DEPARTMENT OF FINANCE

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December 12, 2007

Ms. Pamela A. Prudhomme, Chief
California Department of Corrections and Rehabilitation
Community Correctional Facilities Administration
P.O. Box 942883
Sacramento, CA 94283-0001

Dear Ms. Prudhomme:

Final Audit Report—Adelanto Community Correctional Facility Contract R89.1591.103

Enclosed is our final report on Adelanto Community Correctional Facility (Facility) for the period July 1, 2004 through June 30, 2006. The Department of Finance, Office of State Audits and Evaluations, performed this audit under an interagency agreement with the California Department of Corrections and Rehabilitation (Corrections).

The scope of work included a fiscal compliance audit of the contract between the Facility and Corrections. We reviewed revenue and expenditures, internal control, and compliance with contract provisions. Additionally, we reviewed the Inmate Telephone Revenue Fund, Equipment Replacement Fund, Inmate Welfare Fund, Debt Service Fund, and Inmate Trust Fund transactions for completeness.

The Facility's response and our evaluation of its response are incorporated into this report.

If you have any questions regarding this report, please contact Frances Parmelee, Manager, or Zach Stacy, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

Janet I. Rosman, Assistant Chief
Office of State Audits and Evaluations

Enclosure

cc: On following page

cc: Mr. James Hart, City Manager, City of Adelanto
Mr. Calvin White, Facility Director, Adelanto Community Correctional Facility
Mr. Terry Dickinson, Correctional Administrator, Community Correctional Facilities Administration, California Department of Corrections and Rehabilitation
Mr. Michael Enos, Facility Captain, Community Correctional Facilities Administration, California Department of Corrections and Rehabilitation
Mr. Robert Logan, Staff Services Manager I, Special Projects, Community Correctional Facilities Administration, California Department of Corrections and Rehabilitation
Mr. Otis Crockette, Contract Analyst, Community Correctional Facilities Administration, California Department of Corrections and Rehabilitation
Ms. Kim Holt, External Audits Coordinator, Office of Audits and Compliance, California Department of Corrections and Rehabilitation
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A Fiscal Compliance Audit

Adelanto Community Correctional Facility
Contract R89.1591.103
For the Period July 1, 2004
through June 30, 2006

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

075225113 DIR

October 2007

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PREFACE

The California Department of Corrections and Rehabilitation (Corrections) entered into a contract with the City of Adelanto (City), giving the City responsibility for the operation of the Adelanto Community Correctional Facility (Facility). The City is responsible for providing inmate housing and sustenance as well as coordinating inmate activities within the Facility. Under the direction of on-site Corrections staff, the City also assists with the custody of inmates and the security of the Facility. The Facility, located in San Bernardino County, began operations in 1990 and is designed to house 500 inmates, including overcrowding capacity and high occupancy.

At the request of Corrections, we performed a fiscal compliance audit of contract R89.1591.103 for the period July 1, 2004 through June 30, 2006. The audit objectives were:

- To determine whether the Facility's cost reports accurately represent revenue received and expenditures incurred.

- To determine whether the Facility's internal control allows for the accurate and timely development of cost reporting data and adequate safeguarding of state assets.

- To determine the Facility's compliance with the contract's fiscal and reporting requirements.

This report is intended solely for the information and use of City and Corrections management, and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

STAFF:

Frances Parmelee, CPA
Manager

Zach Stacy
Supervisor

KieuChinh Tran
Charles White
Toni Silva

EXECUTIVE SUMMARY

The California Department of Corrections and Rehabilitation (Corrections) requested the Department of Finance, Office of State Audits and Evaluations, to perform a fiscal compliance audit of contract R89.1591.103 for the period July 1, 2004 through June 30, 2006.

Our findings and identified risks are summarized below. For further details, refer to the *Findings and Recommendations* and *Other Identified Risks* sections of this report.

- ***Inmate Telephone Revenue Fund Access Prohibited:*** The City of Adelanto (City) only allowed access to the Inmate Telephone Revenue Fund (ITRF) records starting July 1, 2004. In October 2004, the Facility transferred $286,191 from the ITRF to a new account maintained by the City. Access to the new account was requested but it was denied. As a result, material ITRF transactions, including the beginning balances, were not audited and the aggregate ending ITRF balance as of June 30, 2006 could not be substantiated. Prohibited access to the ITRF was noted in our prior audit reports.

- ***Misstated Equipment Replacement Fund Balance:*** Prior to March 2000, the Facility did not maintain an Equipment Replacement Fund (ERF). Rather, ERF funding was retained as part of operating revenue. In March 2000, the Facility established the ERF with an initial deposit of $5,000; however, the amount was not based on the actual contracted monthly deposit due to the ERF. The Facility is in the process of calculating the appropriate ERF balance and has compiled a Master Property Inventory List (List) to support eligible ERF purchases since contract inception. However, multiple errors were found on the List and several items listed did not meet the criteria for non-expendable equipment. Additionally, the overcrowding funding was not calculated or deposited into the ERF resulting in contributions being less than the contract requirement.

- ***Questioned Expenditures:*** Questioned expenditures of $48,000 in unallowable fines, penalties, and legal expenditures and $1,811 in unallowable employee morale expenditures were identified.

- ***Unsupported Administrative Overhead Expenditures:*** The Facility reported $226,752 during fiscal years 2004-05 and 2005-06 as administrative overhead. However, these amounts were the budgeted contract amounts and were not based on a formal citywide cost allocation plan with written justification for the methodology used. Additionally, the plan, which contains unallowable and unsupported expenditures, was not submitted to Corrections for approval.

- ***Inaccurate Statements of Program Income and Expenses:*** Our review of the Facility's general ledgers identified variances between the general ledgers and the Statements. Interest income, ERF transfers, and service fees were not accurately reflected in the Statements.

- ***Misstatement of the Inmate Welfare Fund Balance:*** The Inmate Welfare Fund (IWF) may be misstated. Specifically, our audit identified that the Inmate Trust Fund (ITF) is maintained in an interest bearing account; however, earned interest is transferred to the Facility's General Fund instead of the IWF. Also, the IWF contained "Due To" and "Due From" balances. The City explained that these balances were not truly due to/due from other funds; however, the City could not provide adequate support to substantiate these balances.

- ***Internal Control Weaknesses:*** For the IWF and General Fund, inadequate separation of duties exists with the Facility's cash receipting and disbursement functions. Other instances of inadequate separation of duties were identified over the ITF and the canteen. The ITF also has numerous outstanding checks dating as far back as 1999.

- ***Inaccurate Annual Reports:*** Purchases of equipment have not been added to the annual reports' fixed asset categories for 2003-04, 2004-05, and 2005-06; therefore, the annual reports submitted to Corrections are unreliable.

The severity of the following identified risks is not raised to the level of a finding but warrants disclosure.

- ***Failure to Tag Equipment:*** Equipment was purchased from the ITRF with approval from Corrections. However, the Facility failed to tag the equipment with State decals as requested by Corrections.

- ***Pending Litigation:*** The City's legal counsel reported information regarding litigation which involves claims asserted by or on behalf of the bargaining units of Facility employees.

BACKGROUND, SCOPE, AND METHODOLOGY

BACKGROUND

The California Department of Corrections and Rehabilitation (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. Of the seven contracts awarded to public entities under this Program, one was awarded to the City of Adelanto, Adelanto Community Correctional Facility (Facility).

As stipulated by contract R89.1591.103, the Facility's funding is a combination of flat rate expenditures reimbursement and per diem funding. The Facility receives a monthly flat rate of $413,543 ($4,962,516 annually), and $417,148 ($5,005,776 annually) for fiscal years 2004-05 and 2005-06, respectively, to cover various contract expenditures including salaries and benefits, insurance, administrative overhead, general operating expenditures, and service fees.

During 2004-05 and 2005-06, the Facility also received a regular per diem rate of $3.80 per participant for the first 380 participants per day (up to a maximum annual amount of $527,060). Over and above the regular per diem rate, the Facility was allowed an overcrowding rate of $10.60 per participant day for up to 97 additional occupied beds (up to a maximum annual amount of $375,293). The Facility was allowed a high occupancy rate of $5.60 (up to a maximum annual amount of $47,012) if it operated with occupancy over 477 participants per day (i.e., 380 participants at the regular per diem rate plus 97 participants at the overcrowding per diem rate). The combined maximum annual amount the Facility could receive for per diem reimbursement is $949,365. The per diem reimbursement is designed to cover food, clothing, and any additional expenditures associated with overcrowding or high occupancy.

The Facility also maintains several funds required to be accounted for separately. Below is a description of each fund held by the Facility:

- *Equipment Replacement Fund*—Contract funds allocated for the replacement of Facility equipment.
- *Telephone Revenue Fund*—Special program funds received for inmate telephone services designed for specific activities outlined in the contract.
- *Inmate Welfare Fund*—A fund operated for the benefit and welfare of the inmates who are under the jurisdiction of Corrections.

- *Inmate Trust Fund*—A fund that accounts for the funds belonging to the inmates through work performed or money received from family or friends.
- *Debt Service Fund*—Accounts for the debt service on the outstanding bonds.

Appendix B presents fund balances as of June 30, 2005 and 2006.

SCOPE AND OBJECTIVES

Under an interagency agreement with Corrections, the Department of Finance, Office of State Audits and Evaluations, performed a fiscal compliance audit of contract R89.1591.103 between the City of Adelanto (City) and Corrections for the period July 1, 2004 through June 30, 2006. The audit objectives were:

- To determine whether the Facility's cost reports accurately represent revenue received and expenditures incurred.
- To determine whether the Facility's internal control allows for the accurate and timely development of cost reporting data and adequate safeguarding of state assets.
- To determine the Facility's compliance with the contract's fiscal and reporting requirements.

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 and observations of Facility staff. A judgmentally 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 and the *Financial Management Handbook for Public Community Correctional Centers* dated 1989 (Handbook) was performed to determine that selected items met eligibility requirements.

Selected transactions of the funds—Inmate Telephone Revenue Fund, Equipment Replacement Fund, Inmate Welfare Fund, Debt Service Fund, and Inmate Trust Fund—were performed to test for completeness and propriety. Our review included the following:

- General internal control assessment.
- Review of the Facility's general ledgers 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 while immaterial, non-reportable findings and observations were discussed with Facility representatives. Corrections requested that other identified risks that warranted disclosure be presented in the *Other Identified Risks* section of this report. 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. This review was conducted during the period May 2007 to September 2007.

We conducted our audit in accordance with *Generally Accepted 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 the performance of contract R89.1591.103, 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.

Original signed by Richard R. Sierra, CPA, for:

Janet I. Rosman, CPA
Assistant Chief, Office of State Audits and Evaluations
(916) 322-2985

October 5, 2007

FINDING 1 **Inmate Telephone Revenue Fund Access Prohibited**

Condition: The Facility only allowed access to the Inmate Telephone Revenue Fund (ITRF) records starting July 1, 2004. On July 1, 2004, the ITRF had an un-audited beginning balance of $291,504 because the Facility prohibited access to the ITRF. This is a condition that has been noted in our prior audit reports. In October 2004, a transfer of $286,191 was made from the ITRF to a new account maintained by the City. Access to the new account was requested, but our request was denied. As a result, the aggregate ending ITRF balance as of June 30, 2006 could not be substantiated.

Criteria: *Financial Management Handbook for Public Community Correctional Centers* dated 1989 (Handbook), Section III.D, states program income consists of, but is not limited to, contract revenue, other contributions, and donations. Program income must be recorded and identified to offset specific program expenditures.

Recommendation: Authorize access to all ITRF activity.

FINDING 2 **Misstated Equipment Replacement Fund Balance**

Condition: Prior to March 2000, the Facility did not maintain an Equipment Replacement Fund (ERF); rather, the ERF was retained as part of operating revenue and was not accounted for separately. Consequently, the Facility established the ERF in March 2000 with an initial deposit of $5,000. However, the deposit was not based on a sound methodology. The deposit should have been comprised of the contracted ERF monthly provisions less related equipment replacement expenditures since the contract inception. As a result, the ERF beginning balance for our audit period could not be substantiated.

This was a prior audit finding. In our December 2002 report, the Facility agreed to calculate the ERF fund balance using the required deposit amounts, eligible equipment replacement expenditures, and accrued interest. Our January 2005 report stated that the Facility was in the process of calculating the ERF balance. The Facility is currently still in the process of calculating the ERF balance which includes determining eligible equipment replacement expenditures.

For our current audit, a review of the Facility's process of calculating the ERF was performed. The Facility has developed a Master Property Inventory List and identified equipment purchases considered valid

equipment replacement expenditures. Based on our review of 20 items, 45 percent of the items reviewed were questioned. The following errors were identified:

- One item was a duplicate entry.
- One item was for leased equipment.
- One item showing an estimated cost of $1,500 was actually a donation.
- Five items could not be adequately supported with an invoice or other form of support.
- One item indicates it was purchased from the ITRF.

Several equipment items being identified by the Facility as equipment replacement expenditures did not meet the nonexpendable equipment criteria outlined in the Handbook.

Furthermore, although the Facility began making deposits into the ERF in March 2000, the contributions were less than what was required by the contract. For 2004-05 and 2005-06, the Facility annually deposited $33,792, which is consistent with the contract budget for on-going expenditures; however, the contract also includes overcrowding funding, which includes up to $5,680 annually in additional equipment funding that is not being deposited into the ERF.

Criteria:

The Handbook, Section III.C.6b, states that the contractor must establish an Equipment Replacement Fund Account. This account will be in an interest bearing account in which depreciation costs as identified in the Return to Custody Facility Equipment Schedule of the Memorandum of Understanding would be deposited by the contractor.

The Handbook, Section III.C.6a, states that the contractor is required to take a yearly inventory of contractor-owned nonexpendable equipment utilized in the program and submit to the Department of Corrections, Parole and Community Services Division, Reentry Administration.

Contract R89.1591.103, Amendment 7, Exhibit J.2 and Exhibit N, illustrates that equipment depreciation funding is $33,792 and $5,680, respectively.

Recommendations:

From contract inception to current, calculate the current ERF balance and make the appropriate transfers. For ERF revenue, ensure the calculation includes ongoing as well as overcrowding equipment depreciation expenditures plus any accrued interest. For ERF expenditures, ensure expenditures are valid and supported equipment replacement expenditures and that the nonexpendable criteria is met.

Deposit the appropriate amount to the ERF as required by the contract.

Regularly reconcile the Master Property Inventory List to the general fixed assets account balance to ensure accuracy and completeness.

FINDING 3 **Questioned Expenditures**

Condition: The Facility reported questionable General Fund expenditures. The two instances were as follows:

- The City settled a 1996 wrongful termination claim by a former employee and continues to pay and report the expenditure in the General Fund. Specifically, the court awarded $2,000 per month to be paid from April 1, 1996 through April 15, 2010 as a disability payment to compensate for pain, suffering, and emotional distress. The City paid $24,000 a year for pain and suffering damages to the former employee. In fiscal years 2004-05 and 2005-06, the Facility reported those General Fund expenditures in the Statement of Program Income and Expenses (Statement). Questioned expenditures for unallowable fines, penalties, and legal expenditures totaled $48,000.

  This is an uncorrected prior audit finding.

- Unallowable employee morale expenditures totaling $1,058 and $753 for 2004-05 and 2005-06, respectively, were reported. These expenditures were generally for holiday parties and monthly employee accommodations. While the amounts are not material, these expenditures should be excluded from reported expenditures.

Criteria: The Handbook, Appendix A, Section C.3, states that costs resulting from violations of or failure to comply with federal, state, and local laws and regulations are unallowable.

The Handbook, Appendix A, Section B.8, states that the cost of health or first aid clinic and/or infirmaries, recreational facilities, employees' counseling services, employee information publications and any related expense incurred in accordance with general state policy are allowable. However, holiday parties and monthly employee awards are not allowable State expenditures.

Recommendation: Discontinue reporting unallowable litigation settlement and employee morale expenditures. The City argues that settlement expenditures associated with an employee termination are not considered violations of or failure to comply with federal, state and local laws and regulations. The City claims it made an error in judgment in the termination of a former employee and in doing so, agreed to a settlement of the case for the amounts stipulated without admission of any guilt.

Corrections will make the final determination regarding these questioned expenditures.

FINDING 4 **Unsupported Administrative Overhead Expenditures**

Condition: Annually, the City charges the Facility administrative overhead of $226,752, an amount based on the budgeted contract amount. However, the cost allocation plans were not submitted to Corrections for approval and did not contain a written justification to support the percentage allocated to the Facility. Additionally, the cost allocation plans included city council expenditures, an unallowable expenditure. Lastly, the composition of line item "Non-Departmental" could not be determined, resulting in uncertainty as to whether these expenditures were allowable or not.

Because the reported overhead charges are based on the budgeted amount and the validity of the cost allocation plans could not be supported, the reported expenditures may not accurately reflect actual cost incurred.

Criteria: The Handbook, Section III.C.10, states that administrative overhead costs are costs incurred for services provided to the contracted program by the administrative branch of the organization. Such services rendered must be measurable and applicable to the contracted facility program. The cost allocation plan must include written justification for the method used in allocating administrative overhead costs to the contracted program.

The Handbook also states that a cost allocation plan must be submitted to the Department of Corrections, Financial Management and Support Services Branch. The cost allocation plan must include written justification for the method used in allocating administrative overhead expenditures to the contracted program. Documentation supporting the administrative overhead rate is subject to audit.

Office of Management and Budget Circular 87, Cost Principles for State, Local and Indian Tribal Governments, Attachment B, Section 23.a(2), states that the general costs of government are unallowable, including salaries and other expenditures of State Legislators, city councils, or similar local government bodies, such as county supervisors, city councils, or school boards, whether incurred for purposes of legislation or executive direction.

Recommendation: Develop a citywide cost allocation plan consistent with the Office of Management and Budget Circular A-87 requirements and allocate administrative costs to all City cost centers accordingly. Submit the cost allocation plan to Corrections for approval, including a written justification for the method used to allocate administrative overhead expenditures.

FINDING 5 **Inaccurate Statement of Program Income and Expenses**

Condition: The Statements for 2004-05 and 2005-06 are inaccurate. In order to meet the Cost Report reporting deadline, the Facility prepared the year-ending Statements prior to the closing of the City's general ledger. Consequently, City accounting staff continued to record revenue and expenditure

transactions in the general ledger after the reports had been prepared and submitted to Corrections. Moreover, the submitted Statements were not amended to reflect the final general ledger balances. Several discrepancies between the City's final general ledger balance and the submitted Statements were identified.

The Facility also included interest income from various sources on the Statements. The Statement line item, Other Revenue - Interest, included interest income from the debt service bank account and the ERF. While interest earnings should be reported, the current presentation is misleading since the income is not used for the General Fund.

The Facility's Statements also did not reflect the transfer of funds from the General Fund to the ERF. Specifically, a portion of the Facility's funding is to be set aside in the ERF for future equipment purchases. Although the Facility transferred $33,792 from the General Fund to the ERF, the transfer was not reflected in the Statements. Because of this, the Facility overstated funding available for the General Fund.

Lastly, the Facility does not accurately report the service fees. For 2004-05 and 2005-06, $386,244 of service fees was reported on the Statements. These amounts represented budgeted amounts at the design rate and did not include service fee amounts that should be reported as a result of per diem funding.

Criteria: The Handbook, Section II.K, states that the contractor must submit quarterly and annual cost reports.

The Handbook, Section III.A, states that expenditures of contract funds must be recorded in the general ledger accounts which parallel specific budget categories.

Recommendations: Ensure Statements submitted to Corrections are supported by the Facility's general ledger.

Consult with Corrections to determine an appropriate method for reporting debt service and ERF bank account activity.

Include ERF transfers and all service fees earned on quarterly Statements.

Submit amended 2004-05 and 2005-06 Statements that accurately reflect the final revenue and expenditure balances recorded in the general ledger.

FINDING 6 **Misstatement of Inmate Welfare Fund Balance**

Condition: Several instances specific to the IWF were identified. Such misstatements could negatively impact the accuracy of the IWF balance. They are as follows:

- The ITF is maintained in an interest bearing account. However, the interest earned on these funds is transferred to the Facility's General Fund instead of the IWF. Interest earnings belong to the inmates and should be deposited into the IWF.

- The IWF general ledger contains incomplete information. Specifically, the June 30, 2006 IWF general ledger illustrated the following inter-fund balances:

  - Due From Other Funds: $120,470
  - Due To Other Funds: $105,977

  The City explained these balances were accumulated posting errors from past transactions whose resolution would involve correcting and eliminating journal entries rather than transferring funds. Since the accuracy of these account balances is in question, the current IWF statements may not accurately portray the IWF's financial position.

Criteria: The California Department of Corrections and Rehabilitation, *Department Operations Manual*, Chapter 2, Section 23010.5, states that interest made from idle ITF money be placed in the IWF as a source of revenue for the IWF.

The Handbook, Section III, Part E, states that the Facility is required to maintain an accounting system that provides accurate and current information relative to each individual inmate trust account.

Recommendations: Research the amount of interest earned on inmate money and transfer that balance to the IWF.

Determine the accuracy of the account balances and make the corresponding adjusting entries, if applicable. Retain adjusting entry supporting documentation for audit.

FINDING 7 **Internal Control Weaknesses**

Condition: For the IWF and General Fund, inadequate separation of duties over cash disbursements and cash receipts exist. Specifically, the Business Officer performs the following duties:

- Maintains the cash disbursement register
- Posts disbursement transactions to the general ledger
- Prepares checks
- Compares checks with invoices for approval.
- Authorizes invoices for payment
- Mails, maintains, and distributes checks
- Controls the blank check stock
- Records cash receipts to the general ledger

- Prepares monthly bank reconciliations
- Accesses the safe

Other instances of inadequate separation of duties were identified over the ITF and the canteen. Specifically, the Trust Accountant reconciles the ITF bank account and is responsible for all other ITF cash receipts and disbursement functions. The Canteen Manager is responsible for ordering and receiving goods used and sold in the Facility canteen.

Lastly, the ITF has numerous outstanding checks dating as far back as 1999.

Criteria: The Handbook, Section II.H, states that it is the responsibility of the Facility Director and Fiscal Officer to implement adequate internal control procedures. The contractor is responsible for monitoring these controls and will be held responsible for any misappropriation of contract funds.

The Handbook, Section III.E, states that the Facility is to maintain up to date and accurate accounting records that reflect a true picture of each account's current standing.

Recommendation: Reassign incompatible duties to achieve adequate separation of duties.

Develop a system to research and clear long outstanding checks on a timely basis.

FINDING 8 **Inaccurate Annual Reports**

Condition: Annual reports submitted to Corrections are inaccurate. Specifically, purchases of equipment have not been added to fixed asset categories for 2003-04, 2004-05, and 2005-06. The reported values of fixed assets have remained unchanged over the three fiscal years, resulting in unreliable annual reports submitted to Corrections.

Criteria: The Handbook, Section III.A, states that the accounting system maintained by the contractor must be in conformance with generally accepted accounting principles to ensure that the accounting records will provide information necessary to identify receipt and expenditure of all project funds. It also states that recorded costs must accurately reflect the financial condition of the contracted program.

Recommendation: Submit amended annual reports that accurately reflect the financial condition.

OBSERVATION 1 **Failure to Tag Equipment**

Printing equipment totaling $15,000 was purchased from the ITRF. In an October 21, 2005 letter, Corrections approved the purchase and requested the equipment to be tagged with State identification tags. However, the Facility considers the equipment items the property of the Facility and failed to attach the State identification tags provided.

OBSERVATION 2 **Litigation Claims**

The City's legal counsel has reported the following information regarding settled or pending litigation which involve claims asserted by or on behalf of bargaining units of Facility employees:

- Current and former management employees, including covered employees of the Facility, sought compensation for breach of contract and declaratory relief for unpaid increases to salary, insurance, and retirement benefits. The case was settled for $75,000 in June 2006.

- An employee seeks award of damages for a work related injury.

Appendix A: Schedules

Schedule of Budgeted, Reported, and Questioned Revenue and Expenditures

Adelanto Community Correctional Facility
Contract R89.1591.103
Schedule of Budgeted, Reported, and Questioned Revenue and Expenditures
For the Period July 1, 2004 through June 30, 2005

Category	Contract Budget	Amounts Reported	Questioned Amounts	Adjusted Balance[1]
Revenue:				
Contract Revenue	$7,206,509	$7,045,153	$ 0	$7,045,153
Interest Revenue	0	12,380	0	12,380
Other Revenue—Misc	0	3,707	0	3,707
Total Revenue	7,206,509	7,061,240	0	7,061,240
Expenditures:				
Personnel and Staff Benefits	3,221,412	3,579,705	0	3,579,705
Training	42,594	9,420	0	9,420
Equipment Depreciation	39,472	29,563	0	29,563
General Operating Costs	655,813	701,697	25,058	676,639
Transportation	14,490	0	0	0
Medical Services	36,837	6,490	0	6,490
Consultant Services	67,079	35,595	0	35,595
Liability Insurance	59,709	0	0	0
Administrative Overhead	296,336	226,752	0	226,752
Service Fee	450,858	386,244	0	386,244
Food Costs	592,930	567,287	0	567,287
Energy Deficiencies	136,666	0	0	0
Contingency Fee	57,414	0	0	0
Inmate Programs	46,633	9,059	0	9,059
Overcrowding Package	92,628	0	0	0
Inmate Clothing	101,006	38,159	0	38,159
Subtotal	5,911,877	5,589,971	25,058	5,564,913
Facility Lease/Use	1,294,632	1,294,638	0	1,294,638
Total Expenditures	$7,206,509	$6,884,609	$ 25,058	$6,859,551

[1] Additional adjustments may be necessary upon resolution of related findings in this report.

SCHEDULE OF BUDGETED, REPORTED, AND QUESTIONED REVENUE AND EXPENDITURES

Adelanto Community Correctional Facility
Contract R89.1591.103
Schedule of Budgeted, Reported, and Questioned Revenue and Expenditures
For the Period July 1, 2005 through June 30, 2006

Category	Contract Budget	Amounts Reported	Questioned Amounts	Adjusted Balance[1]
Revenue:				
Contract Revenue	$7,363,122	$7,202,368	$ 0	$7,202,368
Interest Revenue	0	22,677	0	22,677
Other Revenue—Misc	0	389	0	389
Total Revenue	7,363,122	7,225,434	0	7,225,434
Expenditures:				
Personnel and Staff Benefits	3,300,130	3,711,432	0	3,711,432
Training	42,594	7,824	0	7,824
Equipment Depreciation	39,472	21,398	0	21,398
General Operating Costs	758,660	719,203	24,753	694,450
Transportation	14,490	0	0	0
Medical Services	36,837	5,179	0	5,179
Consultant Services	67,079	35,344	0	35,344
Liability Insurance	59,709	0	0	0
Administrative Overhead	296,336	226,752	0	226,752
Service Fee	465,969	386,244	0	386,244
Food Costs	591,615	573,333	0	573,333
Energy Deficiencies	136,666	0	0	0
Contingency Fee	57,414	0	0	0
Inmate Programs	46,633	12,785	0	12,785
Overcrowding Package	92,628	0	0	0
Inmate Clothing	102,254	19,885	0	19,885
Subtotal	6,108,486	5,719,379	24,753	5,694,626
Facility Lease/Use	1,254,636	1,254,638	0	1,254,638
Total Expenditures	$7,363,122	$6,974,017	$ 24,753	$6,949,264

[1] Additional adjustments may be necessary upon resolution of related findings in this report.

Appendix B: Supplemental Information
Inmate Telephone Revenue Fund Balances

Adelanto Community Correctional Facility
Contract R89.1591.103
Inmate Telephone Revenue Fund
For the Periods July 1, 2004 through June 30, 2005 and
July 1, 2005 through June 30, 2006[1]

	July 1, 2004 to June 30, 2005	July 1, 2005 to June 30, 2006
Beginning Balance	$291,504	$ 57,675
Revenue:		
Telephone Commissions	144,613	161,263
Interest Income	635	408
Total Revenue	145,248	161,671
Disbursements:		
Transfers Out	286,191	0
Expenditures	92,885	162,819
Total Disbursements	379,076	162,819
Ending Cash Balance	$ 57,675	$ 56,527

[1] Beginning balance represents an un-audited cash balance. Additionally, access to documentation supporting the $286,191 transfer out was denied; therefore, the aggregate ending cash balance of the ITRF was unable to be substantiated. See Finding 1 of this report.

Adelanto Community Correctional Facility
Contract R89.1591.103
Equipment Replacement Fund
For the Periods July 1, 2004 through June 30, 2005 and
July 1, 2005 through June 30, 2006

	July 1,2004 to June 30, 2005	July 1, 2005 to June 30, 2006
Beginning Balance	$145,097[1]	$171,508
Revenue:		
Deposits	25,344[2]	42,240
Interest Income	1,066	1,927
Total Revenue	26,410	44,167
Disbursements	0	0
Ending Cash Balance	$171,508	$215,675

[1] Balances represent the cash balances between July 1, 2004 and June 30, 2006. Actual fund balance may materially differ from the cash balances represented in this Schedule. See Finding 2 of this report.

[2] Deposits do not include the contract required overcrowding portion of equipment replacement deposits. See Finding 2 of this report.

Adelanto Community Correctional Facility
Contract R89.1591.103
Inmate Welfare Fund
For the Periods July 1, 2004 through June 30, 2005 and
July 1, 2005 through June 30, 2006

	July 1, 2004 to June 30, 2005	July 1, 2005 to June 30, 2006
Beginning Balance	$ 47,440	$ 71,072
Revenue:		
Deposits	269,220	308,264
Interest Income	282	550
Total Revenue	269,502	308,814
Disbursements	245,870	277,087
Ending Cash Balance	$ 71,072	$ 102,799

Adelanto Community Correctional Facility
Contract R89.1591.103
Debt Service Fund
For the Periods July 1, 2004 through June 30, 2005 and
July 1, 2005 through June 30, 2006

	July 1, 2004 to June 30, 2005	July 1, 2005 to June 30, 2006
Beginning Balance	$1,195,959	$ 755,718
Revenue:		
Facility Lease Reimbursements	1,186,746	1,362,524
Interest Earned	6,261	11,125
Total Revenue	1,193,007	1,373,649
Disbursements:		
Payments—Principal and Interest	1,251,875	1,211,368
Other[1]	381,373	0
Total Disbursements	1,633,248	1,211,368
Ending Cash Balance	$ 755,718	$ 917,999

[1] Due to the City refinancing its bond obligations effective September 27, 2001, Corrections overpaid the debt service in 2001-02 and 2002-03. Per Exhibit J.2 of Amendment 7 of the contract, Corrections redirected the overpayment to the Facility's General Fund.

ADELANTO
COMMUNITY CORRECTIONAL FACILITY

CITY OF ADELANTO
(760) 246-3328
FAX (760) 246-3050

November 21, 2007

Ms. Janet I. Rossman, Assistant Chief
Office of State Audits and Evaluations
Department of Finance
300 Capitol Mall, Suite 801
Sacramento, CA 95814

RE: Draft Audit Report - Adelanto Community Correctional Facility Contract R89.1591.103

Dear Ms. Rossman:

Delineated below are the City of Adelanto's and Adelanto Community Correctional Facility's (City) responses to the above referenced audit report.

Finding 1 - Inmate Telephone Revenue Fund Access Prohibited

Response - The City and the Department of Corrections and Rehabilitation have not concluded negotiations regarding access to the Inmate Telephone Revenue Fund (ITRF) prior to the 2004/05 fiscal year.

Finding 2 - Misstated Equipment Replacement Fund Balance

Response - (Item 1) The calculations for the Equipment Replacement Fund (ERF) will be completed and expenditures reviewed for validity and appropriate transfers made. (Item 2) The appropriate amount will be transferred to the ERF. (Item 3) The Master Property List will be verified as part of calculating the ERF in Item 1 above. It will be reconciled annually.

Finding 3 - Questioned Expenditures

Response - As stated is previous audit responses, the City is using service fees received to cover the questioned costs. There is sufficient service fee income to cover the costs of the payments in question. Therefore, the City is using its "profit" to pay for the settlement and employee morale costs, which does not violate any provisions in the Financial Management Handbook. The City still contends that the settlement cost is not an inappropriate expenditure The Department of Corrections and Rehabilitation has not responded to our correspondence regarding this finding.

10400 RANCHO ROAD P.O. BOX 5005 ADELANTO, CA 92301-0724

Finding 4 - Unsupported Administrative Overhead Expenditures

Response - Beginning with the 2002/03 fiscal year, an internal cost allocation plan was prepared by the City Finance Director based on average time spent on all City-wide activities. We believe this cost allocation procedure is consistent with OMB Circular A-87. The City cost allocation plan exceeded the budgeted amount of $226,752 for both the 2004/05 and 2005/06 fiscal years. The City made an internal decision to only charge ACCF for $226,752, instead of the higher actual amount.

Finding 5 - Inaccurate Statement of Program Income and Expense

Response - (Item 1) The reporting deadline is prior to completion of the audited statements. The statements submitted reflected known amounts at the time the reports are prepared. If directed by Corrections, the City will amend and correct the final quarterly reports to agree with the final revenue and expenditure balances. (Item 2) Corrections has not responded to our previous correspondence requesting assistance in determining the appropriate method for reporting reserve account, debt service and ERF bank account activity. (Item 3) Corrections has not responded to our correspondence requesting assistance in determining to the appropriate method to report ERF transfers on the quarterly report. The service fee is received as part of the flat rate and per diem (day) rate and is not a separate line item in the revenue category. The service fee expenditure is that portion that is remitted to the City General Fund. There is no requirement in the reports to separately track service fee revenue. (Item 4) See Item 1.

Finding 6 - Misstatement of Inmate Welfare Fund Balance

Response - (Item 1) We will research the amount of interest earned beginning with the 2004/05 fiscal year and make the appropriate transfers. (Item 2) The City Finance Director will review the accounts and make the appropriate adjusting entries, which will be retained for audit.

Finding 7 - Internal Control Weaknesses

Response - (Item 1) As stated in previous audit responses, the separation of duties to achieve perfect internal control will never be achieved due to lack of personnel. The City believes that certain duties performed by other personnel more than offset the inseparable duties performed by one employee. (Item 2) Long outstanding checks have been cleared and a system is in place to transfer funds to Corrections after eighteen (18) months.

Finding 8 - Inaccurate Annual Reports

Response - We will attempt to ascertain the actual fixed asset amounts for the 2004/05 and 2005/06 fiscal years. This will be done in conjunction with the ERF calculations in Finding 2 since this is a related item. If directed by Corrections, we will submit amended reports.

Observation 1 - Failure to Tag Equipment

Response - The printing equipment was tagged with facility purchased Inmate Telephone Revenue Fund equipment tags. The equipment is not State equipment, so State equipment tags were inappropriate.

Respectfully submitted,

Original signed by:

CALVIN R. WHITE
Warden

EVALUATION OF FACILITY RESPONSE

We appreciate the Adelanto Community Correctional Facility's (Facility) response and comments. We reviewed the Facility's response, and where the Facility disagreed with our findings, we provided the following comments.

FINDING 1 **Inmate Telephone Revenue Fund Access Prohibited**

Our finding remains unchanged as access to the Inmate Telephone Revenue Fund is still under negotiations.

FINDING 3 **Questioned Expenditures**

The Facility indicates that service fees are used to cover the questioned costs. However, the questioned costs are reported to the Department of Corrections and Rehabilitation (Corrections) through the General Operating Expenses line item on the quarterly Statements of Program Income and Expenses (Statements). Costs that are unallowable per the Financial Management Handbook should not be reported in the Statements.

The Facility's response and previous responses argue that settlement costs are an appropriate expenditure. We believe the settlement costs paid to avoid litigation in which the City of Adelanto appears to believe it would lose, are similarly unallowable as costs incurred due to a specific violation or fine. However, Corrections should make the final determination regarding these questioned expenditures.

FINDING 4 **Unsupported Administrative Overhead Expenditures**

The Facility stated that its cost allocation plan (plan) is consistent with Office of Management and Budget (OMB) Circular A-87 and the Facility's planned allocation exceeded the amount billed for administrative overhead. We reiterate that OMB circular A-87, Cost Principles for State, Local and Indian Tribal Governments, Attachment B, Section 23.a(2) states that general costs of government are unallowable, including city council.

During fieldwork, we were unable to determine the composition and allowability of the Non-Departmental line item within the City's cost allocation plan. Therefore, we were unable to determine if the actual administrative overhead charged to the Facility accurately reflected the cost incurred. Since no additional documentation was provided to us

regarding the Non-Departmental line item, the finding will remain unchanged.

FINDING 5 **Inaccurate Statement of Program Income and Expenses**

The Facility concurred that the year-ending statements submitted to Corrections are not adequately supported by the Facility's accounting records. The deadline to submit the Statements to Corrections is prior to the completion of the annual audit, and therefore, audit adjustments are not reflected in the Statements. In order for Corrections to adequately monitor the program, the Statements should be supported by the Facility's accounting system, and amended Statements should be submitted to Corrections.

In the Facility's previous audit responses, it agreed to accurately report Equipment Replacement Fund (ERF) transfers and Service Fees in the quarterly Statements submitted to Corrections. We maintain that a portion of the per diem rate reimbursement is designed for equipment and service fees, and should be accurately reported.

Interest earned from the debt service and ERF should not be presented in the Statements since the interest income is not used for Facility operations.

FINDING 7 **Internal Control Weaknessess**

The Facility stated the separation of duties to achieve perfect internal control will never exist due to a lack of personnel, and that certain duties performed by other personnel more than offset the inseparable duties performed by one employee. However, the Facility did not provide specific examples of compensating factors that would mitigate inadequate separation of duties. While we understand the challenges of implementing perfect internal controls with minimal staff, there is an increased risk for misappropriation of assets when separation of duties is inadequate.

OBSERVATION 1 **Failure to Tag Equipment**

Based on the Facility's response to Finding 1, Corrections and the Facility are in negotiations regarding access and proper use of the ITRF. The Facility contends that the equipment is not State equipment. We leave the issue open until ITRF negotiations are settled and ownership of the printing equipment is established.