August 18, 2010

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

Dear Mr. Schiller:

Final Audit Report—McFarland Community Correctional Facility, Contract R05.007

The Department of Finance, Office of State Audits and Evaluations, has completed its fiscal compliance audit and close out review of the McFarland Community Correctional Facility (Facility) for the period July 1, 2007 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. In accordance with Finance's policy of increased transparency, this report will be placed on our website.

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

Original signed by:

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

Enclosure

cc: Ms. Lisa Brewer, Facility Business Manager, McFarland Community Correctional Facility
Mr. Brian Evans, Vice President, Treasurer and Chief Accounting Officer, The GEO Group Inc.
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. Matthew Abrahamsen, Program Analyst, Community Correctional Facilities Administration, California Department of Corrections and Rehabilitation

A Fiscal Compliance Audit

McFarland Community Correctional Facility
Contract R05.007
For the Period July 1, 2007 through December 31, 2009

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

105225075 DDR

June 2010

MEMBERS OF THE TEAM

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

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EXECUTIVE SUMMARY

The California Department of Corrections and Rehabilitation (Corrections) contracted with the Geo Group, Inc. (Geo), to operate the McFarland Community Correctional Facility (Facility). Geo is responsible for providing inmate housing, sustenance, and coordinating inmate activities within the Facility. Under the direction of on-site Corrections staff, Geo also assists with inmate custody and Facility security. The Facility is located in McFarland, California, and is designed to accommodate an average daily population of 200 inmates. On October 26, 2009, Corrections provided the Geo Group the required sixty-day notice of intent to terminate contract R05.007 under which the Facility is administered. Accordingly, the contract was terminated and the Facility closed effective December 25, 2009.

Corrections requested the Department of Finance, Office of State Audits and Evaluations (Finance), to perform a fiscal compliance and close-out audit of contract R05.007 for the period July 1, 2007 through December 31, 2009.

Review Results:

- The Facility exceeded the contracted budget by more than $10,000 or more than 10 percent for various line-item expenditures without Corrections' prior approval. During fiscal years 2007-08, 2008-09, and the six-month period ended December 31, 2009, the Facility expenditures exceeded the contract budget by $404,406 (10.1 percent), $707,684 (17.8 percent), and $375,190 (18.8 percent) respectively. As a result, Geo decreased its Corporate Fee for the two and a half years reviewed and reported significant losses during the period.

- Geo is to remit to Corrections the December 31, 2009 combined residual Inmate Trust Fund and Inmate Welfare Fund cash balances totaling $35,573 to effectively close the Facility.

BACKGROUND, SCOPE, AND METHODOLOGY

BACKGROUND

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

Penal Code section 6256 authorizes Corrections to enter into contracts with appropriate public and private entities to provide housing, sustenance, supervision, inmate work incentive programs, education, vocational training, pre-release program assessment planning, and other services, as stipulated. Corrections contracted with the Geo Group, Inc. (Geo), for the operation of the Facility. However, on October 26, 2009, Corrections provided the Geo Group the required sixty-day notice of intent to terminate contract R05.007 under which the Facility is administered. Accordingly, the contract was terminated and the Facility closed effective December 25, 2009.

As stipulated by contract R05.007, the Facility's funding is a combination of flat rate expenditure reimbursement and per diem funding. The combined funding was $4,132,928, $4,124,486, and $2,062,243 in fiscal years 2007-08, 2008-09, and July 2009 through December 2009, respectively. Contract funds are used for the expenditure categories as shown in Appendix A.

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

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

SCOPE AND OBJECTIVES

In accordance with an interagency agreement with Corrections, Finance conducted a fiscal compliance audit of contract R05.007 between Geo and Corrections. The audit objectives were to:

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

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

METHODOLOGY

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

To ensure the Facility maintains an effective internal control system, an understanding of the Facility's internal control was obtained through inquiries 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 January 2010 and February 2010.

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to provide an independent assessment of compliance with contract R05.007, 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 the Facility, Geo, 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.

June 7, 2010

FINDING 1 Reported Expenditures Are Not Consistent With the Contract Budget

Condition: During the two and a half year contract period reviewed, Geo reported Facility expenditures that significantly deviated from the contract line item budgets (see Table 1 below). Geo did not request Corrections' prior approval for line item fund transfers exceeding $10,000 or more than 10 percent of the related budget category, as required in the Handbook.

Table 1: Expenditures Significantly Deviating From Contract Budget

Fiscal Year 2007-08

Category	Contract Budget	Reported	(Over)/Under	Percentage
Staff Salaries and Benefits	$1,978,578	$2,369,513	($390,935)	(19.8%)
Food	189,686	131,643	58,043	30.6%
Transportation	14,144	15,926	(1,782)	(12.6%)
Operating Expenses	625,313	685,132	(59,819)	(9.6%)
Administrative Overhead	192,569	192,569	0	0%
Facility Lease/Use	950,000	950,000	0	0%
General Liability Insurance	45,089	55,002	(9,913)	(22.0%)
Total	**$3,995,379**	**$4,399,785**	**($404,406)**	**(10.1%)**

Fiscal Year 2008-09

Category	Contract Budget	Reported	(Over)/Under	Percentage
Staff Salaries and Benefits	$1,978,578	$2,614,901	($636,323)	(32.2%)
Food	189,686	135,903	53,783	28.4%
Transportation	14,144	17,008	(2,864)	(20.2%)
Operating Expenses	616,871	723,903	(107,032)	(17.4%)
Administrative Overhead	192,569	192,569	0	0%
Facility Lease/Use	950,000	950,000	0	0%
General Liability Insurance	45,089	60,337	(15,248)	(33.8%)
Total	**$3,986,937**	**$4,694,621**	**($707,684)**	**(17.8%)**

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

Category	Contract Budget*	Reported	(Over)/Under	Percentage
Staff Salaries and Benefits	$989,289	$1,391,573	($402,284)	(40.7%)
Food	94,843	47,991	46,852	49.4%
Transportation	7,072	5,144	1,928	27.3%
Operating Expenses	308,436	321,837	(13,401)	(4.3%)
Administrative Overhead	96,285	96,285	0	0%
Facility Lease/Use	475,000	475,000	0	0%
General Liability Insurance	22,545	30,830	(8,285)	(36.7%)
Total	**$1,993,470**	**$2,368,660**	**($375,190)**	**(18.8%)**

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

The Handbook requires contractors to obtain Corrections' approval for 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. However, for the periods stated above, Geo forfeited its corporate fee and incurred significant losses (See Appendix A).

Criteria: Handbook, Section D, Request to Change Contract Budgeting/Staffing Line Item(s), page 41, requires the contractor 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 (Appendix E) 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 (not to include prior years).

Recommendation:

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

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

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

FUND	CLOSING CASH BALANCE
ITF	$ 1,317
IWF	34,256
Total	**$ 35,573**

Recommendation: Remit the residual ITF and IWF cash balance of $35,573 to Corrections to achieve final closure of the Facility's funds.

Appendix A
Schedule of Reported and Audited Revenue and Expenditures

McFarland Community Correctional Facility
Contract R05.007
Schedule of Reported and Audited Revenue and Expenditures
For the Period July 1, 2007 through June 30, 2008

Category	Contract Budget	Reported	Questioned	Adjustment	Audited
Revenue	$4,132,928	$4,089,917	$ 0	$ 0	$4,089,917
Expenditures:					
Staff Salaries and Benefits	1,978,578	2,369,513		0	2,369,513
Food	189,686	131,643		0	131,643
Transportation	14,144	15,926		0	15,926
Operating Expenses	625,313	685,132		0	685,132
Administrative Overhead	192,569	192,569		0	192,569
Facility Lease/Use	950,000	950,000		0	950,000
General Liability Insurance	45,089	55,002		0	55,002
Total Expenditures	$3,995,379	$4,399,785	$ 0	$ 0	$4,399,785
Corporate Fee [1]	$ 137,549	($ 309,868)		$447,417	$ 137,549
Profit/(Loss)					($447,417)

[1] **Note:** The Corporate Fee reported by the Geo Group erroneously includes a $447,417 operating loss. This requires the following correcting adjustment:

Reported Revenue	$4,089,917
Less: Reported Expenses	4,399,785
Contracted Corp Fee	137,549
Corporate Fee Adjustment	$ (447,417)

McFarland Community Correctional Facility
Contract R05.007
Schedule of Reported and Audited Revenue and Expenditures
For the Period July 1, 2008 through June 30, 2009

Category	Contract Budget	Reported	Questioned	Adjustment	Audited
Revenue	$4,124,486	$3,765,862	$ 0	$ 0	$3,765,862
Expenditures:					
Staff Salaries and Benefits	1,978,578	2,614,901		0	2,614,901
Food	189,686	135,903		0	135,903
Transportation	14,144	17,008		0	17,008
Operating Expenses	616,871	723,903		0	723,903
Administrative Overhead	192,569	192,569		0	192,569
Facility Lease/Use	950,000	950,000		0	950,000
General Liability Insurance	45,089	60,337		0	60,337
Total Expenditures	$3,986,937	$4,694,621	$ 0	$ 0	$4,694,621
Corporate Fee [1]	$ 137,549	($ 928,759)		$1,066,308	$ 137,549
Profit/(Loss)					($1,066,308)

[1] **Note:** The Corporate Fee reported by the Geo Group erroneously includes a $1,066,308 operating loss. This requires the following correcting adjustment:

Reported Revenue	$3,765,862
Less: Reported Expenses	4,694,621
Contracted Corp Fee	137,549
Corporate Fee Adjustment	$(1,066,308)

McFarland Community Correctional Facility
Contract R05.007
Schedule of Reported and Audited Revenue and Expenditures
For the Period July 1, 2009 through December 31, 2009

Category	Contract Budget	Reported	Questioned	Adjustment	Audited
Revenue	$2,062,245	$1,623,053	$ 0	$ 0	$1,623,053
Expenditures:					
Staff Salaries and Benefits	989,289	1,391,573		0	1,391,573
Food	94,843	47,991		0	47,991
Transportation	7,072	5,144		0	5,144
Operating Expenses	308,436	321,837		0	321,837
Administrative Overhead	96,285	96,285		0	96,285
Facility Lease/Use	475,000	475,000		0	475,000
General Liability Insurance	22,545	30,830		0	30,830
Total Expenditures	$1,993,470	$ 2,368,660	$ 0	$ 0	$2,368,660
Corporate Fee [1]	$ 68,775	($ 745,607)		$814,382	$ 68,775
Profit/(Loss)					($ 814,382)

[1] **Note:** The Corporate Fee reported by the Geo Group erroneously includes an $814,382 operating loss. This requires the following correcting adjustment:

Reported Revenue	$1,623,053
Less: Reported Expenses	2,368,660
Contracted Corp Fee	68,775
Corporate Fee Adjustment	$ (814,382)

Appendix B
Inmate Trust Fund Balances

McFarland Community Correctional Facility
Contract R05.007
Inmate Trust Fund Balances
For the Period July 1, 2007 through December 31, 2009[1]

	July 1, 2007 through June 30, 2008	July 1, 2008 through June 30, 2009	July 1, 2009 through December 31, 2009[1]
Beginning Balance	$ 34,473	$ 23,964	$ 16,357
Deposits	129,715	100,473	36,384
Interest	3	4	1
Service Charge			(35)
Disbursements	(140,227)	(108,084)	(51,390)
Ending Balance	$ 23,964	$ 16,357	**$ 1,317**[2]

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

Appendix C
Inmate Welfare Fund Balances

McFarland Community Correctional Facility
Contract R05.007
Inmate Welfare Fund Balances
For the Period July 1, 2007 through December 31, 2009[3]

	July 1, 2007 through June 30, 2008	July 1, 2008 through June 30, 2009	July 1, 2009 through December 31, 2009[3]
Beginning Balance	$ 20,573	$ 30,633	$ 32,429
Deposits	20,360	7,002	3,873
Interest	143	5	
Disbursements	(10,443)	(5,211)	(2,046)
Ending Balance	$ 30,633	$ 32,429	**$ 34,256**[4]

[3] Balance includes activity occurring during January 2010.
[4] 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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July 29, 2010

Mr. David Botelho, CPA
Chief, Office of State Audits and Evaluations
Department Of Finance
State of California
800 Capital Mall, Suite 800
Sacramento, California 95814

Dear Mr. Botelho,

This letter is in response to the audit of the McFarland Community Correctional Facility, Contract between the California Department of Corrections and Rehabilitation ("CDCR") and The GEO Group, Inc. ("GEO") dated June 30, 2010. The audit includes certain review determinations, reportable findings and recommendations. The following is our response to the findings as outlined in the audit:

FINDING 1: Reported Expenditures Are Not Consistent With the Contract Budget

In an effort to recruit and retain quality staff to ensure the proper operation of McFarland CCF, GEO funded significant salary increases for the facility employees at no cost to the CDCR. GEO's decision to increase staff pay was discussed in detail with CDCR staff as well and the previous DOF auditors. Note a budget revision request was submitted for FY2008/09.

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

The Inmate Welfare and Inmate Trust Fund cash balances of $35,573 (checks #1375 & #1376) were submitted to CDCR prior to the completion of the Department of Finance audit and have notably been cleared which achieves the final closure of the Facility funds.

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

Very truly yours,

Original signed by:

Brian R. Evans
Senior Vice-President and
Chief Financial Officer
The GEO Group, Inc.

EVALUATION OF RESPONSE

We reviewed Geo's July 29, 2010 response and provide the following evaluation:

FINDING 1 Reported Expenditures Are Not Consistent With the Contract Budget

Geo's response included a December 31, 2008 budget revision request (without approval signatures) for "salary increases for facility employees at no cost to the CDCR." However, as noted in the report, the Handbook, which is incorporated into the facility contract by reference, expressly requires the contractor 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." Neither the Geo response nor the December 31, 2008 budget revision request constitute prior written approval for the fiscal year 2007-08, 2008-09, and 2009-10 expenditures. Therefore, our finding remains as reported.