



June 15, 2009

Ms. Paula Ford, Facility Director  
Leo Chesney Community Correctional Facility  
P.O. Box 66  
Live Oak, CA 95953

Dear Ms. Ford:

**Final Audit Report—Leo Chesney Community Correctional Facility, Contract R05.005**

The Department of Finance, Office of State Audits and Evaluations, has completed its fiscal compliance audit of the Leo Chesney Community Correctional Facility (Facility) for the period October 1, 2005 through September 30, 2008.

The Facility's response to the report findings are incorporated into this final report. Please submit an updated corrective action plan to the California Department of Corrections and Rehabilitation, Community Correctional Facilities Administration, within 30 days of receipt of this report.

We appreciate the assistance and cooperation of the Facility. If you have any questions regarding this report, please contact Frances Parmelee, 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: Mr. Blake Barras, Managing Director of Finance, Cornell Companies, Inc.  
Ms. Colleen L. Murphy, Division Controller, Adult Secure Division, Cornell Companies, Inc.  
Mr. Kevin R. Chappell, Acting Chief, Community Correctional Facilities Administration,  
California Department of Corrections and Rehabilitation  
Mr. Terry Dickinson, Correctional Administrator, Community Correctional Facilities Administration,  
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Mr. Robert Logan, Staff Services Manager I, Community Correctional Facilities  
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California Department of Corrections and Rehabilitation  
Mr. Renato Araza, Program Analyst, Community Correctional Facilities Administration,  
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A FISCAL COMPLIANCE AUDIT

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Leo Chesney Community Correctional Facility

Contract R05.005

For the Period October 1, 2005

through September 30, 2008

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

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

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# EXECUTIVE SUMMARY

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The California Department of Corrections and Rehabilitation (Corrections) contracted with Cornell Companies, Inc., (Cornell) for operation of the Leo Chesney 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 Live Oak, California, and is designed to accommodate an average daily population of 200 female inmates.

Corrections requested the Department of Finance, Office of State Audits and Evaluations (Finance), to perform a fiscal compliance audit of contract R05.005.

## Review Results:

- The Facility exceeded the contracted budget by \$10,000 or 10 percent for various line-items without Corrections' prior approval. In addition, Cornell increased the Corporate Fee charged under the contract by 210 percent.

The Facility's revenue reported in the *Statements of Revenue and Expenditures* (Statements) was overstated by \$1,859 in fiscal year 2005-06 and \$47,936 in 2006-07. The Facility understated the Per Diem revenue by \$24,247 in 2007-08 and overstated the Liability Insurance by the same amount.

- The Corrections contract budget negotiated with Cornell duplicates food service personnel costs. This has resulted in a higher per diem rate and a \$354,925 overpayment to Cornell.
- The Facility reported estimated insurance costs in lieu of actual paid premiums, thereby overstating the average annual insurance cost to the state by approximately \$8,000.
- The Facility's procedures for personnel and payroll duties are inadequate.
- The Facility could not provide supporting documentation for \$5,108 of computer costs charged to the Inmate Welfare Fund in 2005-06.
- The Facility has not remitted to Corrections \$8,567 in medical co-pay funds collected from inmates since October 2007.
- The following weaknesses were observed in the Inmate Trust Fund:
  - The Facility's procedure for handling Inmate Trust Fund cash receipts is inadequate

- The Administrator/Canteen Coordinator performs incompatible accounting duties
- The Facility did not provide inmates with a statement of their trust fund balances upon release
- The following weaknesses were observed in the Inmate Welfare Fund (IWF):
  - Inappropriate accounting for IWF operating transactions
  - Inconsistent salary expenses reported in the IWF Income Statement
  - Inappropriate accounting for telephone receipts in the IWF
  - Miscellaneous IWF Income Statement reporting errors and inconsistencies
  - Administration of IWF checking account needs improvement

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

# BACKGROUND, SCOPE, AND METHODOLOGY

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## 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.

As stipulated by contract R05.005, the Facility's funding is a combination of flat rate expenditure reimbursement and per diem funding. The combined funding was \$3,196,410, \$5,857,898, and \$6,924,504 in fiscal years 2005-06, 2006-07, and 2007-08, respectively. Contract funds are used for the expenditure categories as shown in Appendix A.

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 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

Under an interagency agreement with Corrections, the Department of Finance, Office of State Audits and Evaluations (Finance), performed a fiscal compliance audit of contract R05.005 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 October 1, 2005 through June 30, 2008.
- 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 the Inmate Trust Fund for the period October 1, 2005 through September 30, 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 Requirements for Community Correctional Facilities dated November 4, 2005 (Handbook) was performed to determine that 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 October 2008.

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 R05.005, 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.

April 23, 2009

# FINDINGS AND RECOMMENDATIONS

## FINDING 1    Reported Expenditures Are Not Consistent With The Contract Budget

Condition:    During the three-year contract period under review, Cornell Companies, Inc., (Cornell) reported Facility expenditures (including the Corporate Fee) that significantly exceeded the contract line item budget (see Schedule 1 below). Cornell did not request Corrections' prior approval for line item fund transfers exceeding \$10,000 or 10 percent of the related budget category, as required in the Financial Management Requirements for Community Correctional Facilities Handbook (Handbook).

### **Schedule 1: Expenditures in Excess of \$10,000 or 10 percent of Contract Budget**

Line-item	FY 2005-06	%	FY 2006-07	%	FY 2007-08	%
Staff Salaries/Wages & Benefits/Taxes	N/A	N/A	N/A	N/A	\$ 49,217	2%
Food	63,126	30%	26,398	6%	N/A	N/A
Transportation	14,422	210%	13,836	151%	7,710	84%
Facility Lease/Use	146,508	35%	61,610	7%	N/A	N/A
Corporate Fee	348,216	364%	73,335	14%	1,006,673	150%
	<u>\$ 572,272</u>		<u>\$ 175,179</u>		<u>\$ 1062,600</u>	

To facilitate the over-expenditure, Cornell underspent selected budget line-items as shown in Schedule 2.

### **Schedule 2 : Under-Expenditure of Selected Budget Line-items**

Line-item	FY 2005-06	%	FY 2006-07	%	FY 2007-08	%
Staff Salaries/Wages & Benefits/Taxes	\$ -26,426	-2%	\$ -328,157	-14%	\$ NA	N/A
Food	N/A	N/A	N/A	N/A	-28,612	-6%
Consultant	-22,956	-24%	-64,543	-49%	-130,979	-100%
Operating Expenses	-378,409	-49%	-593,266	-49%	-720,631	-51%
Administrative Overhead	-92,139	-32%	-22,143	-6%	-104,172	-27%
Facility Lease	N/A	N/A	N/A	N/A	-249,484	-20%
General Liability Insurance	-475	-2%	-11,883	-31%	-13,937	-30%
<b>Total</b>	<u><b>\$-520,405</b></u>		<u><b>\$-1,019,992</b></u>		<u><b>\$-1,247,815</b></u>	

The Handbook requires contractors to obtain Corrections' approval of transfers of \$10,000 or 10 percent between budget line items. The Handbook provision helps minimize the potential risks of reducing services to inmates in order to maximize the corporate fee. As shown in Schedule 1 above, the under-expenditure of selected budget

line items facilitated an increase of \$348,216 (364 percent) in the FY 2005-06 corporate fee and \$1,005,673 (150 percent) in FY 2007-08.

Criteria: The Handbook, Appendix E, Schedule 1.2, states any change(s) to the budgeted line-item funding that exceeds \$10,000 or 10 percent requires prior approval from the Community Correctional Facilities Administration.

Recommendation: Obtain Corrections' approval prior to incurring program expenditures in excess of \$10,000 or 10 percent of the budgeted line-items.

**FINDING 2 Misstated Statements of Revenue and Expenditures**

Condition: The Facility's Per Diem and Flat Fee revenues as reported in the Statements of Revenue and Expenditures (Statements) were incorrectly reported as follows:

<u>Fiscal Year</u>	<u>Misstatements</u>	<u>Revenue Type</u>
2005-06	\$ 1,859	Per Diem
2006-07	47,936	Flat Fee (Facility Lease)
2007-08	-24,247	Per Diem
2007-08	24,247	Flat Fee (Liability Insurance)

These errors arose from inaccurate Per Diem billings, disallowed Facility lease billings, and misreporting of Per Diem revenues as liability insurance.

Criteria: The Handbook, Section III.C, page 30, states the Contractor's accounting system must ensure the accounting records will provide information necessary to identify all receipts and expenditures of program funds.

The Handbook, Section IV.B, page 39, states Corrections will consider Quarterly Cost Reports (QCR) received to be accurate and will be used to monitor use of funds.

Recommendation: Revise the quarterly and annual cost reports and resubmit the corrected reports to Corrections.

**FINDING 3 Duplicate Food Service Personnel Costs**

Condition: The contract budget negotiated with Cornell duplicated food service personnel costs. Specifically, for 2005-06 through 2007-08, \$354,925 in food service personnel costs were budgeted and paid first (via the contract salaries and wages budget line-item) and second (via the food costs line-item). Cornell does not pay the salaries and wages for food service personnel directly. Instead, the food service personnel costs are factored into the per-meal charges included in invoices submitted by an external food service vendor. Consequently, Corrections pays for food service personnel positions twice (i.e., in personnel costs and in food service invoices). The annual salaries and wages budgets (inclusive of food service budgeted personnel costs) are shown below:

**Budgeted Salaries & Wages**

<b>Program</b>	<b>FY 05-06</b>	<b>FY 06-07</b>	<b>FY 07-08</b>	<b>Total</b>
<b>Salaries &amp; Wages</b>	\$1,256,457	\$2,293,409	\$2,507,523	\$6,057,389
<b>Food Service Personnel Costs Included in S&amp;W Costs (above)</b>	95,069	129,928	129,928	354,925

As a result of the duplication in food service personnel costs, Corrections overpaid Cornell by \$354,925. This overpayment contributes to the excess corporate fees referred to in Finding 1.

**Criteria:** The Handbook, Section II A1-h.ii, page 16, states the food cost category must include only food items used in the preparation of a meal. The Handbook, Section III, A2, page 27, states that, costs not supported by source documentation (regardless of the type of cost) are unallowable.

**Recommendation:** Revise and reissue corrected Annual Statements of Revenues and Expenditures to Corrections. Ensure that duplicate costs are not included in contracts with the state.

**FINDING 4 Overstated Insurance Costs**

**Condition:** In lieu of the actual premiums paid, Cornell reports its budgeted General Liability Insurance projections as expenditures in the Facility’s quarterly and annual Statements of Revenues and Expenditures.

If Cornell had correctly reported the actual General Liability Insurance premiums paid, the insurance costs reported and charged to the contract would have been reduced as follows:

<b>Reported Insurance In Excess of Premiums Paid</b>	
FY 2005-06	\$ 4,798
FY 2006-07	8,198
FY 2007-08	10,862

**Criteria:** The Handbook, Section III, A2, page 27 states, unsupported Costs are unallowable regardless of the type of cost.

**Recommendation:** Revise the annual Statements of Revenue and Expenditures to limit the reported General Liability Insurance expenditures to actual premiums paid.

**FINDING 5                      Lack of Separation of Personnel and Payroll Duties**

Condition:                      The Facility's Financial Officer performs the following incompatible duties: hires new employees; enters newly hired employees into the payroll system; edits timesheets; maintains the timesheet reporting system; edits personnel positions and pay rates; maintains the personnel/payroll system; and maintains custody of unissued debit cards used to pay employee salaries. This sequence of incompatible duties provides the Financial Officer the ability and opportunity to add unauthorized or non-existent employees to the Facility payroll and to manipulate employees' pay without detection.

Criteria:                      The Handbook, page 30, Section (III C2), Internal Controls states that it is the responsibility of the Contractor to implement adequate internal controls, pursuant to Government Code 13400, to ensure appropriate management of all Agreement funds.

Recommendation:            Ensure adequate separation of personnel and payroll duties.

**FINDING 6                      Unsupported Computer Costs**

Condition:                      During fiscal year 2005-06 Cornell charged \$5,108 for computer costs to the Inmate Welfare Fund without explanation or documentation to support these costs. Specifically, through June 30, 2006, Cornell charged the IWF for a computer line and related monthly charges comprising 48 percent of certain vendor computer bills. These charges were not levied after June 30, 2006. Cornell was unable to provide the vendor contract or justification of the 48 percent cost allocation to the IWF.

Criteria:                      The Handbook, Section III, C3c, states the Contractor shall support all general ledger account entries by both the subsidiary records and the original source documentation. All costs recorded shall be supported by sufficient and accurate source documentation.

Recommendation:            Ensure all costs recorded are supported by source documentation. Revise the IWF reports to exclude the unsupported costs.

**FINDING 7                      Unremitted Medical Co-Pay Funds**

Condition:                      The Facility has not remitted to Corrections the medical co-pay funds it collected from inmates since October 2007. The total amount of collected but unremitted medical co-pay funds due to Corrections as of November 18, 2008 was \$8,567. This amount includes a balance of \$222 collected from inmates prior to October 1, 2005.

Criteria:                      The Handbook, Section III, A.1.w.xvi, states the Contractor will collect five dollars from every inmate, if the inmate initiates the request for medical treatment. The five dollars will be charged against the inmate's trust fund and will be submitted to Corrections monthly.

Recommendation: Remit the medical co-pay amounts collected. Ensure future medical co-pay funds collected from inmates are promptly remitted to Corrections each month.

**FINDING 8 Inmate Trust Fund Control Weaknesses**

Conditions: We observed the following Inmate Trust Fund (ITF) control weaknesses:

*Inadequate Cash Receipt Procedures:* Specifically, a Facility officer opens mail containing inmate cash receipts (money orders and cashier's checks) and updates the Facility's *ITF Money Order Log Book* without the presence of a second person. Without independent verification there is no assurance that cash receipts are properly accounted and deposited intact. Approximately \$156,000 was remitted to the ITF for inmates in fiscal year 2007-08.

*The Canteen Coordinator performs incompatible accounting duties for the ITF.* Specifically, the Canteen Coordinator prepares bank deposits, reviews and compares pre-listings to deposits, delivers deposits to the bank, maintains custody of undeposited receipts, and maintains the cash receipts register. At a minimum, duties involving bank deposits and cash receipt register maintenance should be separated to minimize the risk of errors and irregularities.

*Unremitted Commissary Commissions Due to the IWF:* The Facility did not remit \$5,603 in commissary purchase commissions due to the IWF for inmate purchases. During the period October 3, 2005 through December 30, 2005 the Facility paid 81 percent of the inmate purchase costs directly from the ITF to the vendor. However, the remaining 19 percent commission (\$5,603) payable to the IWF remains in the ITF.

*Inmates' Fund Statement:* The Facility did not provide inmates with a statement of their trust fund balances upon release.

Criteria: The Handbook, Section II, states the Contractor shall implement and maintain adequate internal control procedures to ensure and account for appropriate management of funds.

The Handbook, Section III, D1a, states the Contractor shall provide inmates with a fund statement and a check for the balance of his or her account upon release or parole.

- Recommendations:
- A. Require independent verification of cash receipts by a second employee.
  - B. Segregate incompatible ITF accounting duties.
  - C. Remit \$5,603 in Commissary Commissions to the IWF.
  - D. Provide all inmates with a statement of trust fund balances upon release.

**FINDING 9                      Inmate Welfare Fund Accounting and Reporting Weaknesses**

Conditions:                      We observed the following in Inmate Welfare Fund (IWF) accounting and reporting weaknesses:

*Statement of Operations:* The Facility did not display the Statement of Operations at the library and canteen for inmates to view.

*Inappropriate Accounting for Operating Transactions:* The Facility’s IWF does not operate a canteen that purchases and stocks merchandise for resale to inmates. In lieu of an IWF canteen, Facility staff assist inmates in ordering goods from an external vendor and deliver the goods to the inmates. For this service, the inmates pay a commission (i.e., a percentage of the purchase price) to the IWF. Consequently, the IWF revenue from such activities should be limited to the inmate commissions paid on purchases.

However, for the three fiscal years under review, the Facility’s IWF Balance Sheet and Income Statements inappropriately reported canteen operation accounts for the IWF such as *Revenues (Commissary Gross Receipts), Cost of Sales/Commissary Expense, and Inventory*. At no time did the IWF own any of this inventory. The cumulative amounts recorded in these accounts are shown below:

	<u>Commissary Gross Receipts</u>	<u>Inventory</u>	<u>Cost of Goods Sold</u>
FY 2005-06	\$ 43,651	\$63,509	\$ 0
FY 2006-07	132,283	95,454	111,813
FY 2007-08	200,886	0	127,514
Qtr Ended 9/30/2008	44,660	0	42,049

This accounting for inmates’ purchases as though the IWF operated a sales/merchandising operation misrepresents the true nature of the IWF operations, and renders the IWF *Statements of Revenues and Expenses*, meaningless and unreliable.

*Inconsistent Salary Expense Reported in the IWF Income Statement:* IWF salary expenses are not consistently reported in the IWF Income Statements. Per Cornell staff, after June 30, 2006, the IWF incurred deficits and could not support IWF salaries. Consequently, IWF salaries were paid from the Facility’s General Fund and the related expenses were not recorded in the IWF. Since, IWF cash balances became

positive in fiscal year 2007-08, Cornell is considering a possible recovery of prior IWF salaries.

In neglecting to record salaries expense, Cornell overstated net income and fund balance for the periods reported, further rendering the statements unreliable. The proper accounting for IWF salaries should have been to accrue the appropriate salaries expense and the related liability in the IWF's accounts.

*Inappropriate Accounting for Telephone Receipts in the IWF:* The Facility's June 30, 2006 Income Statement reports \$78,298 in Telephone Commission Revenue. This amount consists of non-IWF receipts that should have been redirected to Corrections. Instead, Cornell deposited the receipts in the IWF bank account as IWF revenues. Accounting for non-IWF receipts as revenues overstates IWF revenues, net income, and fund balance.

*Other IWF Income Statement Reporting Errors and Inconsistencies:* The Revenue and Expenses and Net Income balances reported in the quarterly Income Statements do not consistently roll-up to the year-to-date (YTD) balances.

Per Cornell's Assistant Division Controller, the preparer did not consistently carry forward the full quarter's revenue and expenses in preparing the quarterly statements.

Further, in the Balance Sheet for the quarter ended June 30, 2007, the beginning retained earnings of \$ -77,412 used in determining the ending capital balance is not supported by the ending retained earnings of \$ -29,872 reported in the June 30, 2006 Balance Sheet. A similar beginning retained earnings discrepancy was also noted for the June 30, 2006 Balance Sheet.

These accounting and reporting errors and inconsistencies render the statements unreliable.

Criteria:

The Handbook, Section III, D2, states, in accordance with DOM Section 23010.8, the Contractor must prepare quarterly IWF statements and submit them with the Quarterly Cost Reports. These statements must be submitted to the assigned Corrections analyst, posted at the inmate canteen and Facility library, and must be shared with the inmate advisory committee.

The Handbook, page 34, states the contractor shall establish a separate Inmate Welfare Fund (IWF), and that the Contractor's IWF accounting system shall maintain accurate and current account balances and financial reports.

- Recommendations:
- A. Ensure the Statement of Operations is displayed at the Facility library and canteen for inmates to view.
  - B. Revise the IWF accounting and reporting procedures to accurately reflect the true nature of the operating activities. Discontinue reporting IWF activities as merchandise for resale operation.
  - C. Establish appropriate supervisory and managerial oversight of the IWF accounting and reporting processes. Ensure IWF statements are reviewed for accuracy and completeness and approved prior to submission to Corrections.
  - D. Revise and resubmit IWF Balance Sheets and Income Statements for the period December 2005 through September 2008 to Corrections.

**FINDING 10 Administration of IWF Checking Account Needs Improvement**

Condition: Cornell commingles the IWF bank account of five separate Cornell facilities and seven sub-cash accounts and reconciles the individual facility balances to their separate general ledger cash accounts during the monthly bank reconciliation process. Because the bank account and the reconciliation process are centrally administered from Cornell's corporate headquarters in Houston, Texas, individual facilities frequently write checks against the account without knowing their actual cash balances. Consequently, the facilities often overdraw their cash balances. For example, the Facility's IWF had negative cash balances averaging \$18,000 in each quarterly IWF financial statements issued between December 31, 2005 and December 31, 2006.

Further, all IWF quarterly balance sheets issued between December 31, 2005 through December 31, 2006 and the three balance sheets issued between June 30, 2007 and December 31, 2007 reported negative (credit) receivable balances; and less frequently, debit payable balances. Cornell staff believe the effects of the overdrawn checking account and errors in tracking the related receivables and payables may have contributed to the negative balances.

Criteria: The Handbook, page 34, states the contractor shall establish a separate Inmate Welfare Fund (IWF); and the Contractor's IWF accounting system shall maintain accurate and current account balances and financial reports.

- Recommendations:
- A. To eliminate overdrafts, Cornell should provide the Facility with daily access to it's actual IWF cash balances.
  - B. Promptly and accurately record all cash transactions in the Facility's IWF accounts.
  - C. Promptly investigate and resolve any negative balances.

APPENDIX A

SCHEDULE OF REPORTED AND  
AUDITED REVENUE AND EXPENDITURES

**Leo Chesney Community Correctional Facility  
Contract R05.005  
Schedule of Reported and Audited Revenue and Expenditures  
For the Period October 1, 2005 through June 30, 2006**

<u>Category</u>	<u>Contract Budget</u>	<u>Reported</u>	<u>Questioned</u>	<u>Adjustment</u>	<u>Audited</u>
Revenue (1)	\$3,196,410	\$3,248,276	\$ 0	\$ -1,859	\$3,246,417
Expenditures:					
Staff Salaries/Wages & Benefits/Taxes (2)	1,256,457	1,230,031	-95,069	0	1,134,962
Food	212,283	275,409	0	0	275,409
Transportation	6,872	21,293	0	0	21,293
Consulting/Contracted services	95,771	72,815	0	0	72,815
Operating Expenses (3)	793,297	414,888	0	0	414,888
Administrative Overhead	291,464	199,325	0	0	199,325
Facility Lease/Use	424,215	570,723	0	0	570,723
General Liability Insurance (4)	<u>20,355</u>	<u>19,880</u>	<u>-4,798</u>	0	15,082
Total Expenditures	<u>\$3,100,714</u>	<u>\$2,804,364</u>	<u>\$-99,867</u>	<u>\$ 0</u>	<u>\$2,704,497</u>
Corporate Fee (5)	<u>\$ 95,696</u>	<u>\$ 443,912</u>		<u>\$-348,216</u>	<u>\$ 95,696</u>
Profit/(Loss)					\$ 446,224

**Note:** This schedule does not include the Facility's first quarter of revenue and expenses because the first quarter falls under the previous contract between Cornell Corrections of California, Inc. and Corrections.

- (1) See FINDING 2 for revenue adjustment
- (2) See FINDING 3 for the questioned cost in Staff Salaries.
- (3) Reported Operating Expenses includes Property Tax, Property Insurance, and Staff Training Costs.
- (4) See FINDING 4 for the questioned cost in General Liability Insurance.
- (5) Reported revenue in excess of budgeted Corporate Fee and reported expenditures (i.e., the Reported Corporate Fee adjustment per audit) is shown below:

Reported Revenue	\$3,248,276
Less: Reported Expenses	2,804,364
Contracted Corp Fee	<u>95,696</u>
Corporate Fee Adjustment	<u>\$ 348,216</u>

APPENDIX A (Continued)  
 SCHEDULE OF REPORTED AND  
 AUDITED REVENUE AND EXPENDITURES

**Leo Chesney Community Correctional Facility  
 Contract R05.005  
 Schedule of Reported and Audited Revenue and Expenditures  
 For the Period July 1, 2006 to June 30, 2007**

<u>Category</u>	<u>Contract Budget</u>	<u>Reported</u>	<u>Questioned</u>	<u>Adjustment</u>	<u>Audited</u>
Revenue (1)	\$5,857,898	\$5,013,085	\$ 0	\$ -47,936	\$4,965,149
Expenditures:					
Staff Salaries/Wages & Benefits/Taxes (2)	2,293,409	1,965,252	-129,928	0	1,835,324
Food	407,204	433,602	0	0	433,602
Transportation	9,162	22,998	0	0	22,998
Consulting/Contracted services	130,541	65,998	0	0	65,998
Operating Expenses (3)	1,205,999	612,733	0	0	612,733
Administrative Overhead	388,618	366,475	0	0	366,475
Facility Lease/Use	853,236	914,846	0	0	914,846
General Liability Insurance (4)	<u>38,699</u>	<u>26,816</u>	<u>-8,198</u>	<u>0</u>	<u>18,618</u>
Total Expenditures	<u>\$5,326,868</u>	<u>\$4,408,720</u>	<u>\$ -138,126</u>	<u>\$ 0</u>	<u>\$4,270,594</u>
Corporate Fee (5)	<u>\$ 531,030</u>	<u>\$ 604,365</u>		<u>\$ -73,335</u>	<u>\$ 531,030</u>
Profit/(Loss)					\$ 163,525

(1) See FINDING 2 for revenue adjustment

(2) See FINDING 3 for questioned costs.

(3) Reported Operating Expenses includes Property Tax, Property Insurance, and Staff Training Costs.

(4) See FINDING 4 for questioned costs.

(5) Reported revenue in excess of budgeted Corporate Fee and reported expenditures (i.e., the Reported Corporate Fee adjustment per audit) is shown below:

Reported Revenue	\$5,013,085
<u>Less:</u> Reported Expenses	4,408,720
Contracted Corp Fee	<u>531,030</u>
Corporate Fee Adjustment	<u>\$ 73,335</u>

APPENDIX A (Continued)  
 SCHEDULE OF REPORTED AND  
 AUDITED REVENUE AND EXPENDITURES

**Leo Chesney Community Correctional Facility  
 Contract R05.005  
 Schedule of Reported and Audited Revenue and Expenditures  
 For the Period July 1, 2007 to June 30, 2008**

<u>Category</u>	<u>Contract Budget</u>	<u>Reported</u>	<u>Questioned</u>	<u>Adjustment</u>	<u>Audited</u>
Revenue	\$6,924,504	\$6,739,289	\$ 0	\$ 0	\$6,739,289
Expenditures:					
Staff Salaries/Wages & Benefits/Taxes (1)	2,507,523	2,556,740	-129,928	0	2,426,812
Food (Finding)	497,231	468,619	0	0	468,619
Transportation	9,187	16,897	0	0	16,897
Consulting/Contracted services	130,891	-88	0	0	-88
Operating Expenses (2)	1,405,167	684,536	0	0	684,536
Administrative Overhead	389,683	285,511	0	0	285,511
Facility Lease/Use	1,270,319	1,020,835	0	0	1,020,835
General Liability Insurance (3)	<u>46,071</u>	<u>32,134</u>	<u>-10,862</u>	<u>0</u>	<u>21,272</u>
Total Expenditures	<u>\$6,256,072</u>	<u>\$5,065,184</u>	<u>\$ -140,790</u>	<u>\$ 0</u>	<u>\$4,924,394</u>
Corporate Fee (4)	<u>\$ 668,432</u>	<u>\$1,674,105</u>		<u>\$ -1,005,673</u>	<u>\$ 668,432</u>
Profit/(Loss)					\$1,146,463

(1) See FINDING 3 for questioned costs.

(2) Reported Operating Expenses includes Property Tax, Property Insurance, and Staff Training Costs.

(3) See FINDING 4 for questioned costs.

(4) Reported revenue in excess of budgeted Corporate Fee and reported expenditures (i.e., the Reported Corporate Fee adjustment per audit) is shown below:

Reported Revenue	\$6,739,289
<u>Less:</u> Reported Expenses	5,065,184
Contracted Corp Fee	<u>668,432</u>
Corporate Fee Adjustment	<u>\$1,005,673</u>

APPENDIX B  
INMATE WELFARE FUND  
BALANCES

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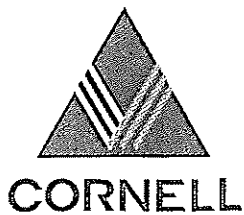
**Leo Chesney Community Correctional Facility  
Contract R05.005  
Inmate Welfare Fund Balances  
For the Period October 1, 2005 through September 30, 2008**

	<u>October 1, 2005 to June 30, 2006</u>	<u>July 1, 2006 to June 30, 2007</u>	<u>July 1, 2007 to June 30, 2008</u>	<u>July 1, 2008 to September 30, 2008</u>
Beginning Balance	\$ -64,172	\$ -15,919	\$ 5,935	\$ 52,909
Receipts	138,083	127,396	204,673	45,246
Adjustment:				
Add Unreported Receipts (1)	5,603	0	0	0
Disbursements	<u>-95,433</u>	<u>-105,542</u>	<u>-157,699</u>	<u>-62,782</u>
Ending Balance	<u>\$ -15,919</u>	<u>\$ 5,935</u>	<u>\$ 52,909</u>	<u>\$ 35,373</u>

(1) See FINDING 8

# FACILITY RESPONSE

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May 29, 2009

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 May 15, 2009 relating to Draft Audit Report – Leo Chesney Community Correctional Facility, Contract R05.005 (Report).

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

**Finding 1      Reported Expenditure Are Not Consistent With the Contract Budget**

Condition: During the three-year contract period under review, Cornell Companies, Inc., (Cornell) reported Facility expenditures (including the Corporate Fee) that significantly exceeded the contract line item budget (see Schedule 1 from draft report). Cornell did not request California Department of Corrections and Rehabilitation (Corrections) prior approval for line item fund transfers exceeding \$10,000 or 10 percent of the related budget category, as required in the Financial Management Requirements for Community Correctional Facilities Handbook (Handbook). The Handbook requires contractors to obtain Corrections' approval of transfers of \$10,000 or 10 percent between budget line items.

Recommendation: Obtain Corrections' approval prior to incurring program expenditures in excess of \$10,000 or 10 percent of the budgeted line-items.

**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 annually.

## **Finding 2 Misstated Statements of Revenue and Expenditures**

Condition: The Facility's Per Diem and Flat Fee revenues as reported in the Statement of Revenue and Expenditures (Statements) were incorrectly reported as follows:

Fiscal Year	Misstaterments	Revenue Type
2005-06	\$ 1,859	Per Diem
2006-07	\$ 47,936	Flat Fee (Facility Lease)
2007-08	\$-24,247	Per Diem
2007-08	\$ 24,247	Flat Fee (Liability Insurance)

These errors arose from inaccurate Per Diem billings, disallowed Facility lease billings, and misreporting of Per Diem revenues as liability insurance.

Recommendation: Revise the quarterly and annual cost reports and resubmit the corrected reports to Corrections.

### **Management response:**

The 2005-06 fiscal year "misstatement" of \$1,859 pertained to a portion of an invoice that was submitted to Corrections for which the amount in question was subsequently withheld from the remittance when payment was issued by Corrections to Cornell. While we concur the revenue in the 2005/2006 period was overstated by the \$1,859, we note that Cornell did not receive the amount in question from Corrections.

The 2006-07 fiscal year "misstatement" of \$47,936 pertained to an item that was disputed by Corrections which was corrected through our provision account during the same period ( the adjustment was not reflected in the QCR report as we excluded the bad debt provision from the QCR report (consistent with our interpretation of the QCR instructions)).

The 2007-08 fiscal year "misstatement" of \$24,247 was the result of a coding error between accounts within the revenue section. There was no net effect on total revenue as reflected in the statements submitted.

## **Finding 3 Duplicate Food Service Personnel Costs**

Condition: The contract budget negotiated with Cornell duplicates food service personnel costs. Specifically, for 2005-06 through 2007-08, \$354,925 in food service personnel costs were budgeted and paid first (via the contract salaries and wages budget line-item) and second (via the food costs line-item). Cornell does not pay the salaries and wages for food service personnel directly. Instead, the food service personnel costs are factored into the per-meal charges included in invoices submitted by an external food service vendor. Consequently, Corrections pays for food service personnel positions twice (i.e. in personnel costs and in food service invoices).

Recommendation: Revise and reissue corrected Annual Statements of Revenues and Expenditures to Corrections. Ensure that duplicate costs are not included in contracts with the state.

**Management response:** The Annual Statements of Revenues and Expenditures as submitted are felt to be correct as they reflect actual revenues and expenditures recognized in each category in the periods presented. Cornell ensures that duplicate costs are not inadvertently included in contracts with the state. In this case, staff and cost per meal were budgeted separately at the request of Corrections. However, Cornell was able to gain efficiencies by contracting staff and meal pricing together.

#### **Finding 4 Overstated Insurance Costs**

Condition: In lieu of the actual premiums paid, Cornell reports its budgeted General Liability Insurance projections as expenditures in the Facility's quarterly and annual Statements of Revenues and Expenditures.

If Cornell had correctly reported the actual General Liability Insurance premiums paid, the insurance costs reported and charged to the contract would have been reduced as follows:

Reported Insurance In Excess of Premiums Paid
FY 2005-06 \$ 4,798
FY 2006-07 \$ 8,198
FY 2007-08 \$10,862

Recommendation: Revise the annual Statements of Revenue and Expenditures to limit the reported General Liability Insurance expenditures to actual premiums paid.

**Management response:** The General Liability Insurance paid by the facility is based on an allocation of actual Premiums paid for Cornell's high-deductible insurance program and projected claims paid under Cornell's deductible. Supporting information was provided to the auditors (in the course of their examination) which showed that when combining premiums paid plus actual claims, the amount actually charged to the facility was less than their allocated portion as reflected in the Annual Statement of Revenues and Expenses as reported. We note that had Cornell adjusted the General Liability Premiums paid plus actual claims paid, the portion allocated to the facility would have been \$13,716 greater (than the amount actually reported). If Corrections would like us to revise the filing for this data we will do so. Please note, by utilizing a high deductible insurance program, Corrections realized significant savings as compared to first dollar guaranteed cost insurance.

#### **Finding 5 Lack of Separation of Personnel and Payroll Duties**

Condition: The Facility's Financial Officer performs the following incompatible duties:

hires new employees, enters newly hired employees into the payroll system; edits timesheets; maintains the timesheet reporting system; edits personnel positions and pay rates; maintains the personnel/payroll system; and maintains custody of unissued debit cards used to pay employee salaries. This sequence of incompatible duties provides the Financial Officer the ability and opportunity to add unauthorized or non-existent employees to the Facility payroll and to manipulate employees' pay without detection.

Recommendation: Ensure adequate separation of personnel and payroll duties.

**Management response:**

Cornell's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. We concur with the Department of Finance that adequate segregation of duties in the personnel/payroll area is a component of our internal controls over financial reporting. We believe that such a system, which includes both those controls and processes in place at the facility level as well as those which operate at Cornell's Houston Service Center, will provide reasonable assurance regarding prevention or timely detection of events that could have a material effect on the financial statements of the Company.

As we will do in this situation (as consistent with the recommendation of the Department of Finance), we continually evaluate our systems of internal control and seek to strengthen such systems (in a cost effective manner). If we determine that an additional position would further strengthen our processes in this particular area, we will submit a "Change in Established Positions" form to Corrections for their consideration and approval.

**Finding 6      Unsupported Computer Costs**

Condition: During fiscal year 2005-06 Cornell charged \$5,108 for computer costs to the Inmate Welfare Fund without explanation or documentation to support these costs. Specifically, through June 30, 2006, Cornell charged the IWF for a computer line and related monthly charges comprising 48 percent of certain vendor computer bills. These charges were not levied after June 30, 2006. Cornell was unable to provide the vendor contract or justification of the 48 percent cost allocation to the IWF.

Recommendation: Ensure all costs recorded are supported by source documentation. Revise the IWF reports to exclude the unsupported costs.

**Management response:** The unsupported computer costs for the period from October, 1, 2005 – June 30, 2006 were actually \$3,571. (The \$5,108 noted was for the period July

1, 2005 – June 30, 2006.) While the support for these costs has not been located currently, it will be promptly provided if available. In accordance of the Department of Finance’s recommendation, Cornell will ensure that future costs recorded will be supported by appropriate source documentation.

**Finding 7 Unremitted Medical Co-Pay Funds**

Condition: The Facility has not remitted to Corrections the medical co-pay funds it collected from inmates since October 2007. The total amount of collected but unremitted medical co-pay funds due to Corrections as of November 18, 2008 was \$8,567. This amount includes a balance of \$222 collected from inmates prior to October 1, 2005.

Recommendation: Remit the medical co-pay amounts collected. Ensure future medical co-pay funds collected from inmates are promptly remitted to Corrections each month.

**Management response:**

As per the Department of Finance’s recommendation, the amounts collected for medical co-pay funds from inmates since October 2007 in the total of \$8,567 will be remitted timely to Corrections. This amount includes a balance of \$222 collected from inmates prior to October 1, 2005. The facility will ensure that future medical co-pay funds collected from inmates are promptly remitted to Corrections each month.

**Finding 8 Inmate Trust fund Control Weaknesses**

Condition: We observed the following Inmate Trust Fund (ITF) control weaknesses (see draft report for specifics) in the following areas: Inadequate Cash Receipt Procedures, The Canteen Coordinator performs incompatible accounting duties for the ITF, Unremitted Commissary Commissions Due to the IWF and Inmates’ Fund Statement

Recommendation: A. Require independent verification of cash receipts by a second employee. B. Segregate incompatible ITF accounting duties. C. Remit \$5,603 in Commissary Commissions to the IWF. D. Provide all inmates with a statement of trust fund balances upon release.

**Management response:**

**With respect to the Department of Finance’s recommendations:**

- A. Inadequate Cash Receipt Procedures:** To ensure cash receipts are properly accounted for and resulting deposits are intact, the verification of cash receipts will be independently verified by two officer employees; the Mailroom Officer and the R & R Sergeant. They will update the Facility’s ITF Money Order Log Book together. In addition, the Administrative Clerk I independently audits the ITF Money Order Log Book for accuracy and prepares the bank deposit. The

Administrative Clerk II audits the amount deposited against the ITF Money Order Log Book and delivers the deposit to the bank. The Fiscal Officer now verifies the amount deposited in the bank daily (effective May 2009).

- B. Segregate incompatible ITF accounting duties:** To ensure segregation of incompatible ITF accounting duties, the Fiscal Officer will maintain custody of un-deposited receipts. The Administrative Clerk I will prepare the bank deposit. The Administrative Clerk II audits the amount deposited against the ITF Money Order Log Book and delivers the deposit to the bank. The Fiscal Officer now verifies the amount deposited in the bank daily (effective May 2009).
- C. Remit \$5,603 in Commissary Commissions to the IWF:** The unremitted Commissary purchase commission (19 percent) due to IWF for inmate purchases in the amount of \$5,603 will be transferred from ITF to IWF by June 30, 2009. Currently, the Administrative Clerk II sends the payment, including commissions, for commissary purchases to the Corporate Fiduciary Accountant. The Accountant pays the invoice and the remaining commissions are deposited in the IWF bank account.
- D. Provide all inmates with a statement of trust fund balances upon release:** Effective May 29, 2009, the Administrative Clerk II provides a statement to the inmate upon release that identifies their trust balance.

#### **Finding 9     Inmate Welfare Fund Accounting and Reporting Weaknesses**

Condition: We observed the following in Inmate Welfare Fund (IWF) accounting and reporting weaknesses (see draft report for specifics) in the following areas: Statement of Operations, Inappropriate Accounting for Operating Transactions, Inconsistent Salary Expense Reported, In the IWF Income Statement, Inappropriate Accounting for Telephone Receipts in the IWF, and Other IWF Income Statement Reporting Errors and Inconsistencies.

Per Cornell's Assistant Controller, the preparer did not consistently carry forward the full quarter's revenue and expenses in preparing the quarterly statements.

Further, in the Balance Sheet for the quarter ended June 30, 2007, the beginning retained earnings of \$-77,412 used in determining the ending capital balance is not supported by the ending retained earnings of \$-29,872 reported in the June 30, 2006 Balance Sheet. A similar beginning retained earnings discrepancy was also noted for the June 30, 2006 Balance Sheet.

These accounting and reporting errors and inconsistencies render the statements unreliable.

Recommendation: A. Ensure the Statement of Operations is displayed at the Facility library and canteen for inmates to view. B. Revise the IWF accounting and reporting procedures to accurately reflect the true nature of the operating activities. Discontinue reporting IWF activities as merchandise for resale operation. C. Establish appropriate supervisory and managerial oversight of the IWF accounting and reporting processes. Ensure IWF statements are reviewed for accuracy and completeness and approved prior to submission to Corrections. D. Revise and resubmit IWF Balance Sheets and Income Statements for the period December 2005 through September 2008 to Corrections.

**Management response:**

- A. The Facility will ensure the Statement of Operations is posted in the library and canteen for inmates to view.
  
- B. The IWF recording of the canteen purchases and commission has historically been recorded in the manner presented. The gross sales are recorded as revenue and the net amount owed to the 3<sup>rd</sup> party, Keefe, is recorded as cost of goods sold. The commission remains in the account. This is the first notice provided to Cornell that Department of Finance did not approve of the manner of the recording of these transactions. Cornell is willing to implement appropriate changes to the recording procedures to incorporate Corrections input.

Currently the Inmate Trust Account sends to the IWF account the gross amount taken from the inmates for the purchases. If Corrections prefers, the Inmate Trust Account can make the payment to Keefe directly and send the commission to the IWF. However, Cornell does not believe that the current recording practices render the IWF Statement of Revenue and Expenses “meaningless and unreliable.”

Further, the inventory account was used in error in the 2005/2006 year (instead of cost of goods sold) and was subsequently corrected in the 2006/2007 year (which caused the retained earnings difference noted in item 5 of this finding, as communicated to the auditors).

In addition, the IWF account did not contain sufficient funds to cover the salaries account as the commissions earned were not enough to support these costs. Therefore, the expense was not accrued in the years in which the account funds were insufficient. Cornell will recover the prior IWF salaries only if Corrections approves such recovery. Cornell does not believe that not recording these salaries renders the statements “unreliable”. If the IWF account cannot reasonably be expected to fund costs that are approved, Cornell believes it is inappropriate to record such expenses if the related liability cannot be funded.

- C. Of the \$78,298 that was booked as telephone commissions, \$64,174 was approved to be received by the IWF from Corrections to cover the shortfall that the Inmate Welfare Account had at the beginning of the audit period (October 1, 2005). See attached support, pages 1&2.

- D. The quarterly income statements that were submitted with the QCR's in certain quarters inadvertently reflected one month's activity instead of the full quarter's activity. However, the year-to-date (YTD) numbers presented reflected the correct YTD data. Cornell will ensure the full quarter's detail is displayed properly in QCR's going forward.

The retained earnings did not agree to the ending balance per the 2005/2006 report and the beginning balance per the 2006/2007 report; however, this was due to the inventory error that had to be recorded properly for the 2006/2007 period of \$47,540. The accountant that incorrectly recorded the cost of goods expense charged the inventory account (balance sheet account) instead of the cost of goods sold account (income statement). To properly correct the error an entry was made to move the prior period's expense in 2006/2007 to the retained earnings (where the expenses are transferred once a year is closed out). The ending retained earnings balance in the 2006/2007 statement was correct and Cornell believes that the statements are reliable.

#### **Finding 10 Administration of IWF Checking Account Needs Improvement**

Condition: Cornell commingles the IWF bank account of five separate Cornell facilities and seven sub-cash accounts and reconciles the individual facility balances to their separate general ledger cash accounts during the monthly bank reconciliation process. Because the bank account and the reconciliation process are centrally administered from Cornell's corporate headquarters in Houston, Texas, individual facilities frequently write checks against the account without knowing their actual cash balances. Consequently, the facilities often overdraw their cash balances. For example, the Facility's IWF had negative cash balances averaging \$18,000 in each quarterly IWF financial statements issued between December 31, 2005 and December 31, 2006.

Further, all IWF quarterly balance sheets issued between December 31, 2005 through December 31, 2006 and the three balance sheets issued between June 30, 2007 and December 31, 2007 reported negative (credit) receivable balances; and less frequently, debit payable balances. Cornell staff believes the effects of the overdrawn checking account and error in tracking the related receivables and payables may have contributed to the negative balances.

Recommendation: A. To eliminate overdrafts, Cornell should provide the Facility with daily access to its actual IWF cash balances. B. Promptly and accurately record all cash transactions in the Facility's IWF accounts. C. Promptly investigate and resolve any negative balances.

#### **Management response:**

- A. The individual facilities do not have the ability to issue checks. For added control, Cornell's Houston Service Center prepares such checks. To alleviate the

- complexity which may have been created by the utilization of one primary account, Cornell established separate bank accounts for each facility in July 2008.
- B. All cash transactions are entered promptly and will continue to be entered promptly.
  - C. While Cornell believes it will be unlikely such accounts will have negative balances in the future, we will monitor all accounts timely and properly investigate and resolve any such negative balances should they arise.

Please feel free to give me a call if you have any questions at 530-695-1800.

Sincerely,

Original signed by:

Paula Ford  
Facility Director

cc: Mr. Blake Barras, Vice President – FP&A  
Ms. Colleen L. Murphy, Division Controller  
Mr. Kevin R. Chappell, Acting Chief, CCFA, CDCR (via email)  
Mr. Terry Dickinson, Correctional Administrator, CCFA, CDCR (via email)  
Mr. Robert Logan, Staff Services Manager I, CCFA, CDCR (via email)  
Ms. Flordeliza Ligaya, Staff Services Manager I, CCFA, CDCR (via email)  
Mr. Renato Araza, Program Analyst, CCFA, CDCR (via email)

Cornell Corrections of California, Inc.  
(Baker CCF)

3

R92.401  
Amendment 12

4. Page 3, Item No. 4 of Amendment 11, is revised to add:  
The annual facility lease costs reimbursed by the CDC to the Contractor shall not exceed \$467,833 for FY 2004/05 and \$116,958 for FY 2005/06.
5. Page 3, Item No. 5 of Amendment 11, is revised to add:  
Effective July 1, 2004, the State shall reimburse the Contractor for allotment costs in accordance with Exhibit 15, Total Contract Allotment (FY 2004/05) and Exhibit 15, Total Contract Allotment (FY 2005/06); and the Contractor's minimum required staffing shall be in accordance with Exhibit 14, Minimum Required Staffing (FY 2004/05) and Exhibit 14, Minimum Required Staffing (FY 2005/06), attached hereto and incorporated herein.
6. Page 3, Item No. 6 of Amendment 11, is revised to add:  
For FY 2004/05, the amount of energy cost reimbursed by the CDC to the Contractor shall not exceed \$45,648; and for FY 2005/06, the amount of energy cost reimbursed by the CDC to the Contractor shall not exceed \$11,412.
7. The following paragraphs are hereby added to the original contract, last page of the Scope of Services:

14. Inmate Telephone Revenue Fund

Telephone revenues that are received by the facility which are a result of inmate telephone usage may be used:

1. to pay for costs associated with the inmate telephone system;
2. to offset budgeted education and pre-release costs;
3. to offset Inmate Welfare Fund (IWF) position costs if inadequate funding is available through the IWF program;
4. to fund program staff and / or one-time costs to improve the facility program;
- \* 5. to offset losses incurred by commissary operation if inadequate funding is available through the IWF program.

Prior Community Correctional Facilities Administration written approval is required. Any facility request not responded to within 30 days of receipt by the CCFA, such request will be considered to be approved by CDC. Telephone revenues must be accounted for in accordance with American Institute of Certified Public Accountants Standards (AICPA) or Governmental Accounting Principles (GAP). Telephone revenues are not considered IWF funds and must be accounted for separately. The facility must submit an Annual ITRF budget and an Annual IWF budget to CCFA by May 1 of the prior Fiscal Year. The ITRF expenditures will be submitted with each Quarterly Cost Report (QCR) and must identify beginning balance, revenues, expenditures, and ending balance.

All other terms and conditions not amended herein shall remain in full force and effect.

CORNELL COMPANIES, INC.  
 Reconciliation and Remittance of ITRF/ERF - Leo Chesney Center  
 As of: 9/30/05

ITRF - Summary
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Reconciled balance as of 9/30/05:

Checking account - WFB #2704896770	40,401.72
CD - WFB #8250550889	100,538.97 *
	<u>140,940.69</u>

\*

Less: Balance due to IWF for commissary operation**	(64,173.59)
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Balance due to CDC	76,767.10
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\* Indicates value upon maturity.

\*\* Refer to Contract R92.132 Amendment 11, page 3 Item 8.14.5.

ERF - Summary
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Reconciled balance as of 9/30/05:

Checking account - WFB #6620148379	(22,711.57)
CD - WFB #8250550848	75,404.22 *
	<u>52,692.65</u>

Balance due to CDC	52,692.65
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\* Indicates value upon maturity.

We have reviewed the Facility's May 29, 2009 response which is incorporated into the final report. In this evaluation of the Facility's response, 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 3** Duplicate Food Service Personnel Costs

The Facility asserts that the statements correctly report actual revenues (including the amounts attributable to duplicated food service personnel costs). However, the facility did not dispute the substance of our finding that food service staff costs (as budgeted and paid by the state) are duplicated: first in personnel costs and second in the components of the per meal charges. Instead, the Facility justifies its consequent receipt of the duplicate food service personnel revenue as efficiencies gained by contracting for the inclusion of paid staff costs in its per-meal-charges also paid by the state. The Facility clearly budgeted, billed, and was paid twice for food service personnel costs. Accordingly, our finding and recommendation remains as reported.

**FINDING 4** Overstated Insurance Costs

The Facility states that its reported General Liability insurance is based on an allocation of actual premiums on high deductible insurance and the deductible amounts on its projected claims. Under generally accepted accounting principles and cost accounting procedures, uninsured claims (including deductible portions of insurance claims) paid are direct costs of the specific cost centers (Facilities) that incurred the claim rather than allocable indirect costs. Cornell did not provide evidence that the Facility incurred insurance claim deductibles that are chargeable to the state contract. Therefore the finding remains as reported.

**FINDING 9** Inmate Welfare Fund Accounting and Reporting Weaknesses

- *Inconsistent Salary Expense Reported in the IWF Income Statement.*

The finding states, in relevant part, that after June 30, 2006, IWF salaries were paid from the Facility's General Fund and the related expenses were not recorded in the IWF. The finding also stated that in neglecting to record the salary expense, Cornell overstated IWF net income and fund balance for the periods reported, thereby rendering the statements unreliable. We further stated that the proper accounting for IWF salaries should have been to accrue the appropriate salaries expense and the related liability in the IWF accounts.

In response, Cornell believes that it is inappropriate to record such expenses if the related liability cannot be funded. However, under generally accepted accounting principles (specifically, the revenue and expense matching principle) an expense and the related liability should be recorded in the period incurred. The ability to fund an expense and thereby prevent recorded liabilities and operating losses is not a relevant or appropriate consideration. Therefore, the finding remains as reported.

- *Inappropriate Accounting for Telephone Receipts in the IWF*

The finding states that the June 30, 2006 IWF Income Statement reports \$78,298 in Telephone Commission Revenue that should have been redirected to Corrections rather than accounted for as IWF revenues. The Facility's response provides new information to support its authority from Corrections to use telephone revenues to offset \$64,174 in IWF losses incurred as of the quarter ended September 30, 2005. As of that date, the Facility's records summarize its Inmate telephone funds as follows:

Checking Account—WFB # 8250550889	\$40,402
CD—WFB	<u>100,539</u>
Total Inmate Telephone Cash	140,941
Less: Required to Offset IWF Operating Losses	<u>64,174</u>
Balance Due to Corrections, September 30, 2005	<u>\$76,767</u>

Further, our review of the Facility's subsequent quarterly IWF Income Statements through June 30, 2006 shows the following:

Accumulated Telephone Funds	\$78,298
IWF Loss Before Telephone Fund Offsets	<u>53,412</u>
Balance Due to Corrections, June 30, 2006	<u>\$24,886</u>

We note further that the Facility's IWF Income Statement at June 30, 2006 erroneously reported the \$24,886 balance due to Corrections as IWF Net Income.

Consequently, as stated in Finding 10, accounting for non-IWF receipts (such as Telephone Fund Revenue) as IWF revenue—rather than as offsets to operating losses—is misleading. It overstates IWF revenue, net income, and fund balance and renders the statements unreliable. The original recommendation remains as reported.