

**AUDIT REPORT
OF THE
NEBRASKA DEPARTMENT OF
CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES**

JULY 1, 1999 THROUGH JUNE 30, 2000

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

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NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

BACKGROUND

In 1967, the Division of Corrections was created within the Department of Public Institutions. The Department of Correctional Services (Department) was established as a separate agency of State government in 1973. The Department has responsibility for custody, control, study, correctional treatment, training, and rehabilitation of persons committed to it so they may be prepared for lawful and productive community living.

To further this goal the Department operates Cornhusker State Industries (CSI), which enables the Department Director to make available to inmates participation in productive work in traditional industries and private venture projects. The first prison industry shop opened in 1886 and operated the following shops: shoes, furniture, laundry, paint, and canning. In 1935, the Legislature passed an act providing for what is commonly called the "State Use System of Prison Industries" and in 1969 passed the law that authorizes CSI to exist.

CSI locates its various operations in a majority of the department's secure adult institutions. Inmate on-the-job training is currently available in the areas of painting, printing, sheet metal, furniture manufacturing, signs, soaps and detergents, garments, mattresses, word processing, and Braille materials. Tax-supported agencies, political subdivisions, public schools and colleges, and charitable, fraternal, or registered non-profit organizations may purchase the items produced by CSI's traditional industries. Braille materials may be sold to individuals and firms.

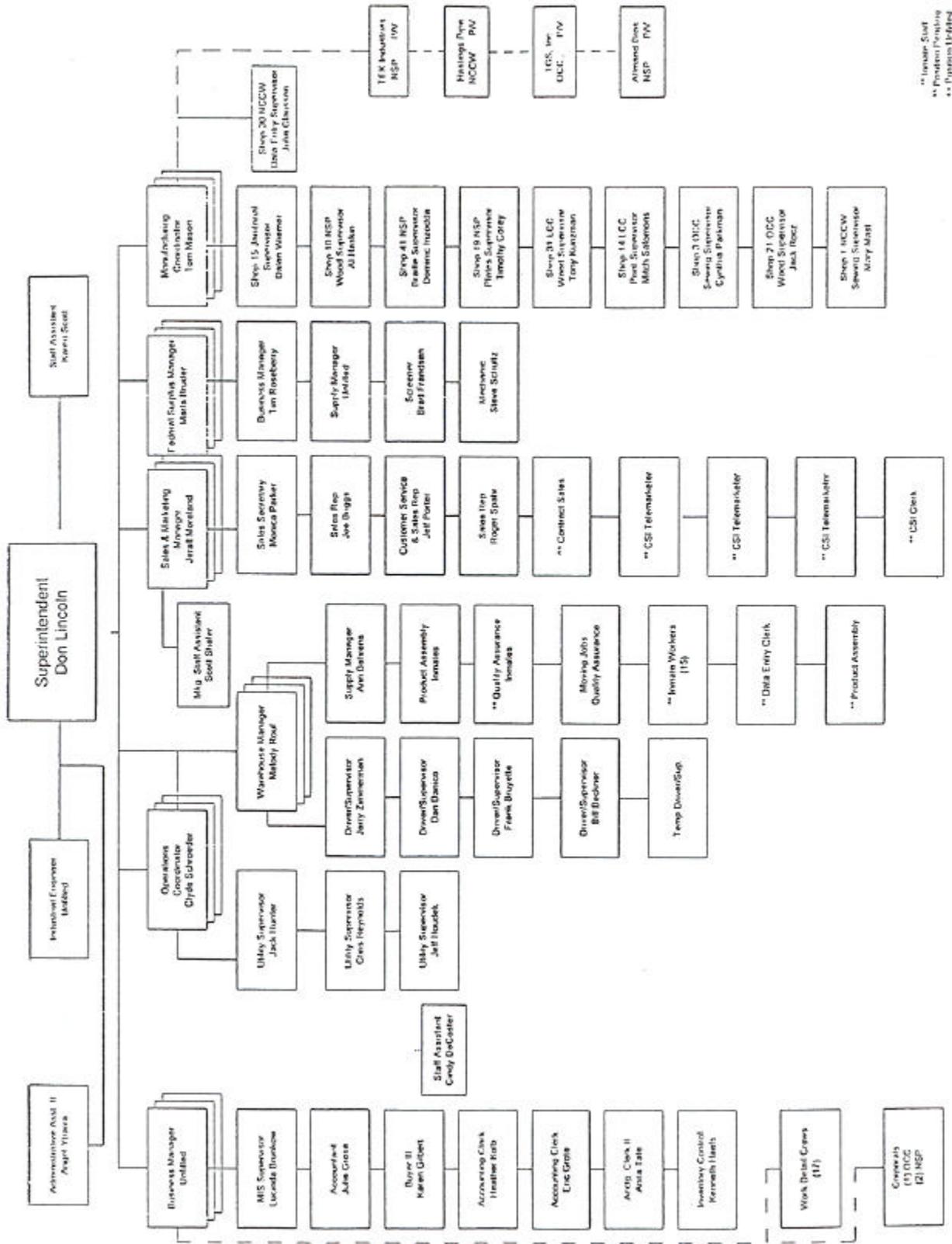
Private venture projects, which operate under the sponsorship of the Private Sector/Prison Industry Enhancement Certification Program of the U.S. Department of Justice, started in 1988. Inmates work for a private company within the institution while fulfilling a variety of requirements imposed by the federal government. CSI also provides inmate labor for road and park crews and delivery services.

MISSION STATEMENT

The mission of the Department of Correctional Services is to serve and protect the public by providing control, humane care and program opportunities for those individuals placed in its custody and supervision, thereby facilitating their return to society as responsible persons.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

ORGANIZATIONAL CHART



** Inmate Staff
** Prisoner Paying
** Prisoner Unpaid

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

SUMMARY OF COMMENTS

During our audit of the Nebraska Department of Correctional Services - Cornhusker State Industries, we noted certain matters involving the internal control over financial reporting and other operational matters that are presented here. Comments and recommendations are intended to improve the internal control over financial reporting, ensure compliance, or result in operational efficiencies.

1. ***Segregation of Duties Over Receipts:*** We noted one individual opened the mail, prepared deposits, posted payments to the receivable accounts, and prepared the general document to deposit the payments to the Department's bank account.

We also noted no reconciliation of accounts receivable was being performed. A lack of segregation of duties increases the possibility of loss or misuse of state funds.

2. ***Inmate Pay:*** During our testing of inmate wage and bonus payments we noted:
 - Bonuses were overpaid in 8 shops by a total of \$5,061.
 - Twelve workers in one shop did not receive eligible bonuses of \$130 each.
 - Some bonuses are not equitably distributed.
3. ***Audit Delays:*** The availability of the Department of Corrections staff and records to complete the audit in a timely manner was not made available to us. For this reason the audit completion was delayed several months.
4. ***Late Payments:*** Twenty-eight of 199 invoices tested were not paid within 45 days as required by State Statute.

More detailed information on the above items is provided hereafter. It should be noted this report is critical in nature since it contains only our comments and recommendations on the areas noted for improvement.

Draft copies of this report were furnished to the Department to provide them an opportunity to review the report and to respond to the comments and recommendations included in this report. All formal responses received have been incorporated into this report. Responses have been objectively evaluated and recognized, as appropriate, in the report. Responses that indicate corrective action has been taken were not verified at this time but will be verified in the next audit.

We appreciate the cooperation and courtesy extended to our auditors during the course of the audit.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

COMMENTS AND RECOMMENDATIONS

1. Segregation of Duties Over Receipts

Good internal control requires a plan of organization, procedures, and records designed to safeguard assets and provide reliable financial records. A system of internal control should include a segregation of duties so no one individual can be involved in all phases of a transaction from beginning to end.

We noted one individual opened the mail, prepared deposits, posted payments to the receivable accounts, and prepared the general document to deposit the payments to the Department's bank account. We also noted no reconciliation of accounts receivable was being performed.

A lack of segregation of duties increases the possibility of loss or misuse of state funds.

We recommend the Department implement procedures to provide for an adequate segregation of duties. This should include a reconciliation of accounts receivable.

Department's Response: We agree that it is important to have adequate segregation of duties over receipts. Procedures have been changed so that two people are involved in this process. We require that the person opening the mail and preparing receipts is not the person posting the payment to Accounts Receivable. Additionally, we will be developing a monthly process for an independent reconciliation of Accounts Receivable by someone other than the two individuals involved in the receipts process.

2. Inmate Pay

Department of Correctional Services Cornhusker State Industries Operational Memorandum 113.18.01, "CSI Inmate Bonus Pay Program," dated February 11, 1998, allows for direct inmate bonuses equal to 12% of the quarterly profits for each shop and indirect inmate bonuses equal to 12% of the total CSI quarterly profit. This operational memorandum further states bonuses cannot exceed \$525 per inmate, and defines direct inmate as an inmate assigned to a specific shop and indirect inmate as an inmate assigned to general CSI operations such as the warehouse, inventory control, and sales office. In addition, sound business practices require a fair distribution of profits among eligible workers.

The following was noted during our testing of inmate wage and bonus payments:

- All bonuses paid to inmates for the quarter ending June 30, 2000 were based on estimated profits because the actual profit or loss for each shop had not yet been calculated. When the actual profits and losses were calculated, bonuses were recalculated. Those inmate workers who were underpaid were paid their additional bonuses, but those inmates who had been overpaid did not have deductions made to their accounts. Bonuses were overpaid in 8 shops by a total of \$5,061.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

COMMENTS AND RECOMMENDATIONS

2. Inmate Pay (Continued)

- One shop earned a profit of \$13,014 for the quarter ended September 30, 1999 and had twelve inmate workers eligible to receive a bonus of \$130 each. While all other inmate workers for shops earning a profit during this quarter were paid their bonuses, the workers for this one shop were not paid their bonuses.
- The bonuses paid to indirect inmate workers appears to have been a disproportionate amount of total profits compared to their contributions to the total profits, and as compared to the bonuses received by direct inmate workers. While direct workers shared in only the profit of the shop where they worked, indirect workers shared in the net profit of all shops.

As a result, inmates did not receive overtime pay as required by the Department's administrative regulations, some inmate workers received a bonus in excess of the limits established by the Department's regulations, workers in and one shop did not receive bonuses due them. In addition, the method of indirect bonus calculation used resulted in the indirect workers normally receiving a larger bonus each quarter than the direct workers in each shop.

We recommend the Department:

- Comply with their administrative regulations and pay overtime wages to inmates for hours worked over the standard 38.5 hours per week.
- Obtain reimbursement from the inmates that were overpaid bonuses for the quarter ending June 30, 2000. If there is a concern about deducting amounts directly from inmate accounts, we recommend the amounts be deducted from future bonus payments until the reimbursement is complete.
- Pay bonuses due to the eligible workers from the shop who were not paid their bonuses for the quarter ending September 30, 1999, and
- Review their administrative regulations to determine whether the method used is a representative distribution of the total CSI quarterly profits.

Department's Response:

- *We agree that inmate overtime pay should be consistent with the Administrative Regulation. In September 2001 we will bring the practice and policy into compliance. A statistical sampling of pay over the last 24 months will be completed to identify potential adjustments to inmate pay. From this statistical sampling a process will be developed to make reasonable adjustments.*

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

COMMENTS AND RECOMMENDATIONS

2. Inmate Pay (Concluded)

- *The decision to not make an adjustment for overpayments of bonuses related to the quarter ending June 2000 is a management decision made for the overall management of Cornhusker State Industries and the institutions.*
- *Inmate bonuses were mistakenly not paid for the one shop identified for the quarter ending September 30, 1999. These bonuses were posted to the inmate's institutional accounts in June 2001.*
- *We will consider comments on the bonuses paid to indirect inmate workers. However, this appears to be performance auditing and not within the scope of a financial audit.*

3. Audit Delays

Neb. Rev. Stat. Section 84-304 R.S.Supp., 2000 establishes the powers and duties of the Auditor of Public Accounts. These duties included; “(3) To examine or cause to be examined, at such time as he or she shall determine, books, accounts, vouchers, records, and expenditures of all state officers, state bureaus, state boards, state commissioners, the state library, societies and associations supported by the state, state institutions, state colleges, and the University of Nebraska, except when required to be performed by other officers or persons; . . . (5) To report promptly to the Director of Administrative Services and the appropriate standing committee of the Legislature the fiscal condition shown by such examinations conducted by the auditor, including any irregularities or misconduct of officers or employees, any misappropriation or misuse of public funds or property, and any improper system or method of bookkeeping or condition of accounts; . . . (9) To conduct all audits and examinations in a timely manner and in accordance with the standards for audits of governmental organizations, programs, activities, and functions published by the Comptroller General of the United States.”

Our audit of CSI was started on March 26, 2001. The audit field-work was performed with great difficulty and delays because of the Department’s requirement that all information and documentation requests be processed through one staff member. We completed as much testing as possible, with the information and documentation made available to us on May 4, 2001. On May 16, 2001 we left a listing with the Department of information needed to complete the audit and requested an exit conference meeting be set up. The needed information was not obtained until June and the Department did not set up an exit conference until August.

Without complete and timely access to Department records and staff, we were not able to complete the audit of CSI in a timely manner. As a result, any corrective action required of the Department has not yet been made and the provision of the results of the audit to the Legislature and the Department of Administrative Services was delayed.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

COMMENTS AND RECOMMENDATIONS

3. Audit Delays (Concluded)

We recommend the Department make available to the Auditor of Public Accounts the necessary staff and records to complete audits in a timely manner.

Department's Response: We agree that information needs to be provided timely and we will make every effort to see that it is accomplished. Staffing issues during this particular audit period presented unforeseen situations and limited the Departments ability to complete all essential tasks on a timely basis.

4. Late Payments

Neb. Rev. Stat. Section 81-2403(1) R.R.S. 1999 states, "each agency shall make payment in full for all goods delivered or services rendered on or before the forty-fifth calendar day after (a) the date of receipt by the agency of the goods or services or (b) the date of receipt by the agency of the bill for the goods or services, whichever is later."

During our review, 28 of 199 (14%) invoices tested were not paid within the 45-day limit. The number of days between receipt of the bill or goods and payment ranged from 48 to 106 days for the 28 exceptions.

Late payment of invoices increases the risk the agency could be charged interest by the vendor.

We recommend the Department review their procedures for paying invoices to ensure all invoices are paid within the 45-day limit set by the statute.

Department's Response: We agree that payments should be made within the 45-day limit. Without completing a comprehensive review of the related transactions we cannot determine the cause of these delays. Possible delays could have been for disputes with vendors on billing or receiving.

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NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES CORNHUSKER STATE INDUSTRIES

INDEPENDENT AUDITORS' REPORT

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We have audited the accompanying general purpose financial statements of the Nebraska Department of Correctional Services - Cornhusker State Industries as of and for the fiscal year ended June 30, 2000, as listed in the Table of Contents. These general purpose financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit.

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We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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As discussed in Note 1, the general purpose financial statements present only the Nebraska Department of Correctional Services - Cornhusker State Industries and are not intended to present fairly the financial position and results of operations of the State of Nebraska, in conformity with generally accepted accounting principles.

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Review Coordinator
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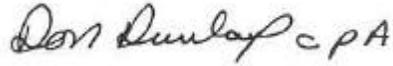
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In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the Nebraska Department of Correctional Services - Cornhusker State Industries, as of June 30, 2000, and the results of its operations and cash flows of its proprietary fund for the year then ended in conformity with generally accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued our report dated August 14, 2001, on our consideration of the Nebraska Department of Correctional Services - Cornhusker State Industries' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

The accompanying schedule is presented for purposes of additional analysis and is not a required part of the general purpose financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, according, we express no opinion on it.

August 14, 2001


Manager

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
 CORNHUSKER STATE INDUSTRIES
BALANCE SHEET
INTERNAL SERVICE FUND 5251
 June 30, 2000

	Correctional Industries Fund 5251
ASSETS	
CURRENT ASSETS:	
Cash in State Treasury	\$ 3,898,348
Deposit with Vendors	275
Petty Cash	6,000
Receivables, net of allowance:	
Accounts	590,991
Private Venture	274,671
Interest	16,070
Merchandise Inventory	1,381,203
TOTAL CURRENT ASSETS	6,167,558
 Property, Plant and Equipment, Net	 5,042,702
TOTAL ASSETS	\$ 11,210,260
LIABILITIES AND FUND EQUITY	
CURRENT LIABILITIES:	
Accounts Payable	\$ 191,979
Accrued Payroll	84,212
TOTAL LIABILITIES	276,191
 NONCURRENT LIABILITIES,	
Accrued Compensated Absences	247,908
TOTAL NONCURRENT LIABILITIES	247,908
 TOTAL LIABILITIES	 524,099
 FUND EQUITY,	
Retained Earnings	10,686,161
TOTAL FUND EQUITY	10,686,161
 TOTAL LIABILITIES AND FUND EQUITY	 \$ 11,210,260

See Notes to General Purpose Financial Statements.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
 CORNHUSKER STATE INDUSTRIES
**STATEMENT OF REVENUES, EXPENSES,
 AND CHANGES IN RETAINED EARNINGS**
INTERNAL SERVICE FUND 5251
 For the Year Ended June 30, 2000

	Correctional Industries <u>Fund 5251</u>
OPERATING REVENUES:	
Charges for Services	\$ 6,154,794
TOTAL OPERATING REVENUES	<u>6,154,794</u>
 OPERATING EXPENSES:	
Personal Services	2,157,483
Operating Expenses	3,594,682
Travel Expenses	109,983
Depreciation Expense	<u>223,409</u>
TOTAL OPERATING EXPENSES (Note 6)	<u>6,085,557</u>
OPERATING INCOME	<u>69,237</u>
 NONOPERATING REVENUES:	
Interest Income	190,376
Gain on Sale of Fixed Asset	<u>961</u>
TOTAL NONOPERATING REVENUES	<u>191,337</u>
NET INCOME	260,574
RETAINED EARNINGS, JULY 1, 1999	<u>10,425,587</u>
RETAINED EARNINGS, JUNE 30, 2000	<u><u>\$ 10,686,161</u></u>

See Notes to General Purpose Financial Statements.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
 CORNHUSKER STATE INDUSTRIES
STATEMENT OF CASH FLOWS
INTERNAL SERVICE FUND 5251
 For the Year Ended June 30, 2000

	Correctional Industries <u>Fund 5251</u>
CASH FLOWS FROM OPERATING ACTIVITIES:	
Cash Received from Sales & Charges	\$ 6,595,723
Cash Paid to Employees	(2,155,095)
Cash Paid to Suppliers	<u>(3,670,895)</u>
NET CASH FLOWS FROM OPERATING ACTIVITIES	<u>769,733</u>
 CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:	
Acquisition and Construction of Capital Assets	(370,979)
Proceeds from Sale of Fixed Assets	<u>954</u>
NET CASH FLOWS FROM CAPITAL AND RELATED ACTIVITIES	<u>(370,025)</u>
 CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest Income	<u>191,009</u>
NET CASH FLOWS FROM INVESTING ACTIVITIES	<u>191,009</u>
NET INCREASE IN CASH	590,717
CASH AND CASH EQUIVALENTS, JULY 1	3,313,906
CASH AND CASH EQUIVALENTS, JUNE 30	<u>\$ 3,904,623</u>
 RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES:	
Operating Income	<u>\$ 69,237</u>
Adjustments to reconcile operating income to net cash flows from operating activities:	
Private Venture Receivable	432,632
Depreciation	223,415
Change in Assets and Liabilities:	
Decrease in Accounts Receivable	8,297
(Increase) in Inventories	(80,585)
Increase in Accounts Payable	114,349
(Decrease) in Accrued Payroll	(10,202)
Increase in Accrued Compensating Absences	<u>12,590</u>
Total Adjustments	<u>700,496</u>
NET CASH FLOWS FROM OPERATING ACTIVITIES	<u>\$ 769,733</u>

See Notes to General Purpose Financial Statements.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
 CORNHUSKER STATE INDUSTRIES
**STATEMENT OF RECEIPTS, EXPENDITURES,
 AND CHANGES IN FUND BALANCE**
 BUDGET AND ACTUAL (Budgetary Basis)
 For the Year Ended June 30, 2000

	REVOLVING FUND		
	BUDGET	ACTUAL (BUDGETARY BASIS)	VARIANCE FAVORABLE (UNFAVORABLE)
RECEIPTS:			
Sales and Charges		\$ 5,984,701	
Miscellaneous		<u>791,861</u>	
TOTAL RECEIPTS		<u>6,776,562</u>	
EXPENDITURES:			
Personal Services	\$ 2,165,174	2,155,095	\$ 10,079
Operating	3,976,351	3,551,737	424,614
Travel	108,000	109,983	(1,983)
Capital Outlay	824,162	380,154	444,008
TOTAL EXPENDITURES	<u>7,073,687</u>	<u>6,196,969</u>	<u>876,718</u>
Excess of Receipts Over Expenditures		<u>579,593</u>	
OTHER FINANCING SOURCES (USES):			
Sale of Assets		954	
Net Distributive Activity		<u>(130)</u>	
TOTAL OTHER FINANCING SOURCES (USES)		<u>824</u>	
Excess of Receipts and Other Financing Sources Over Expenditures and Other Financing (Uses)		580,417	
FUND BALANCES, JULY 1, 1999		<u>3,313,906</u>	
FUND BALANCES, JUNE 30, 2000		<u><u>\$ 3,894,323</u></u>	

See Notes to General Purpose Financial Statements.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
For the Fiscal Year Ended June 30, 2000

1. Summary of Significant Accounting Policies

- A. Basis of Presentation.** The accompanying general purpose financial statements of the Nebraska Department of Correctional Services (Department) - Cornhusker State Industries (CSI) have been prepared in conformance with generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The general purpose financial statements have been prepared primarily from accounts maintained by the State Accounting Administrator of the Department of Administrative Services.

- B. Reporting Entity.** The Department is a State agency established under and governed by the laws of the State of Nebraska. As such, the Department is exempt from State and federal income taxes. The financial statements include all funds of CSI. CSI has also considered all potential component units for which it is financially accountable, and other organizations which are fiscally dependent on CSI, or the significance of their relationship with CSI are such that exclusion would be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of CSI to impose its will on that organization, or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on CSI.

As required by generally accepted accounting principles, these financial statements present the Nebraska Department of Correctional Services - Cornhusker State Industries. No component units were identified. The Nebraska Department of Correctional Services - Cornhusker State Industries is part of the primary government for the State of Nebraska's reporting entity.

- C. Fund Structure.** The Department's accounts are maintained in accordance with the principles of fund accounting to ensure compliance with limitations and restrictions placed on the use of resources available to it. Under fund accounting, individual funds are established for the purpose of carrying on activities or attaining objectives in accordance with specific regulations, restrictions, or limitations. Each individual fund is a self-balancing set of accounts recording cash and other financial resources, together with liabilities and residual equities or

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
(Continued)

1. **Summary of Significant Accounting Policies (Continued)**

balances, and changes therein. These generic fund types differ from the Department's budgetary funds which are described later in Note 2. A brief description of the fund type as used in the Department and the category into which it is grouped follows:

Proprietary Funds. Transactions related to activities similar to those found in the private sector. Proprietary funds include:

Internal Service Funds. Reflect transactions used to account for centrally operated services and centrally procured commodities which are provided to other State departments and agencies and other governmental units of the State. The services and commodities are charged to recipient agencies on a cost-reimbursement basis.

D. Basis of Accounting. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

All proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the balance sheet. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings components. Proprietary fund-type operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net total assets.

The Department applies all applicable GASB pronouncements, as well as the requirements of FASB Statements and Interpretations, APB Opinions, and ARBs, issued on or before November 30, 1989, unless they conflict with or contradict GASB pronouncements. In addition, the Department applies all FASB Statements and Interpretations issued after November 30, 1989, except those that conflict with or contradict GASB pronouncements in accounting and reporting for its operations.

Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when they become both measurable and available). "Measurable" means the amount of the transaction can be determined, and "available" means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Major revenues that are determined to be susceptible to accrual include appropriations, intergovernmental, sales and charges, and miscellaneous revenue.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
(Continued)

1. **Summary of Significant Accounting Policies (Continued)**

Generally, the Department considers a one-year availability period for revenue recognition.

Expenditures are recorded when the related fund liability is incurred. Exceptions to the general modified accrual expenditure recognition criteria include compensated absences, which are recognized when paid.

The accrual basis of accounting is utilized by proprietary fund types. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

- E. Cash.** Cash reported on the balance sheet is under the control of the State Treasurer or other administrative bodies as determined by law. All cash deposited with the State Treasurer is maintained by the Treasurer in an investment pool. The State Investment Officer invests the deposited cash in short-term securities and other investments. All interest revenue is allocated to the State General Fund, except allocations required by law to be made to other funds. All the funds of the Department were designated for investment during fiscal year 2000. Amounts are allocated monthly, based on average balances of all invested funds.
- F. Receivables.** Receivables are stated net of estimated allowances for uncollectible amounts, which are determined based upon past collection experience and current economic conditions. The receivables in the proprietary funds are amounts that have arisen in the normal course of business.
- G. Inventories.** Inventories of materials and supplies are determined by both physical counts and through perpetual inventory systems. Proprietary funds valuation method is primarily at the lower of cost (first in, first out) or market.
- H. Fixed Assets.** General fixed assets are not capitalized in the funds used to acquire or construct them. All purchased fixed assets are valued at cost, where historical records are available, and at estimated historical cost, where no historical records exist. Donated fixed assets are valued at their estimated fair market value on the date received.

Fixed assets do not include infrastructure such as highways, bridges, and lighting systems, as these assets are immovable and of value only to the government. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset life are not capitalized.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
(Continued)

1. **Summary of Significant Accounting Policies (Continued)**

Generally, equipment which has a cost in excess of \$300 at the date of acquisition and has an expected useful life of two or more years is capitalized. Initial building costs, land, land improvements, building improvements, and renovations are capitalized case by case based on management review.

Depreciation of machinery, equipment, and buildings in the proprietary fund types is recorded using the straight-line method.

- I. Compensated Employee Absences.** All permanent employees working for the Department earn sick and annual leave and are allowed to accumulate compensatory leave rather than being paid overtime. Temporary and intermittent employees and Board and Commission members are not eligible for paid leave.

Department employees accrue vested annual leave at a variable rate based on years of service. Generally, accrued annual leave cannot exceed 35 days at the end of a calendar year.

Employees accrue sick leave at a variable rate based on years of service. In general, accrued sick leave cannot exceed 180 days for employees under the Nebraska Classified System Personnel Rules and Regulations. In general, there is no maximum limit on the accumulation of sick days for employees under a labor contract. Sick leave is not vested, except upon death or upon reaching the retirement eligibility age of 55, at which time the State is liable for 25 percent of the employee's accumulated sick leave. Employees under labor contracts can be paid a maximum of 50 days. It is the Department's policy to liquidate unpaid annual leave, vested sick leave, and compensatory leave from future sources rather than from currently available expendable resources.

All internal service funds recognize the expense and accrued liability when vacation and compensatory leave is earned or when sick leave is expected to be paid as termination payments.

- J. Revenues.** The major account titles and descriptions as established by the Nebraska Accounting System that are used by the Department are:

Sales and Charges. Income derived from sales of merchandise and commodities, compensation for services rendered, and charges for various licenses, permits, and fees.

Miscellaneous. Revenues from sources not covered by other major categories.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
(Continued)

1. **Summary of Significant Accounting Policies (Concluded)**

Investment Interest. Revenues from interest on investments.

K. Expenses. The major account titles and descriptions as established by the Nebraska Accounting System that are used by the Department are:

Personal Services. Salaries, wages, and related employee benefits provided for all persons employed by a government.

Operating. Expenses directly related to a program's primary service activities.

Travel. All travel expenses for any state officer, employee, or member of any commission, council, committee, or board of the State.

2. **Budgetary Process**

The Department's biennial budget cycle ends on June 30 of the odd-numbered years. By September 15, prior to a biennium, the Department must submit its budget request for the biennium beginning the following July 1. The requests are submitted on forms that show estimated funding requirements by programs, sub-programs, and activities. The Executive Branch reviews the requests, establishes priorities, and balances the budget within the estimated resources available during the upcoming biennium.

The Governor's budget bill is submitted to the Legislature in January. The Legislature considers revisions to the bill and submits the revised appropriations bill to the Governor for signature. The Governor may: a) approve the appropriations bill in its entirety, b) veto the bill, or c) line item veto certain sections of the bill. Any vetoed bill or line item can be overridden by a three-fifths vote of the Legislature.

The appropriations that are approved will generally set spending limits for a particular program within the agency. Within the agency or program, the Legislature may provide funding from one to five budgetary fund types. Thus, the control is by fund type, within a program, within an agency. The central accounting system maintains this control. A separate publication entitled "Annual Budgetary Report" shows the detail of this level of control. This publication is available from the Department of Administrative Services, Accounting Division.

Appropriations are usually made for each year of the biennium with unexpended balances being reappropriated at the end of the first year of the biennium. For most appropriations, balances lapse at the end of the biennium.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
(Continued)

2. Budgetary Process (Continued)

The budgetary fund type used by the Department differs from the fund type presented in the financial statements. In the Statement of Receipts, Expenditures, and Changes in Fund Balance – Budget to Actual the Department’s Fund is identified as a Revolving Fund. A Revolving Fund accounts for the financing of goods or services provided by one State agency to another State agency on a cost-reimbursement basis.

The accompanying financial statements were prepared by classifying budgetary fund data into the fund format required by GAAP. The cash basis of accounting is used for all budgetary fund types.

All State budgetary expenditures for the revolving fund type are made pursuant to the appropriations which may be amended by the Legislature, upon approval by the Governor. State agencies may allocate the appropriations between major object of expenditure accounts, Increases in total revolving fund appropriations must also be approved by the Legislature as a deficit appropriations bill.

The Department utilizes encumbrance accounting to account for purchase orders, contracts, and other expenditure commitments. However, State law does not require that all encumbrances be recorded in the State’s centralized accounting system, and, as a result, the encumbrances that were recorded in the accounting system have not been included in the accompanying financial statements, except for the impact as described below.

Under State budgetary procedures, appropriation balances related to outstanding encumbrances at the end of the biennium are lapsed and reappropriated in the first year of the next biennium. The effect of the Department’s current procedure is to include in the budget columns, Total Expenditure line, of the Statement of Revenues, Expenditures, and Changes in Fund Balances - Budget and Actual the current year’s appropriations plus the amounts reappropriated for encumbrances outstanding at the end of the prior biennium. This procedure indicates the Department’s intention to honor the encumbrances at the end of a biennium. The expenditures columns of the Statement include cash payments related to the appropriated and reappropriated amounts. For the year ended June 30, 2000, there were no budgetary funds in which expenditures exceeded appropriations.

Budgets for object of expenditure accounts are included in the Nebraska Department of Administrative Services Budget Status Report.

They Revenues are not budgeted. Therefore, there are no budgeted amounts shown on the Budget and Actual Statement.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
(Continued)

2. Budgetary Process (Concluded)

A reconciliation of the budgetary versus the financial statements funds as of June 30, 2000 follows:

	BUDGETARY FUND EQUITIES	FINANCIAL STATEMENT FUND EQUITIES
		PRIMARY GOVERNMENT
		Internal Service
	Total	
PERSPECTIVE DIFFERENCES:		
Classifications of budgetary fund equities into Financial Statement fund structure:		
Revolving	\$ 3,894,323	\$ 3,894,323
Budgetary fund equities classified into Financial Statement fund structure	\$ 3,894,323	
BASIS DIFFERENCES:		
Record fixed assets		5,042,702
Record net accrued receivables, liabilities, and inventories		1,749,136
Financial Statement Fund Equities, June 30, 2000		\$ 10,686,161

3. Fixed Assets

The following is a summary of proprietary fund-type fixed assets at June 30, 2000:

Machinery and equipment	\$ 2,153,354	
Buildings	5,016,171	
Land	315,000	
Total	7,484,525	
Less: Accumulated Depreciation	2,441,823	
Net Fixed Assets	\$ 5,042,702	

In the proprietary fund the following estimated useful lives are used to compute depreciation:

Buildings	30-40 years
Equipment	5-20 years

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS

(Continued)

4. State Employees Retirement Plan (Plan)

The Plan is a single-employer defined contribution plan administered by the Public Employees Retirement Board in accordance with the provisions of the State Employees Retirement Act and may be amended by Legislative action. In the defined contribution plan, retirement benefits depend on total contributions, investment earnings, and the investment options selected. Membership in the Plan is required of all permanent full-time employees on reaching the age of thirty and completion of twenty-four months of continuous service, and voluntary participation is permitted for all permanent full-time or part-time employees upon reaching age twenty and completion of twelve months of service within a five-year period, except any individual appointed by the Governor may elect to not become a member of the Plan.

Employees contribute 4.33% of their monthly compensation until such time as they have paid during any calendar year a total of eight hundred sixty four dollars, after which time they shall pay a sum equal to 4.8% of their monthly compensation for the remainder of such calendar year. The Department matches the employee's contribution at a rate of 156% of the employee's contribution.

The employee's account is fully vested. The employer's account is vested 100% after five years participation in the plan or at retirement.

For the Fiscal Year Ended June 30, 2000, Department's employees contributed \$68,266 and the Department contributed \$106,494.

5. Contingencies and Commitments

Risk Management. The Department is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets, errors and omissions, injuries to employees, natural disasters, and health care insurance. The Department, as part of the primary government for the State, participates in the State's risk management program. The Nebraska Department of Administrative Services (DAS) Division of Risk Management is responsible for maintaining the insurance and self-insurance programs for the State. The State generally self-insures for general liability and workers compensation. The State has chosen to purchase insurance for:

1. Motor vehicle liability, which is insured for the first \$5 million of exposure per accident. Insurance is also purchased for medical payments, physical damage, and uninsured and underinsured motorists with various limits and deductibles.
2. Health care insurance for employees selecting certain coverage options. All health care insurance was purchased.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

NOTES TO GENERAL PURPOSE FINANCIAL STATEMENTS
(Continued)

5. Contingencies and Commitments (Concluded)

3. Crime coverage, with a limit of \$1 million for each loss, and a \$10,000 retention per incident.
4. Real and personal property on a blanket basis for losses up to \$250,000,000, with a self-insured retention of \$100,000 per loss occurrence. The perils of flood and earthquake are covered up to \$9,000,000. Newly-acquired properties are covered up to \$1,000,000 for 60 days or until the value of the property is reported to the insurance company.

No settlements exceeded commercial insurance coverage in any of the past three fiscal years. Health care insurance is funded in the Risk Management Internal Service Fund through a combination of employee and State contributions. Worker's compensation is also funded in the Risk Management Internal Service Fund through assessments on each agency based on total agency payroll and past experience. Tort claims, theft of, damage to, or destruction of assets, errors or omissions, and natural disasters would be funded through the State General Fund or by individual agency assessments as directed by the Legislature, unless covered by purchased insurance. No amounts for estimated claims have been reported in the Nebraska Department of Correctional Services - Cornhusker State Industry's financial statements.

Litigation. The potential amount of liability involved in litigation pending against the Department, if any, could not be determined at this time. However, it is the Department's opinion that final settlement of those matters should not have an adverse effect on the Department's ability to administer current programs. Any judgement against the Department would have to be processed through the State Claims Board and be approved by the Legislature.

6. Total Operating Expenses

Total Operating Expenses include only those costs charged directly to CSI. The Department incurs other costs related to CSI that are not included in the financial statement. These other Department costs could include Accounting and Finance, Director and Director of Administrative Services, Budget, Engineering, Legal Training, and Human Resources. These other costs are budgeted in the General Fund.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
 CORNHUSKER STATE INDUSTRIES
**SCHEDULE OF AVERAGE MONTHLY NUMBER OF INMATES EMPLOYED,
 ESTIMATED INMATE HOURS WORKED, AND PROFIT AND (LOSS) BY SHOP**
 For the Fiscal Years Ending June 30, 1998, 1999, and 2000
 UNAUDITED

	<u>1998</u>	<u>1999</u>	<u>2000</u>
Average Monthly Number of Inmates employed (Note 1)	293	290	280
Estimated Number of Inmate hours worked through CSI work programs (Note 1, 2)	439,500	435,000	420,000
Profit (Loss) by Shop:			
NCCW Sewing - Shop 1	\$ 20,950	\$ 13,767	\$ 30,074
NCCW Hastings Pipe - Shop 2	\$ 7,433	\$ 2,176	\$ 5,502
OCC Sewing - Shop 3	\$ 24,848	\$ 57,516	\$ 43,915
NSP Allmand Brothers - Shop 6	N/A	N/A	\$ 14,084
NSP Wood and Upholstery - Shop 10	\$ 4,035	\$ (49,429)	\$ 35,941
Tourism - Shop 11	\$ 3,272	\$ 2,408	\$ 761
LCC Printing - Shop 14	\$ 160,841	\$ 148,807	\$ 105,399
NSP Janitorial - Shop 15	\$ (7,183)	\$ 1,886	\$ 3,567
NSP Plates and Metals - Shop 19	\$ 965,030	\$ 762,379	\$ (186,440)
OCC Wood - Shop 21	\$ 44,527	\$ 24,216	\$ 35,329
NCCW Data Entry - Shop 30	\$ 39,159	\$ 26,467	\$ 29,267
LCC Wood - Shop 31	\$ 13,078	\$ (31,934)	\$ (711)
NSP Braille - Shop 41	<u>\$ 165,211</u>	<u>\$ 139,792</u>	<u>\$ 156,347</u>
Total Profit	<u>\$ 1,441,201</u>	<u>\$ 1,098,051</u>	<u>\$ 273,035</u>

NCCW - Nebraska Correctional Center for Women
 OCC - Omaha Correctional Center
 NSP - Nebraska State Penitentiary
 LCC - Lincoln Correctional Center
 N/A - Not Applicable

Note 1: Number of inmates working at CSI and number of inmate hours are both measures of reducing inmate idleness. The profit (loss) measures the Department's ability to be self-supporting.

Note 2: The number of inmate hours were estimated by the Department as follows: CSI history has shown inmates work an average of 1,500 hours annually. For example, 1,500 x 293 = 439,500 labor hours. The Average Monthly Numbers of Inmates employed do not include detail crews or private venture inmate workers.

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NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES
**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

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We have audited the general purpose financial statements of the Nebraska Department of Correctional Services - Cornhusker State Industries as of and for the year ended June 30, 2000, and have issued our report thereon dated August 14, 2001. The report was modified to emphasize that the financial statements present only the funds of the Nebraska Department of Correctional Services - Cornhusker State Industries. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Nebraska Department of Correctional Services - Cornhusker State Industry's general purpose financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards. We noted certain immaterial instances of noncompliance that we have reported to management of the Nebraska Department of Correctional Services - Cornhusker State Industries in the Comments Section of this report as Comment Number 2 (Inmate Pay) and Comment Number 4 (Late Payments).

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Nebraska Department of Correctional Services - Cornhusker State Industries's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of Nebraska Department of Correctional Services - Cornhusker State Industries in the Comments Section of this report as Comment Number 1 (Segregation of Duties Over Receipts).

This report is intended solely for the information and use of the agency, the appropriate Federal and regulatory agencies, and citizens of the State of Nebraska, and is not intended to be and should not be used by anyone other than these specified parties.

August 14, 2001



Manager