867

A copy of the lease agreement was provided to the auditors during field work as support for the reported expenses. However the underlying asset detail was not provided. We request the audit team reconsider this finding in light of the additional information being provided.

Finding 3 – Reported Expenses Are Not Consistent With Contract Budget

The facility transferred budgeted funds from one line item to another by more than $10,000 or more than 10 percent without Corrections' prior approval. We recommend Cornell request and receive Corrections' approval prior to transferring funds among line item categories that exceed established limits on any future contracts.

Management Response

As per the Department of Finance's recommendation, Cornell will seek to obtain Corrections' approval prior to incurring program expenditures in excess of $10,000 or 10 percent of the budgeted line items where necessary.

Finding 4 – Inmate Welfare Misstatements

The facility overstated payroll and understated operating expenses in the QCR due to the misclassification of wages paid from the Inmate Welfare Fund (IWF). We recommend Cornell revise and resubmit its QCRs to properly present IWF salaries and operating expenses.

Management Response

As noted in the Report, the overall net effect to the QCR is zero. On a forward basis, Cornell will deduct wages paid from the IWF to the proper line item.

Finding 5 – Incorrect Corporate Fee Reporting

The Corporate Fee reported in the QCR incorrectly included the Facility operating profit/loss. We recommend Cornell and revise and resubmit its QCRs to properly present the Corporate Fee.

Management Response

On a forward basis, Cornell will present its Corporate Fee on a separate line item below the profit/loss line item.

Observation 1 – Inmate Trust and Inmate Welfare Funds Cash Balance Close-Out

Cornell is to remit to Corrections the December 31, 2009 combined residual IWF and Inmate Trust Fund (ITF) cash balances totaling $24,756 to effectively close the Facility.

Management Response

Cornell is near completion of the final reconciliation of the ITF and IWF accounts and will forward the balances to Corrections as directed.

Cornell appreciates the professionalism of the Department of Finance and their personnel during the audit of the Mesa Verde Community Correctional Facility and the opportunity to respond to the preliminary audit findings. Further, we greatly appreciate your review of our responses and the reconsideration of the audit results. If you require any additional information please do not hesitate to contact me at (561)-999-7421.

We believe we have provided quality and professional services to the Department of Corrections and look forward to building on our successful relationship.

Sincerely,

Original signed by:

Ronald A. Brack
Vice President, Chief Accounting Officer and Controller

cc: Brian Evans, Senior Vice President, Chief Financial Officer, GEO
John Hurley, Senior Vice President, Operations, GEO
Amber Martin, Vice President, Contracts Administration, GEO
Kyle Schiller, Vice President, Operations-Administration, GEO
Chuck Hill, WR Director of Business Management, GEO

We have reviewed The Geo Group, Inc.'s (Geo Group) November 30, 2010 response (on behalf of Cornell[22]) which is incorporated into this final report. Attachments referenced in the response have been omitted in the interest of brevity. In this evaluation, we do not provide additional comments on findings where the Facility agrees, or proposes adequate action. However, for findings where the Facility did not agree, did not propose adequate action, or where we deem additional comments necessary, we provide the following evaluation:

Finding 1: Inflated Per Diem Rate
Cornell disagrees with this finding and believes food costs were not duplicated. However, Cornell acknowledges that food preparation personnel staff costs and food costs were budgeted separately, and that both costs were were borne by its food service subcontractor and paid for entirely within the Food line item of the Facility's budget. As presented in Appendix A, for all periods audited, the Food expendiures reported were less than the budgeted amounts. Accordingly, the budgeted food service personnel line item was unncessary for the Facility's operation and therefore is duplicative in the per diem calculation. The Handbook requires Cornell to submit a budget revision to notify Corrections of the unnecessary food service personnel budgeted line item. The response acknowledges that Cornell did not submit the required budget revision.

Additionally, Cornell contends that Consultant Services were provided in-house and a budget revision was submitted to Corrections. However, an approved budget revision or other evidence substantiating what services were provided, how the services were rendered in-house, and at what cost was not submitted to substantiate their claim.

Handbook, section D requires Cornell to obtain prior written approval from Corrections for any change(s) to a budget line item funding that exceeds $10,000 or 10 percent of any line item in the contract allotment…before implementation. The Budget Revision Form is to be used when the contractor wishes to adjust funding or staffing based on actual spending patterns by increasing or decreasing the budget allotment from one line item to another.

Cornell also contends that because the budget allotment and subsequent per diem were based on 100 percent occupancy while the actual inmate population was approximately 87 percent, the resulting revenue shortfall of approximately $1.8 million implies the per diem is not inflated. According to Contract R05.003, Corrections recognizes that contractors are entitled to fair and reasonable compensation, including a reasonable profit in return for operating the facility. Historically, Corrections has provided for a "per diem" payment rate as the sole source of contractor profit; however, that profit is not guaranteed. Therefore, the 100 percent occupancy rate is a measure of the maximum achievable per diem revenue under the contract. However, the contract states that if the monthly participant days falls below 70 percent of total participant days available for a specific month, Corrections will pay the contractor at the per diem rate for 70 percent of

[22] Cornell was acquired by The Geo Group on August 12, 2010. Therefore, The Geo Group responded to our draft report on behalf of Cornell.

the total participant days available for that specific month. Consequently, an occupancy rate of 87 percent falls within the range of reasonable compensation under the contract.

Because Cornell did not provide evidence (via approved budget revisions or other documentation) that Food Services Personnel and Consultant Services were pre-authorized to be reallocated, maintaining the Food Services Personnel and Consultant Services as cost drivers in the per diem calculations inflates the per diem rate. Therefore, our finding remains as originally reported.

Finding 1, Recommendation C was clarified to reflect that in future contracts, ensure services are satisfactorily rendered in conformance with the contract budget. Should changes be necessary, follow the budget revision procedures as specified in the Handbook.

Finding 2: Questioned Expenses

During audit fieldwork, Cornell's management refused to provide records supporting $700,503 Intercompany Rent claimed in the monthly per diem invoices. However, in its response, Geo Group stated the amounts reported were related to depreciation expenses for leased equipment and included an asset inventory and depreciation schedule on which the $700,503 was based. Upon review, we identified that, in addition to depreciation charges, Cornell included $308,254 (i.e. 44% of the $700,503) as a capital charge levied by its wholly owned subsidiary, WPB (lessor).

Contract R05.003 between Cornell and Corrections prohibits all such equipment charges. Specifically, the General Scope of Work states:

"The Contractor agrees to provide a secure facility for the housing, sustenance, supervision, security, care, custody, programming, approved correctional programs, materials and equipment for male/female inmates eligible for placement in a Community Correctional Facility …"

Additionally, the Contract's General Scope of Work item 11 deleted the 1995 Handbook Section IV.C.5.b which allowed for depreciation charges; and replaced the language with the following:

"The contractor shall be responsible for the procurement, installation/removal, repair, maintenance, and or replacement of all furniture, fixtures, and equipment deemed necessary to operate the facility pursuant to the terms of the contract. Corrections will provide its own on-site staff with office furniture and equipment…."

Additionally, item 12 states "The contractor shall prepare and maintain an inventory of all equipment utilized in the operation of the facility…Changes, if any shall be made by the Contractor…Corrections shall have no obligation to increase payments to the Contractor for potential increases to furniture, fixtures, and equipment costs."

We therefore revised Finding 2 and the related recommendations to question the $700,503 Intercompany Rent claimed in the QCRs as unallowable expenses.

Finding 5: Incorrect Corporate Fee Reporting

Upon review of Cornell's response, we identified an error in the presentation of the Corporate Fee in Appendix A. Specifically, the Handbook states the Service Fee is to be reported as a stand-alone item below the profit/loss line item. Therefore, we revised the Corporate Fee presentation in Appendix A to be in conformance with the Handbook.