DEPARTMENT OF FINANCE
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Transmitted via e-mail

February 2, 2012

Ms. Dalinda Harman, Chief
Contract Beds Unit
California Department of Corrections and Rehabilitation
10961 Sun Center Drive
Rancho Cordova, CA 95670

Dear Ms. Harman:

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

The Department of Finance, Office of State Audits and Evaluations, has completed its fiscal compliance audit of the Central Valley Modified Community Correctional Facility (Facility) for the period July 1, 2007 through June 30, 2010.

The enclosed report is for your information and use. The GEO Group's response to the report observation and our evaluation of the response are incorporated into this final report. 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 Kimberly Tarvin, Manager, 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. Lydia Romero, Chief Deputy Warden, Contract Beds Unit, California Department of Corrections and Rehabilitation

Ms. Joan Smith, Associate Warden, Contract Beds Unit, California Department of Corrections and Rehabilitation

Mr. Robert Logan, Staff Services Manager I, Contract Beds Unit, California Department of Corrections and Rehabilitation

Mr. Renato Araza, Program Analyst, Contract Beds Unit, California Department of Corrections and Rehabilitation

Mr. Ronald A. Brack, Vice President, Chief Accounting Officer and Controller, The GEO Group, Inc.

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

Mr. Chuck Hill, Director, Business Management, The GEO Group, Inc.

Ms. Cheryl Nelson, Director, Contract Compliance, The GEO Group, Inc.

Mr. Johnny Choate, Facility Director, Central Valley Modified Community Correctional Facility

Mr. Jeffrey Chavez, Business Manager, The GEO Group, Inc

A Fiscal Compliance Audit

Central Valley Modified Community Correctional Facility

Contract R96.133

For the Period July 1, 2007 through June 30, 2010

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

115225009 DDR

November 2011

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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 Central Valley Modified 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 600 male inmates. The Facility closed in October 2011 when the contract terminated.

Corrections requested the Department of Finance, Office of State Audits and Evaluations (Finance), to perform a fiscal compliance audit of contract R96.133 for the period July 1, 2007 through June 30, 2010.

Results:

The cost reports included $1,986,630 in unsupported and unallowable costs including $1,580,581 in administrative costs, $257,675 in unsupported property taxes, and $148,374 in unallowable depreciation costs. The Facility should ensure all costs reported are supported and allowable.

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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 the GEO Group, Inc. (GEO), for operation of the Central Valley Modified Community Correctional Facility (Facility).

As stipulated by contract R96.133, the Facility's funding is a combination of flat rate expenditure reimbursement and per diem funding. The combined funding was $10,949,610 for fiscal year 2007-08; and $13,139,580 for 2008-2009, and $13,139,580 for 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.
- *Inmate Telephone Revenue Fund*—Special program funds received for inmate telephone services designed for specific activities, as outlined in the contract.

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 of contract R96.133 between GEO and Corrections for the period July 1, 2007 through June 30, 2010. The audit objectives were to:

- Obtain an understanding of the Facility's internal control related to accurate and timely development of cost reporting data and safeguarding of state assets.

- Determine whether the Facility's cost reports accurately represent revenue received and expenditures incurred.
- 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 Telephone Revenue Fund.
- Determine the ending balances of the Inmate Welfare Fund and Inmate Telephone Revenue Fund as of June 30, 2010.

Because our objectives did not include performing a financial statement audit, we do not express an opinion on the financial information presented in the Appendices. Furthermore, our review of the Facility's internal control and 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.

METHODOLOGY

To determine whether the Facility's cost reports were accurate and in compliance with the contract's fiscal and reporting requirements, we performed the following:

- Reviewed the contract agreement, Corrections' Department Operations Manual, and the Financial Management Requirements for Community Correctional Facilities dated January, 1995 (Handbook).
- Obtained an understanding of the Facility's internal control through inquiries of Facility staff.
- Traced information reported on the cost reports to the Facility's general ledger and subsidiary ledgers.
- Assessed revenue and expenditures reported in the Facility's general ledger for reasonableness.
- Traced a sample of receipts and disbursements to supporting documentation.

To assess the completeness and propriety of the Inmate Welfare Fund and Telephone Revenue Fund, we performed the following:

- Gained and understanding of the internal control.
- Reviewed the Facility's general ledger and/or subsidiary ledgers.
- Identified fund transfers.
- Determined whether transfers met eligibility requirements.
- Assessed fund disbursements.
- Investigated any unusual transactions.
- Verified that the Facility maintained the funds in accordance with contract requirements.

The results are presented in the *Finding and Recommendation* section of this report. The Appendices include schedules of financial related information presented for additional information and analysis.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This report is intended solely for the information and use of 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.

FINDING 1 Unsupported and Unallowable Expenditures Totaling $1,986,630

Condition: The cost reports included unsupported administrative costs of $1,580,581, unsupported property taxes of 257,675, and unallowable depreciation costs of $148,374. See Table 1 for details.

Table 1: Summary of Unsupported and Unallowable Expenditures

Category	2007-08	2008-09	2009-10	Total
Administrative Costs	$508,955	$524,721	$546,905	$1,580,581
Property Tax	62,085	153,521	42,069	257,675
Depreciation	36,521	26,839	85,014	148,374
Total	$607,561	$705,081	$673,988	$1,986,630

Administrative Costs
The Administrative Overhead Plan is provided in GEO's annual reports. However, GEO did not provide the following information requested related to the Administrative Overhead Plan. Without this information, GEO could not provide reasonable assurance that its overhead cost allocation is fair and equitable.

- Professional Salaries—Composition of the professional salaries to verify that unallowable items such as bonuses and special pay were not included in the costs allocated to the Facility.

- Other Professional Fees—Composition of costs included in this line item to verify that these costs should be allocated to the Facility.

- Corporate-Wide Administrative Overhead Costs—Evidence that the corporate-wide administrative overhead costs were allocated to all its facilities, including both foreign and domestic facilities.

Property Tax
GEO reported property tax payments of $257,675 in the cost reports that were not supported by property tax payment records.

Depreciation
GEO reported $148,374 in unallowable equipment depreciation expenses in the cost reports.

Criteria: The Financial Management Requirements for Community Correctional Facilities (Handbook), section IV.C.10 states that administrative services rendered must be measurable and applicable to the contracted facility program. In addition, documentation supporting the administrative overhead rate is subject to audit. The Handbook further states that the cost allocation plan must include a detailed breakdown of costs, identify cost categories that are allowable, and must identify cost categories that are allowable as administrative overhead costs.

The Handbook section IV.B states that all costs recorded will be supported by sufficient, competent, and relevant source documentation.

Contract R96.133 between GEO and Corrections and the Handbook prohibits equipment depreciation expenses.

Recommendation:

The Facility should ensure that only allowable and adequately supported costs are reported in the cost reports and close-out reports in accordance with the terms of the contract agreement and Handbook.

Appendix A

Schedule of Reported and Audited Revenue and Expenditures

Central Valley Modified Community Correctional Facility Contract R96.133 Schedule of Reported and Audited Revenue and Expenditures For the Period July 1, 2007 through June 30, 2008				
Category	**Contract Budget**	**Reported**	**Questioned**[1]	**Audited**
Revenue	$10,949,610	$10,885,203		$10,885,203
Expenditures:				
Staff Salaries and Benefits	4,542,021	4,766,230		4,766,230
Food	467,522	455,399		455,399
Transportation	47,156	26,476		26,476
Consulting/Contracted Services	77,504	54,412		54,412
Operating Expenses	1,079,021	839,931	(36,521)	803,410
Property Tax	395,540	415,120	(62,085)	353,035
General Liability Insurance	143,650	110,998		110,998
Administrative Overhead	488,062	508,955	(508,955)	0
Facility Lease/Use	3,128,664	3,128,664		3,128,664
Total Expenditures	$10,369,140	$10,306,185	($607,561)	$ 9,698,624
Profit/(Loss)				$ 1,186,579
Corporate Fee[2]	$ 580,470	$ 579,019		$ 579,019

[1] See Finding 1.
[2] The Corporate Fee is presented separately because it represents a portion of the Facility's Profit/(Loss).

SCHEDULE OF REPORTED AND AUDITED REVENUE AND EXPENDITURES

Central Valley Modified Community Correctional Facility Contract R96.133 Schedule of Reported and Audited Revenue and Expenditures For the Period July 1, 2008 through June 30, 2009				
Category	**Contract Budget**	**Reported**	**Questioned[1]**	**Audited**
Revenue	$13,139,580	$13,030,093		$13,139,580
Expenditures:				
Staff Salaries and Benefits	5,329,611	5,364,754		5,364,754
Food	488,713	481,759		481,759
Transportation	44,067	28,807		28,807
Consulting/Contracted Services	75,000	14,927		14,927
Operating Expenses	1,079,445	1,020,222	(26,839)	993,383
Property Tax	448,833	380,967	(153,521)	227,446
General Liability Insurance	132,720	124,381		124,381
Administrative Overhead	536,477	524,721	(524,721)	0
Facility Lease/Use	4,200,000	4,200,000		4,200,000
Total Expenditures	$12,334,866	$12,140,538	($705,081)	$11,435,457
Profit/(Loss)				$ 1,704,123
Corporate Fee[2]	$ 804,714	$ 889,555		$ 889,555

[1] See Finding 1.
[2] Corporate Fee is presented separately because it represents a portion of the Facility's Profit/(Loss).

Central Valley Modified Community Correctional Facility Contract R96.133 Schedule of Reported and Audited Revenue and Expenditures For the Period July 1, 2009 through June 30, 2010				
Category	**Contract Budget**	**Reported**	**Questioned[1]**	**Audited**
Revenue	$13,139,580	$13,124,210		$13,139,580
Expenditures:				
Staff Salaries and Benefits	5,329,611	5,665,467		5,665,467
Food	488,713	472,870		472,870
Transportation	44,067	12,464		12,464
Consulting/Contracted Services	75,000	0		0
Operating Expenses	1,079,445	1,082,877	(85,014)	997,863
Property Tax	448,833	341,232	(42,069)	299,163
General Liability Insurance	132,720	128,604		128,604
Administrative Overhead	536,477	546,905	(546,905)	0
Facility Lease/Use	4,200,000	4,200,050		4,200,050
Total Expenditures	$12,334,866	$12,450,469	($673,988)	$11,776,481
Profit/(Loss)				$ 1,363,099
Corporate Fee[2]	$ 804,714	$ 673,741		$ 673,741

1 See Finding 1.
2 Corporate Fee is presented separately because it represents a portion of the Facility's Profit/(Loss).

Appendix B

Inmate Welfare Fund Balances

Central Valley Modified Community Correctional Facility Contract R96.133 Inmate Welfare Fund Balances For the Period July 1, 2008 through June 30, 2010			
	January 1, 2008 through June 30, 2008	**July 1, 2008 through June 30, 2009**	**July 1, 2009 through June 30, 2010**
Beginning Balance	$ 17,289	$ 79,202	$ 80,348
Add:			
Deposits	181,586	52,070	55,538
Subtotal	198,875	131,272	135,886
Deduct:			
Disbursements	(119,673)	(50,924)	(51,472)
Ending Balance	$ 79,202	$ 80,348	$ 84,414

APPENDIX C

INMATE TELEPHONE REVENUE FUND BALANCES

Central Valley Community Correctional Facility Contract R96.133 Inmate Telephone Revenue Fund Balances For the Period February 1, 2009 through June 30, 2010		
	February 1, 2009 through June 30, 2009	**July 1, 2009 through June 30, 2010**
Beginning Balance	$1,595.692	$1,598,462
Add:		
Interest	3,280	5,413
Subtotal	1,598,972	1,603,875
Deduct		
Disbursements	(510)	(1,141)
Ending Balance	$1,598,462	$1,602,734

Response

The GEO Group, Inc.
Western Region Office
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Suite 825
Los Angeles, CA 90045

TEL: 310 348 3000
www.geogroup.com

December 14, 2011

Mr. David Botelho, CPA
Department of Finance
Chief, Office of State Audits and Evaluations
300 Capitol Mall, Suite 801
Sacramento, CA 05814

RE: Draft Audit Report – Central Valley MCCF, Contract R96.133

Dear Mr. Botelho:

I am writing to you in response to your communication dated November 21, 2011 regarding the Draft Audit Report – Central Valley Modified Community Correctional Center (Report).

In the Report there was one finding, with multiple parts, (summarized below) to which we have provided initial comments for each on an individual basis as noted:

Finding 1

The cost reports included unsupported administrative costs of $1,580,581, unsupported property taxes of $257,675, and unallowable depreciation costs of $148,374.

Management Response

GEO will address each of these areas separately beginning with administrative costs.

Administrative Costs

GEO provided The Administrative Overhead Plan and allocation methodology. The three areas that have been identified as having insufficient information were:

- Professional Salaries
- Other Professional Fees
- Corporate-Wide Administrative Overhead Costs

Management has a corporate allocation method, previously approved in prior audits, which eliminates unallowable salaries, entire department costs, and other unallowable expenses from our calculations. The table below shows the total Corporation's overhead, reduced by specific unallowable departments, and then the remaining amount of unallowable costs we have deducted from our overhead which then leaves the amount used in our allocation method. Management is confident that our plan follows the guidelines as per the previously approved Corporate

Allocation Method, as is evidenced by our elimination of 44-46% of our annual overhead costs from our Administrative Overhead Plan calculations.

		2007-2008 OH Summary		2008-2009 OH Summary		2009-2010 OH Summary
Total Overhead	**$**	**66,127,772**	**$**	**66,030,865**	**$**	**70,031,955**
Less: Business Development	$	720,258	$	4,546,039	$	4,746,127
Less: Legal	$	3,841,322	$	4,246,974	$	2,528,890
Less: International	$	950,248	$	478,472	$	641,677
Less: M & A	$	1,697,829	$	-	$	2,347,250
Net Overhead	$	58,918,115	$	56,759,380	$	59,768,011
Excluded Overhead	$	21,744,118	$	21,204,838	$	22,255,652
Reported Overhead	**$**	**37,173,997**	**$**	**35,554,542**	**$**	**37,512,359**

Professional Salaries. GEO reported only allowable professional salaries in our "Administrative Overhead Plan". This is evidenced by the table below showing total overhead wages, our reported allowable wages, and the amount GEO did not allocate to the facilities. The amount not allocated is comprised of executive compensation above the maximum limit, bonuses, and special pay.

	2007-2008	2008-2009	2009-2010
Total Compensation	$23,799,703	$24,357,648	$26,056,857
Allocated Compensation	$17,074,071	$15,387,968	$15,367,317
Unallowable Compensation	$ 6,725,632	$ 8,969,680	$10,689,540

Management believes we have fairly and accurately represented the allowable compensation as "Professional Salaries" and our amounts do not contain unallowable costs.

Other Professional Fees. GEO excludes significant overhead costs. GEO only includes allowable costs in the Administrative Overhead allocation and has specifically excluded legal fees, entertainment, fines and/or penalties, interest costs, merger and acquisition fees, business development fees, and lobbying/political contributions, and other contributions/donations from the amounts that comprise our overhead to be allocated.

Corporate-Wide Administrative Overhead Costs. GEO's Administrative Overhead Plan includes allowable overhead/administrative expenses that are directly related to our GEO Corrections North America division and has allocated those expenses over the facilities within GEO Corrections North America. In our calculation of total allowable expenses, GEO excludes all costs associated with other subsidiaries (International and GEOCare). All expenses related to the "International" division housed in our Corporate Office were excluded from the Overhead Plan allocation calculations, as were all expenses associated with our various international subsidiaries. We have three foreign subsidiaries, or joint ventures in the case of our South

African company, each with their own dedicated home (corporate) office providing oversight and support. Management therefore believes, due to the complete exclusion of these costs in the Overhead Plan, GEO correctly allocated the total allowable Administrative Overhead based on our domestic facilities within the Corrections North America division.

Property Taxes

Management's review of the auditor's report of payment amounts found that supplemental tax payments made under the Proposition 13 revaluation were not included, nor were payments made for tangible property taxes included in the auditor's report. In January 2007, when GEO acquired CPT, the owner of the Central Valley facility, the assessors were permitted to revalue the properties under California Proposition 13. In reporting the tax amounts on the annual cost reports, GEO used calculations based on our best estimate of values. The assessing jurisdictions commenced their revaluation. It took several years for Kern County to finalize the values. Therefore, the reported amounts were, what management believed at the time, based on our assumption of the new values and assumed new tax rate and supplemental tax amounts. Subsequently, the County billed GEO for supplemental taxes for the reported period, as shown in the table below, however in the years following, GEO's reported tax amount was in fact higher than actual taxes paid. The table below illustrates what true tax amounts were paid and should have been reported. Additionally, tax payments made on "Tangible Property" were not included in the auditor's reported amounts and are included in the table below.

	FY07/08	FY08/09	FY 09/10
Reported Amount	$415,120	$380,967	$341,232
Audited Amount	$353,035	$227,446	$299,163
Additional Prop. Payments	$32,204	$32,172	$0
Tangible Property Tax	$4,509	$4,347	$5,111
New Amount	$389,748	$263,965	$304,274
Difference	($25,372)	($117,002)	($36,958)

Management acknowledges that there were differences between the reported amounts and actual payments, however at the time GEO reported the best estimated tax payments based on the information available at the time. The difference between the amounts should be removed from the Property Tax line item, and the Corporate Fee should be amended to include that amount.

Depreciation

Depreciation for the cost of the facility was not included in the reported amounts. Depreciation reported was not for "leased equipment" but for computers, furniture, and other non expendable equipment. These are "contractor owned non expendable equipment", and consistent with prior practice and per the Financial Management Handbook section IV.C.5.(b) those may be recognized as costs and reported as such.

Conclusion

GEO appreciates you taking the time to send us this draft report, as well as allowing us the opportunity to clarify any misunderstandings regarding the reported results.

Sincerely,

"Original Signed By"

James C. Hill
Director, Business Management

cc: file

EVALUATION OF RESPONSE

We have reviewed The GEO Group, Inc.'s (GEO), December 14, 2011 response, which is incorporated into this final report. Our comments related to the response are as follows:

FINDING 1 Unsupported and Unallowable Expenditures Totaling $1,986,630

Administrative Costs
GEO disagrees with this finding and states that administrative costs including professional salaries, other professional fees, and corporate-wide administrative overhead costs fairly and accurately represent the allowable compensation.

GEO did not provide records supporting the composition of the professional salaries, other professional fees, or evidence that the allocated corporate-wide administrative overhead costs exclude all costs associated with other subsidiaries. Therefore, the finding remains as originally reported.

Property Taxes
GEO acknowledges there were differences between reported amounts and actual payments, but that the audited amounts did not include supplemental tax payments under Proposition 13 and tangible property taxes. However, GEO did not provide payment records supporting these amounts. The audited amounts reflect actual payments received by the Kern County Assessor's Office. Therefore, the finding remains as originally stated.

Depreciation
GEO disagrees with this finding and states the depreciation costs are for contractor owned nonexpendable equipment including computers, furniture, and other nonexpendable equipment. Additionally, GEO indicated the Financial Management Handbook section 1V.C.5(b) allows these costs.

We concur that the questioned depreciation costs pertained to computers, furniture, and other nonexpendable equipment and deleted the term "leased" from the final report. However, Contract R96.133 Amendment 1, section 3, Equipment, states the Financial Management Handbook section IV.C.5 is no longer applicable to the contract and is deleted in its entirety. As a result, the equipment depreciation expenses are not an allowable cost. Therefore, this finding remains in the final report.