DEPARTMENT OF FINANCE
ARNOLD SCHWARZENEGGER, GOVERNOR
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July 15, 2008

Mr. Kyle Schiller, Director of Business Management
The GEO Group, Inc.
Western Region Office
5900 La Place Court, Suite 120
Carlsbad, CA 92008

Dear Mr. Schiller:

Final Audit Report —Central Valley Modified Community Correctional Facility, Contract R96.133

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its compliance audit of Central Valley Modified Community Correctional Facility (Facility).

The enclosed report is for your information and use. The Geo Group's response to the report findings are incorporated into this final report. Please submit an updated corrective action plan to Finance and the Department of Corrections and Rehabilitation, Community Correctional Facilities Administration, within 30 days of receipt of this report.

In accordance with Finance's policy of increased transparency, this report will be placed on our website.

We appreciate the assistance and cooperation of the Facility. If you have any questions regarding this report, please contact Richard R. Sierra, Manager, or Zach Stacy, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

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

Enclosure

cc: On following page

A Fiscal Compliance Audit

Central Valley Modified Community Correctional Facility
Contract R96.133
For the Period July 1, 2006
through February 29, 2008

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

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May 2008

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Executive Summary

The California Department of Corrections and Rehabilitation (Corrections) contracted with The GEO Group, Inc., for operation of the Central Valley Modified Community Correctional Facility (Facility). The GEO Group, Inc. is responsible for providing inmate housing, sustenance, and coordinating inmate activities within the Facility. Under the direction of on-site Corrections staff, The GEO Group also assists with inmate custody and Facility security. The Facility is located in McFarland, Kern County, and is designed to accommodate an average daily population of 600 male inmates.

Corrections requested the Department of Finance, Office of State Audits and Evaluations (Finance), to perform a fiscal compliance audit of contract R96.133.

Review Results

Except for the following issue, the Facility has resolved the prior findings reported in Finance's November 1, 2006 audit report:

- **Salary Expenditures Exceeded Contract Budget:** In fiscal year 2006-07, the Facility exceeded its budget for salary expenditures by $648,012, or 18 percent. Budget Revision Forms were not submitted to Corrections.

Additionally, one new finding was identified, as summarized below:

- **Misstated Statements of Revenue and Expenditures:** Salaries in the Facility's Statements of Revenue and Expenditures were overstated by $20,622 in fiscal year 2006-07. Additionally, Operating Expenses were understated by $31,443 in 2006-07.

For further details, refer to the *Findings and Recommendations* section of this report.

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 a 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 private entities under this Program, one was awarded to The GEO Group, Inc., for the Central Valley Modified Community Correctional Facility (Facility).

As stipulated by contract R96.133, the Facility's funding is a combination of flat rate expenditure reimbursement and per diem funding. In fiscal year 2006-07, the Facility received annual flat rates of $1,962,972, $94,356, and $62,928 for the facility use, pre-start up expenses, and energy deficiency, respectively.

Also during 2006-2007, the Facility received per diem rates of $30.19, $26.75, and $25.11 for 500 Design Beds, 25 Over Crowding Beds, and 75 Over Crowding Beds, respectively, per participant per day (up to a maximum annual amount of $6,441,130). The per diem reimbursement is to cover various contract expenditures, including salaries and benefits, food, transportation, consulting/contracted services, operating expenses, property taxes, general liability insurance, and administrative overhead.

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

- *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.

- *Telephone Revenue Fund*—Special program funds received for inmate telephone services designed for specific activities, as outlined in the contract.

SCOPE AND OBJECTIVES

Under an interagency agreement with Corrections, the Department of Finance, Office of State Audits and Evaluations (Finance), performed a fiscal compliance audit of contract R96.133 between The GEO Group of Central Valley Modified Community Correctional Facility (Facility) 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, 2006 through June 30, 2007.
- 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.
- Determine if the Facility had implemented corrective action for findings issued in Finance's previous audit report dated November 1, 2006.
- Review the activities and contract compliance of the Inmate Welfare Fund and Inmate Trust Fund for the period October 1, 2006 through December 31, 2007.
- Review the Inmate Telephone Revenue Fund and verify the cash balance as of February 29, 2008.

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 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 Handbook for Private Community Correctional Facilities* dated January 1995 (Handbook) was performed to determine that selected items met eligibility requirements.

To determine if the Facility implemented corrective action for the prior audit findings, we reviewed the prior audit report dated November 1, 2006 and the Facility's response to that report. To determine what steps the Facility had taken to resolve the findings, staff were interviewed and current processes and records were reviewed.

The funds (Inmate Welfare Fund, Inmate Telephone Revenue 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. This review was conducted during the period February 2008 through March 2008.

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 compliance with contract R96.133, 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 and Corrections management, and is not intended to be and should not be used by anyone other than the specified parties. However, this restriction is not intended to limit the distribution of this report, which is a matter of public record.

May 5, 2008

STAFF:

Richard R. Sierra, CPA
Manager

Zach Stacy
Supervisor

Muang Saeteurn
Jason Craft
Nasira Quettawala

FINDING 1 **Misstated Statements of Revenue and Expenditures**

Condition: The following errors were found in the Statements of Revenue and Expenditures (Statements):

A. Salaries reported in supporting schedules 3.1, 3.2, and 3.3 did not agree with the quarterly payroll registers.
B. Disallowed salary costs, such as incentive bonuses, settlements, and car allowances were incorrectly deducted from operating expenses and not offset against salaries.

The misstatements are summarized as follows:

Fiscal Year 2006-07	Salaries (Over) Understatement	Operating Expenses Understatement
A. Salaries not in agreement with payroll register	$ 10,821	N/A
B. Misclassified salary adjustments	$ (31,443)	$31,443
Net (Over) Understatement	$ (20,622)	$31,443

Criteria: *The Financial Management Handbook for Private Community Correctional Facilities* dated January 1995 (Handbook), Section IV.B, page 13, states that all costs will be supported by sufficient, competent, and relevant source documentation. The Handbook, Section III.A, page 10, states that Corrections will consider the actual costs as submitted in the Statements for negotiations of future contract per diem rates.

Recommendation: A. Ensure salaries reported in the Statements agree with the payroll registers.
B. Properly offset unallowable salary expenses, such as incentive bonuses, settlements, and car allowances against the related salaries.

FINDING 2 **Salary Expenditures Exceeded Contract Budget**

Condition: In fiscal year 2006-07, the Facility exceeded its budget for salary expenditures by $648,012, or 18 percent. Budget Revision Forms were not submitted to Corrections. As a result, the revised spending plan was not approved prior to expenditure, circumventing Corrections' oversight. This issue was also noted in Finance's November 1, 2006 audit report.

Criteria: The Handbook, page ten and Appendix F, states that any change(s) to the budgeted line item funding exceeding $10,000 or 10 percent, whichever is greater, requires prior approval from the Community Correctional Centers Administration (CCCA) Administrator.

The Handbook, Appendix F, also states that the Budget Revision Form is to be mailed to the designated CCCA Contract Analyst for advance approval.

Recommendation: Obtain Corrections' approval before expending funds in excess of the budget category when required.

APPENDIX A

SCHEDULE OF BUDGETED, REPORTED, AND QUESTIONED REVENUE AND EXPENDITURES

Central Valley Modified Community Correctional Facility
Contract R96.133
Schedule of Budgeted, Reported, and Questioned Revenue and Expenditures
For the Period July 1, 2006 through June 30, 2007

Category	Contract Budget	Amounts Reported	Questioned Amounts	Adjusted Amounts[1]	Adjusted Balance
Revenue:	$8,561,386	$8,583,907	$ 0	$ 0	$8,583,907
Expenditures:					
Salaries and Benefits	3,576,318	4,224,330	0	$ (20,622)	4,203,708
Food Costs	439,470	416,632	0	0	416,632
Transportation	50,556	28,166	0	0	28,166
Consulting/Contracting	80,024	51,184	0	0	51,184
Operating Expenses	1,072,052	734,762	0	31,443	766,205
Administrative Overhead	427,447	432,491	0	0	432,491
Property Taxes	329,668	345,056	0	0	345,056
Energy Deficiency Costs	62,928	0	0	0	0
Subtotal	6,038,463	6,232,621	0	10,821	6,243,442
Facility Lease/Use	2,057,328	2,057,328	0	0	2,057,328
General Liability Insurance	155,813	101,745	0	0	101,745
Total Expenditures	$ 8,251,604	$8,391,694	$ 0	$ 10,821	$8,402,515
Corporate Fee (Profit)	$ 309,782	$ 192,213			$ 181,392

[1] See Finding 1 in the *Findings and Recommendations* section of this Report for an explanation of adjusted amounts.

APPENDIX B
INMATE WELFARE FUND BALANCE

Central Valley Modified Community Correctional Facility
Contract R96.133
Inmate Welfare Fund
For the Period October 1, 2006 through December 31, 2007

	October 1, 2006[2] to December 31, 2007
Beginning Cash Balance	$ 5,766
Revenue:	
Deposits	24,622
Interest Income	0
Total Revenue	24,622
Disbursements	13,099
Ending Cash Balance	$ 17,289

[2] Finance's previous audit report dated November 1, 2006 reported on the Inmate Welfare Fund cash balance through September 30, 2006.

Inmate Telephone Revenue Fund Balance

Central Valley Modified Community Correctional Facility
Contract R96.133
Inmate Telephone Revenue Fund
For the Period October 1, 2006 through February 29, 2008

	October 1, 2006[3] to February 29, 2008
Beginning Cash Balance	$1,162,996
Receipts:	
Commissions	303,060[4]
Interest Income	52,827
Total Receipts	355,887
Disbursements	0
Ending Cash Balance	$1,518,883

[3] Finance's previous audit report dated November 1, 2006 reported on the Inmate Telephone Revenue Fund cash balance through September 30, 2006.
[4] Includes telephone commissions through December 31, 2007 (most recent information available at the end of fieldwork).

The GEO Group, Inc.

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June 4, 2008

Mr. David Botelho
Chief, Office of State Audits and Evaluations
Department Of Finance
State of California
300 Capital Mall, Suite 801
Sacramento, California 95814

Dear Mr. Botelho:

This letter is in response to the audit of the Central Valley Modified Community Correctional Facility, Contract R96.133 between the California Department of Corrections and Rehabilitation ("CDCR") and The GEO Group, Inc. ("GEO") dated April 2008. The following is our response to the findings as outlined in the audit:

Finding 1: Misstated Statements of Revenue and Expenses

A. *Salaries reported in supporting schedules 3.1, 3.2 and 3.3 did not agree with the quarterly payroll registers.*

   GEO will ensure the salaries reported in the Statements agree with the quarterly payroll registers. Please note the understated salaries of $10,821 in fiscal year 2006-07 represents less than .4% of the total salaries reported.

B. *Disallowed salary costs, such as incentive bonuses, settlements and car allowances, were incorrectly deducted from operating expenses and not offset against salaries.*

   GEO was reporting unallowable salary expenses as an off-set to operating expenses; GEO will now deduct unallowable salary expenses from salary expenses as recommended. Please note there is no net affect to the Statement's bottom line, as this is an expense reclassification.

Finding 2: Salary Expenditures Exceeded Contract Budget

> *In fiscal year 2006-07, the Facility exceeded its budget for salary expenditures by $648,012, or 18 percent. Budget Revision Forms were not submitted to Corrections. As a result, the revised spending plan was not approved prior to expenditure, circumventing Corrections' oversight. This issue was also noted in Finance's November 1, 2006 audit report.*

> GEO will submit a Budget Revision Request to Corrections in the future if expenditures are anticipated to exceed budget, as recommended. Please note GEO must pay competitive salaries to attract and retain quality staff and any increase in expense is borne by GEO and does not result in an increase in cost to the Department of Corrections.

GEO appreciates the professionalism of the Department of Finance and their personnel during the audit of the Central Valley Modified Community Correctional Facility. We believe we have provided quality and professional services to the Department of Corrections and look forward to building on our successful relationship.

Very truly yours,

Original signed by:

John G. O'Rourke
Senior Vice-President and
Chief Financial Officer
The GEO Group, Inc.