Transmitted via e-mail

April 11, 2011

Mr. Ronald A. Brack, Vice President
Chief Accounting Officer and Controller
The GEO Group, Inc.
One Park Place, Suite 700
621 Northwest 53rd Street
Boca Raton, FL 33487

Dear Mr. Brack:

Final Audit Report—Baker Community Correctional Facility, Contract R05.006

The Department of Finance, Office of State Audits and Evaluations, has completed its fiscal compliance audit and close-out review of the Baker Community Correctional Facility (Facility) for the period July 1, 2008 through December 31, 2009.

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

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

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

Sincerely,

Original signed by:

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

Enclosure

cc: On following page

cc: Ms. Dalinda Harman, Chief, Community Correctional Facilities Administration, California Department of Corrections and Rehabilitation
Mr. Terry Dickinson, Correctional Administrator, Community Correctional Facilities Administration, California Department of Corrections and Rehabilitation
Mr. Robert Logan, Staff Services Manager I, Community Correctional Facilities Administration, California Department of Corrections and Rehabilitation
Ms. Flordeliza Ligaya, Staff Services Manager I, Community Correctional Facilities Administration, California Department of Corrections and Rehabilitation
Mr. Renato Araza, Program Analyst, Community Correctional Facilities Administration, California Department of Corrections and Rehabilitation
Mr. Brian Evans, Senior Vice President and Chief Financial Officer, The GEO Group, Inc.
Mr. Chuck Hill, Director, Business Management, Western Regional Office, The GEO Group, Inc.

A Fiscal Compliance Audit

Baker Community Correctional Facility
Contract R05.006
For the Period July 1, 2008 through December 31, 2009

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

105225115 DDR

February 2011

MEMBERS OF THE TEAM

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Manager

M. Osman Sanneh, CPA
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Final reports are available on our website at http://www.dof.ca.gov

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Table of Contents

The California Department of Corrections and Rehabilitation (Corrections) contracted with Cornell Companies, Inc. (Cornell)[1], to operate the Baker 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 Baker, California, and is designed to accommodate an average daily population of 262 male inmates. On October 26, 2009, Corrections provided Cornell the required 60 day notice of intent to terminate contract R05.006 under which the Facility was administered. Accordingly, the contract was terminated and the Facility closed effective December 25, 2009.

Corrections requested the Department of Finance, Office of State Audits and Evaluations (Finance), to perform a fiscal compliance and close-out audit of contract R05.006 for the period July 1, 2008 through December 31, 2009.

Review Results:

- The per diem rate paid to Cornell was inflated resulting in $215,719 of questionable revenue received by the Facility. Included in its budget estimates were duplicate food service costs and unexpended funds for consultant services. We recommend Cornell refund Corrections $215,719. Further, in future contracts, ensure duplicative costs are not included in per diem contract rates, and compensated services are satisfactorily rendered in conformance with the contract budget.

- Questioned operating expenses totaling $913,381 were identified in the Quarterly Cost Reports (QCR). The questioned amounts consist of unallowable Intercompany Rent totaling $884,554; incorrectly reported Other Insurance totaling $5,781; and unallowable Employee Residence Expense totaling $23,046. We recommend Cornell revise and resubmit its QCRs to properly present allowable operating expenses.

- The Facility transferred budgeted funds from one line item to another exceeding $10,000 or more than 10 percent without Corrections' prior approval. We recommend Cornell request and receive Corrections' approval prior to transferring funds among line item categories in excess of established limits.

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

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

- Cornell is required to remit to Corrections the December 31, 2009 combined residual IWF and Inmate Trust Fund (ITF) cash balances totaling $1,325 to effectively close the Facility.

[1] Cornell was acquired by The GEO Group, Inc., on August 12, 2010.

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. Corrections contracted with Cornell Companies, Inc. (Cornell)[2], for operation of the Baker Community Correctional Facility (Facility). However, on October 26, 2009, Corrections provided Cornell the required 60 day notice of intent to terminate contract R05.006 under which the Facility is administered. Accordingly, the contract was terminated and the Facility closed effective December 25, 2009.

As stipulated by contract R05.006, the Facility's funding is a combination of flat rate expenditure reimbursement and per diem funding. The combined funding was $4,989,137 per fiscal year 2008-09 and 2009-10. Contract funds are used for the expenditure categories as shown in Appendix A.

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

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

SCOPE AND OBJECTIVES

In accordance with an interagency agreement with Corrections, the Department of Finance, Office of State Audits and Evaluations (Finance), conducted a fiscal compliance audit and close-out review of contract R05.006 between Cornell and Corrections. The audit objectives were to:

- Determine whether the Facility's cost reports accurately represent revenue received and expenditures incurred for the period July 1, 2008 through December 31, 2009.

[2] Cornell was acquired by The GEO Group, Inc., on August 12, 2010.

- Determine whether the Facility's internal control allows for the accurate and timely development of cost reporting data and adequate safeguarding of state assets.
- Determine the Facility's compliance with the contract's fiscal and reporting requirements.
- Review the activities and contract compliance of the Inmate Welfare Fund and Inmate Trust Fund for the period July 1, 2008 through December 31, 2009.
- Determine the December 31, 2009 ending balances of the Inmate Welfare Fund and Inmate Trust Fund and verify if the remaining funds were reimbursed to the state.

METHODOLOGY

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

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

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

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to provide an independent assessment of compliance with contract R05.006, to provide information to improve accountability, and to facilitate decision-making by parties with responsibility to oversee or initiate corrective action. Because our objective was not to perform a financial statement audit, we do not express an opinion on the financial information presented in the Appendices. Furthermore, our evaluation of the Facility's internal control and tests of compliance was not to provide assurance on the Facility's internal control as a whole, or to provide an opinion on compliance. Accordingly, we do not provide such assurance or express such an opinion.

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

FINDING 1 Inflated Per Diem Rate

Condition: The per diem rate paid to Cornell was inflated by $1.80, resulting in $215,719 of questionable revenue received by the Facility. Included in its budget estimates were duplicate food service personnel costs and funds for consultant services that were not provided.

During the period reviewed, Cornell invoiced and Corrections paid $131,828 in duplicate food service personnel costs. The duplicate payment was a result of Cornell including the food service personnel costs as a component of its budgeted Staff Salaries and Benefits and Food expenditure line items. The duplication of budgeted costs results in an overstatement of the per diem rate by $1.10. See Table 1.

Additionally, Cornell invoiced and Corrections paid $83,891 for consultant services that were not provided, resulting in a per diem rate overstatement of $0.70. See Table 1.

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

Table 1: Inflated Per Diem Rate

Program	**2008-09**	**2009-10**	**Total**	
Food Service				
Total Budgeted Expenditures	$4,493,774	$4,493,774		
Less: Duplicate Food Service Costs	(105,730)	(105,730)		
Adjusted Budgeted Expenditures	$4,388,044	$4,388,044		
Recalculated Per Diem Rate[3]	$ 45.89	$ 45.89		
Less: Contracted Per Diem Rate	46.99	46.99		
Per Diem Overstatement	**$ 1.10**	**$ 1.10**		**$1.10**
Annual Per Diem Bed Count	87,074	32,770		
Questioned Revenue[4]	**$ 95,781**	**$ 36,047**	**$131,828**	
Consultant Services				
Total Budgeted Expenditures	$4,493,774	$4,493,774		
Less: Unexpended Consultant Services	(66,878)	(66,878)		
Adjusted Budgeted Expenditures	$4,426,896	$4,426,896		
Recalculated Per Diem Rate	$ 46.29	$ 46.29		
Less: Contracted Per Diem Rate	46.99	46.99		
Per Diem Overstatement	**$ 0.70**	**$ 0.70**		**$0.70**
Annual Per Diem Bed Count	87,074	32,770		
Questioned Revenue[2]	**$ 60,952**	**$ 22,939**	**$ 83,891**	
Grand Total	**$ 56,733**	**$ 58,986**	**$215,719**	**$1.80**

[3] Per Diem Rate calculation: (Total Budgeted Expenditures / 262 Beds)/365 days per year
[4] Questioned Revenue = Per Diem Overstatement x Annual Bed Count.

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

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

Recommendations:

A. Refund to Corrections $215,719:

   a. $131,828 in duplicated food service personnel payments received.

   b. $83,891 in invoiced program consultant services not provided.

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

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

FINDING 2 Questioned Expenses

Condition: Questioned operating expenses totaling $913,381 were identified in the Quarterly Cost Report (QCR). The questioned amounts consist of unallowable Intercompany Rent totaling $884,554; the erroneous reporting of Other Insurance totaling $5,781; and unallowable Employee Residence Expenses totaling $23,046. See Table 2 for details.

Table 2: Summary of Questioned Operating Expenses

Operating Expenses	**2008-09**	**2009-10**	**Total**
Intercompany Rent	$ 530,370	$ 354,184	**$ 884,554**
Other Insurance	7,966	(2,185)	**5,781**
Employee Residence Costs	23,046	0	**23,046**
Total Questioned	**$ 561,382**	**$ 351,999**	**$ 913,381**

Intercompany Rent

Cornell reported $884,554 of unallowable operating expenses in its QCRs. The unallowable expenses included: Intercompany Rent for Buildings, and Improvements, Furniture, Fixtures, and Equipment reported within the Maintenance, Repair, and Rentals subcategory of the QCR's operating expenses.

The unallowable expenses consisted of leased equipment depreciation expenses and capital charges levied by Cornell's wholly owned subsidiary, WPB (lessor).

Contract R05.006 between Cornell and Corrections and the Handbook prohibits all such equipment charges. Consequently, we question the $884,554 Intercompany Rent reported in the QCRs.

Other Insurance
Cornell incorrectly reported its Other Insurance costs within the QCR's Operating Expenses category. We identified an overstatement for 2008-09 of $7,966 and an understatement for 2009-10 of $2,185. See Table 3 for calculations.

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

Table 3: Other Insurance Misstatements

Expense per Calendar Year	**2008**	**2009**
Other Insurance:		
Performance Bond	$ 24,976	$ 24,976
Employee Fiduciary, Crime	9,632	9,632
Earthquake, Flood & DIC	14,000	10,370
Total Insurance Expense Incurred	**$ 48,608**	**$ 44,978**
Fiscal Year Allocation[5]	**2008-09**	**2009-10***
Expenses Incurred	$ 46,793	$ 22,489
Expenses Reported in QCR	54,759	20,304
Over / (Under) statement	**$ 7,966**	**($ 2,185)**

Unallowable Residence Costs
Cornell included unallowable Employee Residence Expenses totaling $23,046 in its fiscal period 2008-09 QCR under the other Operating Expenses sub-category. A review of the Facility's accounting records and discussion with Cornell staff determined that these expenses are not program related and therefore, should not be reported in the QCR.

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

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

Handbook, section III.A.1.e, states that a complete inventory of all furniture, fixtures, and equipment shall be submitted to Corrections on an annual basis. Any changes shall be

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

reported quarterly. Corrections will not be responsible for any increase in equipment or related costs.

Handbook, section III.A.1.w, states allowable general operating expenses are those expenses (either one-time or ongoing) necessary to operate the contracted program.

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

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

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

Contract R05.006, General Scope of Work item 11, deleted the 1995 Handbook section IV.C.5.b which allowed for equipment depreciation charges; and replaced the language with the following:

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

Contract R05.006, General Scope of Work item 12, states the contractor shall prepare and maintain an inventory of all equipment utilized in the operation of the facility…Changes, if any, to the inventory shall be made by the contractor…Corrections shall have no obligation to increase payments to the contractor for potential increases to furniture, fixtures, and equipment costs.

Recommendations:

A. Revise and resubmit the fiscal year 2008-09 and 2009-10 QCRs to properly reflect allowable operating expenses.

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

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

FINDING 3 Reported Expenditures Are Not Consistent With the Contract Budget

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

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

Table 4: Expenditures Significantly Deviating From Contract Budget

Fiscal Year 2008-09

Category	Contract Budget	Reported	Over/(Under)	Percentage
Staff Salaries and Benefits	$2,010,334	$2,409,404	$399,070	20%
Transportation	30,566	108,814	78,248	256%
Consultant Services	66,878	0	(66,878)	(100%)
Facility Lease/Use	468,463	528,000	59,537	13%
General Liability Insurance	26,901	38,979	12,078	45%
Food	447,423	500,009	52,586	12%
Total	$3,050,565	$3,585,206	$534,641	18%

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

Category	Contract Budget*	Reported	Over/(Under)	Percentage
Staff Salaries and Benefits	$1,005,167	$ 993,289	$(11,878)	(1%)
Transportation	15,283	39,172	23,889	156%
Consultant Services	33,439	0	(33,439)	(100%)
Facility Lease/Use	234,231	255,484	21,253	9%
General Liability Insurance	13,450	21,171	7,721	57%
Operating Expenses	629,491	661,910	32,419	5%
Food	223,712	188,498	(35,214)	(16%)
Administrative Overhead	209,143	188,197	(20,946)	(10%)
Total	$2,363,916	$2,347,721	$(16,195)	(1%)

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

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

Recommendation:

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

FINDING 4 Inmate Welfare Fund Misstatements

Condition: Cornell misstated its Inmate Welfare Fund (IWF) Staff Salaries and Benefits and Operating Expenses by $71,342 for the periods reviewed (as shown in Table 5 below). Cornell paid IWF salaries from the Facility’s Operating Fund but erroneously recorded the subsequent reimbursement as a reduction of its

Operating Expenses rather than Staff Salaries and Benefits. Consequently, the reported Staff Salaries and Benefits is overstated and Operating Expenses is understated. However, the overall net effect to the QCR is zero.

Table 5: Schedule of IWF Misstatements

	2008-09	2009-10	Total
IWF Salaries claimed as Operating Expenses	$ 52,766	$ 18,576	**$71,342**

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

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

Recommendation:

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

FINDING 5 Incorrect Corporate Fee Reporting

Condition: Cornell incorrectly included the Facility's operating profit/loss in the Corporate Fee reported on the QCR. We identified an understatement for 2008-09 and 2009-10 of $874,731 and $662,345 respectively. See Table 6 for calculations.

Table 6: Schedule of Corporate Fee Misstatements

	2008-09	2009-10
Reported Revenue	$ 4,643,780	$ 1,816,028
Less: Reported Expenditures	5,257,207	2,347,721
Contracted Corporate Fee	261,304	130,652
Corporate Fee Over/(Under)statement	**$ (874,731)**	**$ (662,345)**

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

Recommendation:

Revise and resubmit fiscal year 2008-09 and 2009-10 QCRs to properly present the Corporate Fee.

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

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

FUND	Closing Cash Balance
ITF	$ 0
IWF	$ 1,325
Total	**$ 1,325**

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

Recommendation: Remit the closing IWF cash balance of $1,325 to Corrections.

APPENDIX A
SCHEDULE OF REPORTED AND AUDITED REVENUE AND EXPENDITURES

Baker Community Correctional Facility Contract R05.006 Schedule of Reported and Audited Revenue and Expenditures For the Period July 1, 2008 through June 30, 2009				
Category	**Contract Budget**	**Reported**	**Questioned**	**Audited**
Revenue	$4,989,137	$4,643,780	$ (156,733)[6]	$4,487,047
Expenditures:				
Staff Salaries and Benefits	2,010,334	2,409,404	(52,766)[7]	2,356,638
Transportation	30,566	108,814		108,814
Consulting/Contracted Services	66,878	0		0
Facility Lease/Use	468,463	528,000		528,000
General Liability Insurance	26,901	38,979		38,979
Operating Expenses	1,258,981	1,253,714	(508,616)[8]	745,098
Food	447,423	500,009		500,009
Administrative Overhead	418,287	418,287		418,287
Total Expenditures	$4,727,833	$5,257,207	$(561,382)	$4,695,825
Profit/(Loss)				$ (208,778)
Corporate Fee	$ 261,304	$ (613,427)	$ 874,731[9]	$ 261,304

[6] See Finding 1
[7] See Finding 4
[8] See Findings 2 and 4
[9] See Finding 5

Baker Community Correctional Facility
Contract R05.006
Schedule of Reported and Audited Revenue and Expenditures
For the Period July 1, 2009 through December 31, 2009

Category	Contract Budget[10]	Reported	Questioned	Audited
Revenue	$2,494,568	$1,816,028	$ (58,986)[11]	$1,757,042
Expenditures:				
Staff Salaries and Benefits	1,005,167	993,289	(18,576)[12]	974,713
Transportation	15,283	39,172		39,172
Consulting/Contracted Services	33,439	0		0
Facility Lease/Use	234,231	255,484		255,484
General Liability Insurance	13,450	21,171		21,171
Operating Expenses	629,491	661,910	(333,423)[13]	328,487
Food	223,712	188,498		188,498
Administrative Overhead	209,143	188,197		188,197
Total Expenditures	$2,363,916	$2,347,721	$ (351,999)	$1,995,722
Profit/(Loss)				$ (238,680)
Corporate Fee	$ 130,652	$ (531,693)	$ 662,345[14]	$ 130,652

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

Appendix B
Inmate Trust Fund Balances

Baker Community Correctional Facility Contract R05.006 Inmate Trust Fund Balances For the Period July 1, 2008 through December 31, 2009		
	July 1, 2008 through June 30, 2009	**July 1, 2009 through December 31, 2009**[15]
Beginning Balance	$ 73,860	$ 39,260
Deposits	129,274	49,837
Disbursements	(163,874)	(89,097)
Ending Balance	**$ 39,260**	**$ 0**[16]

[15] Balance includes activity occurring during January 2010 and February 2010 and outstanding checks totaling $637.
[16] Refer to Other Observations, Observation 1, for disposition of the ITF ending cash balance at closure.

Appendix C
Inmate Welfare Fund Balances

Baker Community Correctional Facility Contract R05.006 Inmate Welfare Fund Balances For the Period October 1, 2008 through December 31, 2009		
	October 1, 2008 through June 30, 2009	**July 1, 2009 through December 31, 2009**[17]
Beginning Balance	$46,698[18]	$31,318
Deposits	74,836	37,024
Disbursements	(90,216)	(67,017)
Ending Balance	**$31,318**	**$ 1,325**[19]

[17] Balance includes activity occurring during January 2010 and February 2010 and outstanding checks totaling $1,383.
[18] Beginning balance per bank statement as of October 1, 2008. This balance does not include outstanding checks. Finance previously audited the IWF balance through September 30, 2008.
[19] Refer to Other Observations, Observation 1, for disposition of the IWF ending cash balance at closure.

RESPONSE

The GEO Group, Inc.
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March 14, 2011

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 February 25, 2011 regarding the Draft Audit Report – Baker Community Correctional Facility, Contract R05.006 (Report).

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

Finding 1 - Inflated Per Diem Rate

The per diem rate paid to Cornell was inflated resulting in $215,719 of questionable revenue received by the Facility. Included in budget estimates were duplicate food service costs and unexpended funds for consultant services. We recommend Cornell refund Corrections $215,719. Further, in future contracts, ensure duplicative costs are not included in per diem contract rates, and compensated services are satisfactorily rendered in conformance with the contract budget.

Management Response

Cornell believes that food costs of $131,828 were not duplicated and this is an issue related to the allocation within budget allotment categories. In this case, food services staff costs and food cost per meal were budgeted separately on the Contract Budget Allotment at the request of Corrections. Subsequent to the contract award, Cornell contracted food service operations to an independent third party. As a result, the actual costs incurred with the food service contractor were reported on the Quarterly Cost Reports (QCRs) under the Food Services line item. Costs reported in the Staff Salaries & Benefits line item do not reflect any food service staff costs as these were included in the costs for the food service contractor. A Budget Revision Form to move the food service staff salaries from the personnel category to the food category was not submitted because:

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

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

The remaining amount in question of $83,891 relates to Consultant Services. During the procurement process it was anticipated that certain facility services would be provided by outside consultants, however, during actual operations it was determined that these services could be more effectively rendered in-house.

It is important to note that the Contract Budget Allotment was an estimate of a number of expense categories that were rolled up into a per diem and competitively bid during the procurement process. Contract invoices were based on a per diem, not a cost-plus format. The budget allotment and subsequent per diem were based on 100% occupancy. However, during the audit period in question the actual inmate population was approximately 84% resulting in a shortfall of revenue of approximately $1.05 million, much of which could not be mitigated due to the predominately fixed nature of the operating costs. Therefore, the per diem is not inflated, rather it is significantly deflated. Furthermore, this shortfall in revenue resulted in actual Corporate Fee (profit/loss) of ($1,145,120) as opposed to the Contract Budget Allotment amount of $391,956 - this is a loss to Cornell of over a million dollars as reported. Therefore, a "refund" of any expense line funds is neither warranted nor justified.

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

Finding 2 – Questioned Expenses

Questioned operating expenses totaling $913,381 were identified in the Quarterly Cost Reports (QCR). The questioned amounts consist of unallowable Intercompany Rent totaling $884,554; incorrectly reported Other Insurance totaling $5,781; and unallowable Employee Residence Expense totaling $23,046. We recommend Cornell revise and resubmit its QCRs to properly present allowable operating expenses.

Management Response

Intercompany Rent is the result of a sale-leaseback of all capital expenditures provided to the facility. This expense was calculated using depreciation expense and cost of capital of 10% of the asset value, which approximates the company's weighted average cost of capital. A copy of the lease agreement was provided to the auditors during field work as support for the reported expenses.

Finding 3 – Reported Expenses Are Not Consistent With Contract Budget

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

Management Response

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

Finding 4 – Inmate Welfare Misstatements

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

Management Response

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

Finding 5 – Incorrect Corporate Fee Reporting

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

Management Response

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

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

Cornell is to remit to Corrections the December 31, 2009 combined residual IWF and Inmate Trust Fund (ITF) cash balances totaling $1,325 to effectively close the Facility.

Management Response

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

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

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

Sincerely,

Original signed by:

James "Chuck" Hill
Director, Business Management

cc: file

We have reviewed The Geo Group, Inc.'s (Geo Group) March 14, 2011 response (on behalf of Cornell[20]) which is incorporated into this final report. In this evaluation, we do not provide additional comments on findings where the Facility agrees, or proposes adequate action. However, for findings where the Facility did not agree, did not propose adequate action, or where we deem additional comments necessary, we provide the following evaluation:

Finding 1: Inflated Per Diem Rate
Cornell disagrees with this finding and believes food costs were not duplicated. However, Cornell acknowledges that food preparation personnel staff costs and food costs were budgeted separately, and that both costs were borne by its food service subcontractor and paid for entirely within the Food line item of the Facility's budget. Accordingly, the budgeted Food Service Personnel within the Staff Salaries and Benefits line item was unnecessary for the facility's operation and therefore duplicative in the per diem calculation. The Handbook requires Cornell to submit a budget revision to notify Corrections of the unnecessary food service personnel budgeted line item.

Cornell contends that a Budget Revision Form was not required to be submitted. However, as noted in Finding 3, both the Staff Salaries and Benefits and Food line items actual expenditures varied from the budgeted expenditures by more than 10 percent or $10,000; thus a Budget Revsion Form was required.

Additionally, Cornell contends that Consultant Services were provided in-house rather than by outside consultants. However, a budget revision was not submitted to Corrections. Further, evidence substantiating what services were provided, how the services were rendered in-house, and at what cost was not provided to substantiate their claim.

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

Cornell also contends that because the budget allotment and subsequent per diem were based on 100 percent occupancy while the actual inmate population was approximately 84 percent, the resulting revenue shortfall of approximately $1.05 million implies the per diem is not inflated. According to Contract R05.006, Corrections recognizes that contractors are entitled to fair and reasonable compensation, including a reasonable profit in return for operating the facility. Historically, Corrections has provided for a "per diem" payment rate as the sole source of contractor profit; however, that profit is not guaranteed. Therefore, the 100 percent occupancy rate is a measure of the maximum achievable per diem revenue under the contract. However, the contract states that if the monthly participant days falls below 70 percent of total participant days available for a specific month, Corrections will pay the contractor at the per diem rate for 70 percent of the total participant days available for that specific month. Consequently, an

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

occupancy rate of 84 percent falls within the range of reasonable compensation under the contract.

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

Cornell also questions Recommendation C because it states that Cornell should ensure services are satisfactorily rendered in conformance with the contract budget in future contracts. This recommendation does not state or imply that the Facility or Cornell did not provide adequate services. Rather the recommendation addresses that Cornell should operate the facility in accordance with the contract agreement. If adjustments to budgeted line items are necessary, Cornell should follow the protocol as described in the contract to seek the reallocaiton of those funds.

Finding 2: Questioned Expenses

During audit fieldwork, Cornell's management refused to provide records supporting $884,554 Intercompany Rent claimed in the monthly per diem invoices. However, in its response, Geo Group stated the amounts reported were related to depreciation expenses for leased equipment in addition to a 10 percent capital charge levied by its wholly owned subsidiary, WPB (lessor).

Contract R05.006 between Cornell and Corrections prohibits all such equipment charges. Specifically, the General Scope of Work item 11 deleted the 1995 Handbook section IV.C.5.b which allowed for depreciation charges; and replaced the language with the following:

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

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

Therefore, our finding remains as originally reported.