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

JULY 1, 2001 THROUGH JUNE 30, 2002

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

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NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

BACKGROUND

The Department of Correctional Services (Department) was established as a separate agency of State government in 1973. Formerly, it was a division within the Department of Public Institutions. 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's 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.

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, Braille materials, and laundry. 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.

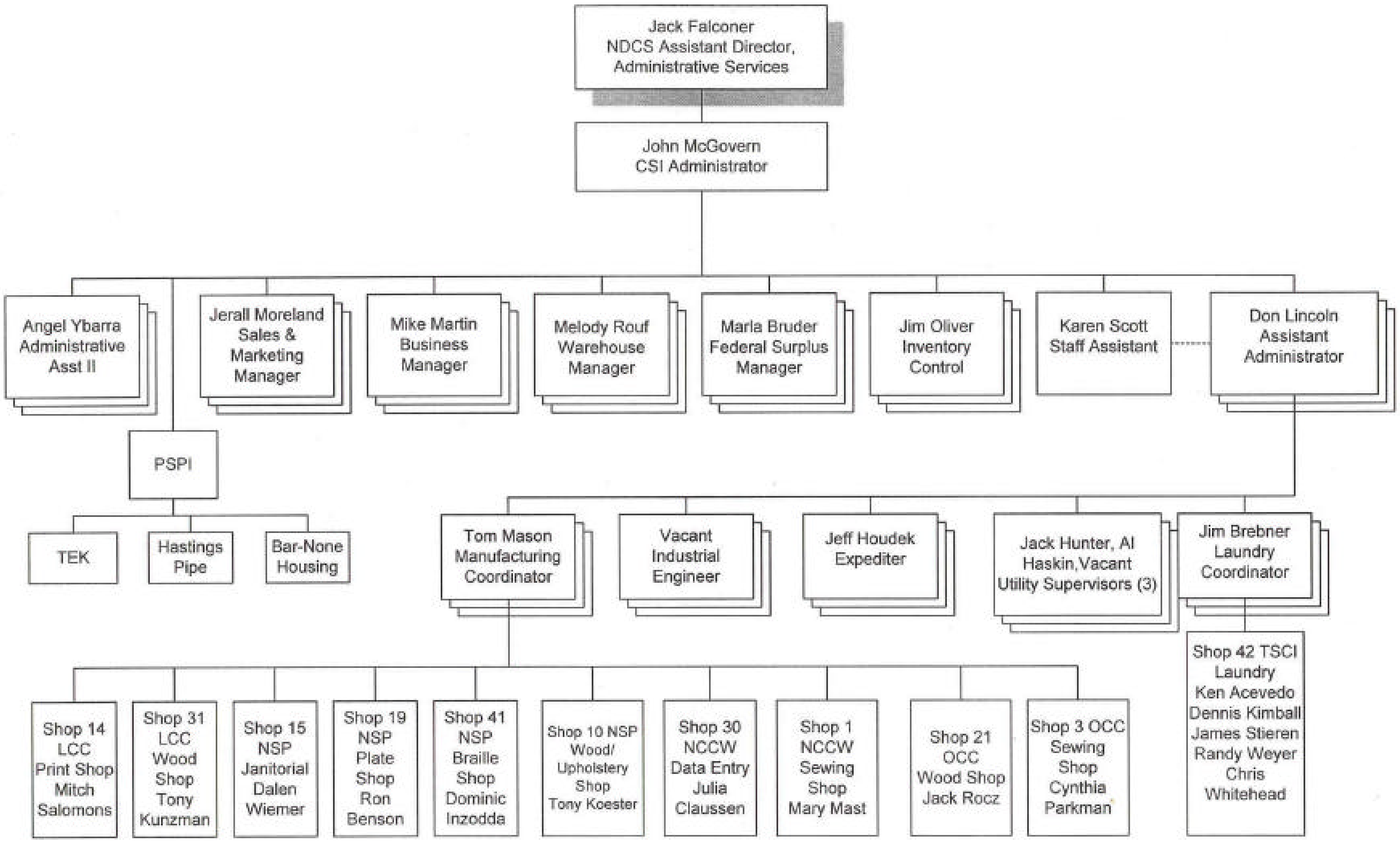
Private venture projects, which operate under the sponsorship of the Private Sector/Prison Industry Enhancement Certification Program of the U.S. Department of Justice, started in 1988. Inmates work for a private company within the Department's facilities, while fulfilling a variety of requirements imposed 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



SUMMARY OF COMMENTS

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

1. ***Accounts Receivable and Accounts Payable Documentation:*** The Department did not maintain a detailed listing of the $1,087,784 in accounts receivable and $376,841 in accounts payable recorded on the financial statements.

2. ***Capital Assets:*** The Department maintained three separate accounting systems for the Cornhusker State Industries' capital assets and depreciation and did not reconcile these systems.

3. ***Accounts Receivable Collections:*** The Department did not have procedures in place to review the outstanding accounts receivable or to send out collection statements.

4. ***Written Travel Policy:*** The Department did not have a policy in place requiring meal logs or receipts be maintained when reimbursing employee travel expenses.

5. ***Merchandise Inventory Count Procedures:*** The Department did not have on file adequate documentation supporting adjustments made as the result of year end merchandise inventory counts.

6. ***Expense Documentation:*** The Department did not maintain adequate documentation supporting the payment of $12,000 in moving expenses for a newly appointed employee.

7. ***Petty Cash Authorization:*** In 1999, the Department requested a temporary increase in the Cornhusker State Industries' petty cash fund from $500 to $6,000. This increase was granted, but the fund was never decreased back to the original $500.

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.

COMMENTS AND RECOMMENDATIONS

1. Accounts Receivable and Accounts Payable Documentation

Sound accounting practices require adequate supporting documentation for amounts recorded on the financial statements.

The Department did not have documentation on file to support the accounts receivable or accounts payable balances at June 30, 2002. The Department had not retained a detailed listing of accounts receivable or accounts payable and Cornhusker State Industries' (CSI) accounting system could not regenerate the report. For the fiscal year end June 30, 2002, the Department reported an accounts receivable balance of $1,087,784, and an accounts payable balance of $376,841.

Without detailed documentation of the accounts receivable and accounts payable balances, the Department cannot properly account for these year end balances and this documentation was not available for audit.

> We recommend the Department retain a hard copy of the detailed accounts receivable and accounts payable balances at fiscal year end to support amounts reported on the financial statements.

Department's Response: We concur with the auditor's point that such documentation should be retained in a hard copy for the fiscal year end. Such information is now being generated at the end of every month. The current system that CSI uses does not allow this information to be generated after the fact, this is one of the reasons that we have pursued the Sales and Manufacturing modules from JDE so that we have one completely integrated system.

2. Capital Assets

CSI uses three separate computer systems for fixed asset and depreciation purposes. The NCR system is the main cost accounting system, the Depreciation Expense Report is a separate program used to calculate depreciation, and the Statewide Inventory System (SWIS) is the official capital asset system for the State. All three systems exist independently and require separate input of data.

Good internal control requires the reconciliation of capital assets and depreciation expenses between the Depreciation Expense Report software, the NCR system, and SWIS. Good internal control also requires additions agree to the Nebraska Accounting System (NAS) disbursements and deletions to capital assets be completed in a timely manner to ensure the inventory listing is accurate and up-to-date.

We noted the following when testing capital assets:

- A reconciliation was not completed between the Depreciation Expense Report, the NCR balance sheet amounts, and SWIS.

COMMENTS AND RECOMMENDATIONS

2. Capital Assets (Concluded)

- Deletions to equipment and buildings were not being made on the Depreciation Expense Report software.
- New purchases were not correctly recorded on the Depreciation Expense Report.
- New purchase amounts on SWIS did not agree to NAS purchase amounts.

Without timely reconciliations between the fixed asset and depreciation systems, there is an increased risk of incorrectly recording fixed assets and depreciation expenses on the financial statements. This was a prior report comment in the June 30, 2000, fiscal year end audit.

> We recommend the Department reconcile the Depreciation Expense Report software to the NCR and SWIS systems. Also, additions and deletions should be made based on NAS and performed in a timely manner to ensure the amounts reported on the financial statements are correct.

Department's Response: The Capital Assets information, including the depreciation, will all be retained in NIS with an estimated completion date of December 31, 2003. We will complete reconciliation between the data that was converted from SWIS to NIS and then update in NIS the correct depreciation information.

3. Accounts Receivable Collections

Good internal control requires procedures be in place to ensure the collection of outstanding accounts receivable.

During our testing of accounts receivable we noted the following:

- Outstanding balances dated back to January 1997.
- The Department did not have procedures in place to review outstanding accounts receivable or to send additional collection statements.
- At March 28, 2003, a detailed listing of accounts receivable balances still outstanding for June 30, 2002 totaled $239,807.
- $96,937 of the $239,807 total was owed by other Department of Correctional Services divisions.
- The Department did not consider any governmental entities to be doubtful accounts.

COMMENTS AND RECOMMENDATIONS

3. Accounts Receivable Collections (Concluded)

A possible loss of State funds exists when accounts receivable balances are left uncollected. The longer an account is left uncollected, there is an increased risk it will become a doubtful account.

> We recommend the Department implement procedures to ensure collection of old outstanding accounts receivable accounts.

Department's Response: Collection procedures were implemented in March 2003 to pursue many of the outstanding Accounts Receivables. The overall receivables have been reduced significantly. We are currently planning a quarterly process, which will become a monthly process by January 2004. Some items had disputes and we are presently in the process of working through those issues with the CSI sales staff.

4. Written Travel Policy

The Internal Revenue Service (IRS) requires employees to substantiate the actual costs of meals under an accountable plan. Adequate accounting requires the use of a meal log or original receipts to document actual expenses. A similar guideline was set forth by the Department of Administrative Services (DAS) as of December 15, 2000. Per NAS Manual, CONC-005, Travel Expense Policies, Section 5, "Adequate accounting generally requires the use of a documentation record such as an account book, expense diary or log, or similar record near the time of incurrence of the expense. Such log should list the date, amount and place (e.g. city) for **each** meal/food cost. A combination of receipts and detailed itemization is permitted."

We noted the Department still did not have a policy in place to reflect the new policy changes. During our review of travel expense reimbursement documents we noted no meal logs or receipts were submitted. This was a prior report comment in the June 30, 2000, fiscal year end audit.

Without the requirement of meal logs or receipts, unsubstantiated meals may be improperly reimbursed since the Department does not enforce the accountable meal policy plan.

> We recommend the Department follow DAS guidelines and immediately develop and implement a meal reimbursement policy as outlined in the NAS Manual's Travel Expense Policies.

Department's Response: A revised travel policy was written and approved with an effective date of June 6, 2003. This policy requires a meal log for the reimbursement of all meals.

COMMENTS AND RECOMMENDATIONS

5. Merchandise Inventory Count Procedures (Concluded)

Good internal control requires proper documentation for adjustments made to merchandise accounts as the result of counting merchandise inventory, and requires maintaining inventory tags documenting the inventory quantity counted, the date it was counted, and who did the counting.

During our testing of the year end merchandise inventory counts we noted the following:

- Two of twenty-two inventory variance adjustments tested lacked supporting documentation. Inventory adjustments were noted for the two inventory items, however, the adjustments made did not agree to the year end counts. The Department was unable to provide documentation to support the adjustments made.

- One item was adjusted in error, as the item was counted at 16 while the inventory report indicated 18. Upon further review, three of the items were found at a separate location. The item was still decreased by two rather than being increased by one.

- Documentation to support the three largest adjustments made because of the year end counts was not on file.

- The ten highest valued inventory items not counted by the auditor were selected to trace to the inventory tag. Two of these ten inventory tags tested were not on file.

Without proper inventory procedures, there is an increased risk the Department will record incorrect inventory values and the risk of loss or misuse of State property increases. This was a prior report comment in the June 30, 2001 fiscal year end audit.

> We recommend the Department retain all supporting documentation to support inventory counts and adjustments. Inventory counts should be reviewed in detail to ensure the documentation is complete and accurate and adjustments are reviewed and approved.

Department's Response: We agree that documentation should be retained related to inventory adjustments. Since we are approaching an upcoming inventory for June 2003, we will provide a review to the staff involved in the process that documentation must be retained and the correct adjustments must be made.

6. Expense Documentation

Good internal control and sound accounting practices require supporting documentation be on file to support all expenses incurred. When incurring moving expenses, NAS Manual CONC-005 states,

COMMENTS AND RECOMMENDATIONS

6. Expense Documentation (Concluded)

"The State may reimburse a newly appointed employee, excluding temporary employees, for moving expenses or a portion of these expenses, at the agency head's discretion, provided the employee agrees in writing to remain in the employment of the State for a period of one year." NAS Manual CONC-005 further requires obtaining a minimum of two bids from commercial carriers when used.

During our testing of expenses, we noted the Director's approval of the moving expenses was on file. However, we also noted the following:

- A $12,000 moving expense payment was made for a newly appointed employee. The employee's agreement in writing to remain in the employment of the State for a period of one year was not on file.

- The bids obtained from the commercial carriers for the new employee were also not on file.

Without proper supporting documentation on file, the risk the Department is paying unreasonable or unnecessary expenses increases.

> We recommend the Department maintain all supporting documentation pertaining to expenses.

Department's Response: The documentation requested was obtained but the written copies could not be located. We will review our process in this area and see that it is all attached to the payment document located in Accounting.

7. Petty Cash Authorization

In November 1999, the Department requested a temporary increase in CSI's petty cash fund from $500 to $6,000. This increase was to meet emergency needs, specifically for any year 2000 (Y2K) computer problems that could occur. This temporary increase was granted by DAS, until January 15, 2000. As of March 2003, the petty cash fund still had a balance of $6,000.

As such, this petty cash fund is no longer authorized at the currently held amount. Further, there is a loss of interest to the State due to these funds being held in the petty cash fund and not being invested. This was a prior report comment in the June 30, 2000 fiscal year end audit.

> We recommend the Department reduce its petty cash fund to the approved level of $500, or obtain proper approval to keep the balance at $6,000.

Department's Response: The authorization level has been reduced to $500, this was completed by the end of April 2003.

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NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying financial statements of the enterprise fund of the Nebraska Department of Correctional Services - Cornhusker State Industries (Department), as of and for the year ended June 30, 2002, which collectively comprise the Department's basic financial statements as listed in the Table of Contents. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, 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 our audit provides a reasonable basis for our opinion.

We were unable to obtain a listing of the accounts receivable stated at $1,087,784 and the accounts payable stated at $376,841 at June 30, 2002, which are included in the Balance Sheet as of June 30, 2002.

Also, as discussed in Note 1, the financial statements of the enterprise fund of the Nebraska Department of Correctional Services - Cornhusker State Industries, are intended to present the financial position and changes in financial position and cash flows, of only that portion of the enterprise fund of the State that is attributable to the transactions of the Nebraska Department of Correctional Services - Cornhusker State Industries. They do not purport to, and do not, present fairly the financial position of the State of Nebraska as of June 30, 2002, and the changes in its financial position and its cash flows for the year then ended.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding the accounts receivable and accounts payable, the financial statements referred to above present fairly, in all material respects, the respective financial position of the enterprise fund of the Nebraska Department of Correctional Services - Cornhusker State Industries, as of June 30, 2002, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 28, 2003, 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.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Department's basic financial statements. The schedule is presented for purposes of additional analysis and is not a required part of the basic financial statements. The schedule has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

Don Dunlap CPA

April 28, 2003 Assistant Deputy Auditor

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES
BALANCE SHEET
June 30, 2002

		Enterprise Fund
ASSETS:		
CURRENT ASSETS:		
Cash and Cash Equivalents	$	3,603,438
Deposits with Vendors		275
Petty Cash		6,000
Interest Receivable		14,173
Private Venture Receivable		66,347
Accounts Receivable (Net of Allowance of $466)		1,087,784
Merchandise Inventory		1,555,966
TOTAL CURRENT ASSETS		6,333,983
NONCURRENT ASSETS:		
Capital Assets:		
Buildings and Equipment		9,641,097
Less Accumulated Depreciation		(2,878,150)
TOTAL NONCURRENT ASSETS		6,762,947
TOTAL ASSETS	$	13,096,930
LIABILITIES AND NET ASSETS:		
CURRENT LIABILITIES:		
Accounts Payable	$	376,841
Accrued Payroll		110,330
Accrued Compensated Absences		40,635
TOTAL CURRENT LIABILITIES		527,806
NONCURRENT LIABILITIES:		
Accrued Compensated Absences		240,968
TOTAL NONCURRENT LIABILITES		240,968
TOTAL LIABILITIES		768,774
NET ASSETS:		
Invested in Capital Assets		6,762,947
Unrestricted		5,565,209
TOTAL NET ASSETS		12,328,156
TOTAL LIABILITIES AND NET ASSETS	$	13,096,930

The accompanying notes are an integral part of the financial statements.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
For the Fiscal Year Ended June 30, 2002

		Enterprise Fund
OPERATING REVENUES:		
Charges for Services	$	9,389,673
Private Venture Revenues		152,926
Other		1,318
TOTAL OPERATING REVENUES		9,543,917
OPERATING EXPENSES:		
Personal Services		2,666,631
Operating Expenses		5,808,358
Travel Expenses		112,810
Depreciation Expense		293,132
TOTAL OPERATING EXPENSES		8,880,931
OPERATING INCOME		662,986
NONOPERATING REVENUES:		
Interest Income		151,290
TOTAL NONOPERATING REVENUES		151,290
CHANGE IN NET ASSETS		814,276
TOTAL NET ASSETS, BEGINNING OF YEAR		11,513,880
TOTAL NET ASSETS, END OF YEAR	$	12,328,156

The accompanying notes are an integral part of the financial statements.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES
STATEMENT OF CASH FLOWS
For the Fiscal Year Ended June 30, 2002

	Enterprise Fund
CASH FLOWS FROM OPERATING ACTIVITIES:	
Receipts from Sales and Charges	$ 9,584,088
Payments to Employees	(2,731,604)
Payments to Suppliers	(4,978,637)
Other Cash Payments	(189)
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,873,658
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:	
Acquisition and Construction of Capital Assets	(1,268,516)
	(1,268,516)
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest Income	148,627
NET CASH FROM INVESTING ACTIVITIES	148,627
NET INCREASE IN CASH AND CASH EQUIVALENTS	753,769
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	2,855,944
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 3,609,713
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Operating Income	$ 662,986
ADJUSTMENTS TO RECONCILE OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Depreciation	293,132
Change in Assets and Liabilities:	
Decrease in Accounts Receivable	95,416
(Increase) in Private Venture Receivable	(55,244)
Decrease in Merchandise Inventories	1,004,632
Increase in Accrued Payroll	15,746
(Decrease) in Accounts Payable	(175,101)
Increase in Accrued Compensated Absences	32,091
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 1,873,658

The accompanying notes are an integral part of the financial statements.

NOTES TO FINANCIAL STATEMENTS

For the Fiscal Year Ended June 30, 2002

1. Summary of Significant Accounting Policies

A. Basis of Presentation

The accompanying 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. CSI reports its activity in an enterprise fund. An Enterprise Fund reflects transactions used to account for those operations that are financed and operated in a manner similar to private business or where the governing body has decided that the determination of revenues earned, expenses incurred, and/or net income is necessary for management accountability.

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

B. Reporting Entity

CSI is a program within the Department and is 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 is such that exclusion would be misleading or incomplete. The Governmental Accounting Standards Board (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 GAAP 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.

NOTES TO FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

C. Measurement Focus, Basis of Accounting

The accounting and financial reporting treatment applied to an enterprise fund is determined by its measurement focus and basis of accounting. An enterprise fund uses the economic resources measurement focus and the accrual basis of accounting. Under this measurement focus and basis of accounting all assets and liabilities associated with the operation of these funds are included on the balance sheet. Enterprise fund operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net total assets. Under the accrual basis of accounting, revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

In reporting its financial activity, CSI applies all applicable GASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless they conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure.

CSI's Statement of Revenues, Expenses, and Changes in Fund Net Assets distinguish operation revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with CSI's principal ongoing operations. The principal operating revenues of CSI's enterprise fund are charges to customers for sales and services. Operating expenses for CSI's enterprise fund include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

D. Assets and Net Assets

Cash and Cash Equivalents. CSI's cash and cash equivalents are considered to be cash on hand and short-term investments with original maturities of three months or less from the date of acquisition.

Cash and cash equivalents represents the cash balance of a fund as reflected on the Nebraska Accounting System. Investment of all available cash is made by the State Investment Officer, on a daily basis, based on total bank balances. Investment income is distributed based on the average daily book cash balance of funds designated for investment. Determination of whether a fund is considered designated for investment is done on an individual fund basis. All of the funds of CSI were designated for investment during fiscal year 2002.

NOTES TO FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Continued)

Inventories. Inventories of materials and supplies are determined by both physical counts and through perpetual inventory systems. CSI's valuation method is weighted average purchase cost.

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 are amounts that have arisen in the normal course of business.

Capital Assets. Capital assets, which would include property, plant, equipment, and infrastructure assets (e.g., sidewalks and parking lots) are reported. All capital 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 historical fair market value on the date received.

Generally, equipment which has a cost in excess of $1,000 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. The cost of normal maintenance and repairs that does not add to the value of the asset or extend asset life is not capitalized.

Depreciation of machinery, equipment, and buildings is recorded using the straight-line method. The following estimated useful lives are used to compute depreciation:

Buildings	25-50 years
Equipment	5-20 years

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 are not eligible for paid leave. The compensated absences liability is reported in the fiduciary fund financial statements, and is recorded in accordance with the State of Nebraska policy which is to 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.

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.

NOTES TO FINANCIAL STATEMENTS
(Continued)

1. Summary of Significant Accounting Policies (Concluded)

Employees accrue sick leave at a variable rate based on years of service. In general, accrued sick leave cannot exceed 180 days. Sick leave is not vested, except upon death or upon reaching the retirement eligibility age of 55, at which time, the Department is liable for 25 percent of the employee's accumulated sick leave.

2. Contingencies and Commitments

Risk Management. The Department is exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets, errors or omissions, injuries to employees, and natural disasters. 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:

A. 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. State agencies have the option to purchase coverage for physical damage to vehicles.

B. The DAS-Personnel Division maintains health care and life insurance for eligible employees.

C. Crime coverage, with a limit of $1 million for each loss, and a $10,000 retention per incident.

D. Real and personal property on a blanket basis for losses up to $250,000,000, with a self-insured retention of $200,000 per loss occurrence. 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. The perils of flood and earthquake are covered up to $10,000,000.

E. State agencies have the option to purchase building contents and inland marine coverage.

No settlements exceeded commercial insurance coverage in any of the past three fiscal years. Health care insurance is funded in the Compensation Insurance Trust Fund through a combination of employee and State contributions. Workers' compensation is funded

2. Contingencies and Commitments (Concluded)

in the Workers' Compensation 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 Industries' 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 judgment against the Department would have to be processed through the State Claims Department and be approved by the Legislature.

3. 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. Prior to April 18, 2002, membership in the Plan was mandatory for all permanent full-time employees on reaching the age of thirty and completion of twenty-four months of continuous service. Full time employee is defined as an employee who is employed to work one-half or more of the regularly scheduled hours during each pay period. Voluntary membership is permitted for all permanent full-time or permanent part-time employees upon reaching age twenty and completion of twelve months of permanent service within a five-year period. Any individual appointed by the Governor may elect to not become a member of the Plan. Legislative Bill 687 (2002), effective April 18, 2002, stated all permanent full-time employees shall begin participation in the plan upon completion of twelve continuous months of service.

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 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%.

NOTES TO FINANCIAL STATEMENTS
(Continued)

3. State Employees Retirement Plan (Plan) (Concluded)

The employee's account is fully vested. The employer's account is vested 100% after five years participation in the system (prior to April 18, 2002) or at retirement. Legislative Bill 687 (2002), effective April 18, 2002, changed the vesting requirement to a total of three years of participation in the system, which includes the twelve-month eligibility period or credit for participation in another governmental plan prior to actual contribution to the Plan.

For the fiscal year ended June 30, 2002, employees contributed $72,865 and the Department contributed $113,670.

4. Capital Assets

Capital Asset activity for the audit period was as follows:

	Balance Balance	Increases	Decreases	Ending Balance
Capital Assets, Not Being Depreciated:				
Land	$ 315,000	$ -	$ -	$ 315,000
Total Capital Assets, Not Being Depreciated:	315,000	-	-	315,000
Capital Assets, Being Depreciated				
Buildings, Improvements, and Infrastructure	5,598,783	242,612	-	5,841,395
Equipment	2,312,062	1,172,640	-	3,484,702
Total Capital Assets, Being Depreciated	7,910,845	1,415,252	-	9,326,097
Less Accumulated Depreciation for:				
Buildings and Improvements	(981,999)	(147,454)	-	(1,129,453)
Equipment	(1,603,019)	(145,679)	-	(1,748,698)
Total Accumulated Depreciation	(2,585,018)	(293,133)	-	(2,878,151)
Total Capital Assets, Being Depreciated, Net	5,325,827	1,122,119	-	6,447,946
Total Capital Assets, Net	$ 5,640,827	$ 1,122,119	$ -	$ 6,762,946

5. 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 statements. These other Department costs could include Accounting and Finance, Director and Director of Administrative Services, Budget, Engineering, Legal, and Human Resources. These other costs are budgeted in the General Fund.

NOTES TO FINANCIAL STATEMENTS
(Continued)

6. GASB 34

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, Basic Financial Statements – and Management Discussion and Analysis – for State and Local Governments. The State of Nebraska implemented the Statement for the fiscal year ending June 30, 2002.

The Department implemented GASB 34 by presenting its financial statements in a format as required by GASB 34. As explained in Note 1.D. CSI's financial statements are presented on the accrual basis of accounting. Previous period financial statements of CSI were also prepared on the accrual basis of accounting; therefore, these financial statements, even though in a different format, are comparable to previous period financial statements of CSI.

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES
SCHEDULE OF AVERAGE MONTHLY NUMBER OF INMATES EMPLOYED, ESTIMATED INMATE HOURS WORKED, AND PROFIT (LOSS) BY SHOP
For the Fiscal Years Ending June 30, 1998, 1999, 2000, 2001, AND 2002
UNAUDITED

	Fiscal Year				
	1998	1999	2000	2001	2002
Average Number of Inmates Employed	293	290	280	292	306
Number of Inmate hours worked through CSI work programs	439,500	435,000	420,000	438,000	439,000
Profit (Loss) by Shop:					
NCCW Sewing - Shop 1	$ 20,950	$ 13,767	$ 30,074	$ 100,169	$ 26,056
NCCW Hastings Pipe - Shop 2	7,433	2,176	5,502	(1,134)	4,946
OCC Sewing - Shop 3	24,848	57,516	43,915	67,440	53,539
NSP Allmand Brothers - Shop 6	n/a	n/a	14,084	n/a	n/a
NSP Wood and Upholstery - Shop 10	4,035	(49,429)	35,941	(24,165)	(74,779)
Tourism - Shop 11	3,272	2,408	761	n/a	n/a
LCC Printing - Shop 14	160,841	148,807	105,399	84,878	(8,854)
NSP Janitorial - Shop 15	(7,183)	1,886	3,567	38,008	(88,816)
NSP Plates and Metals - Shop 19	965,030	762,379	(186,440)	573,991	1,100,440
OCC Wood - Shop 21	44,527	24,216	35,329	98,796	91,838
NCCW Data Entry - Shop 30	39,159	26,467	29,267	21,674	41,893
LCC Wood - Shop 31	13,078	(31,934)	(711)	(127,754)	(157,701)
NSP Braille - Shop 41	165,211	139,792	156,347	59,865	42,381
Tecumseh Laundry - Shop 42	n/a	n/a	n/a	(140)	(183,055)
NIFA Modular Homes - Shop 43	n/a	n/a	n/a	(3,213)	15,947
Total Profit	$ 1,441,201	$ 1,098,051	$ 273,035	$ 888,415	$ 863,835

NCCW - Nebraska Correctional Center for Women
OCC - Omaha Correctional Center
NSP - Nebraska State Penitentiary
LCC - Lincoln Correctional Center

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 Number of Inmates Employed do not include detail crews or private venture inmate workers.

Note 3: The Shop Profit (Loss) was taken directly from CSI's profit and loss statements and the total profit does not agree to the financial statements because CSI's profit and loss statements do not include year end adjustments.

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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*

We have audited the financial statements of the Nebraska Department of Correctional Services - Cornhusker State Industries as of and for the year ended June 30, 2002, and have issued our report thereon dated April 28, 2003. The report notes the financial statements were modified to emphasize that the financial statements present only the funds of the Nebraska Department of Correctional Services - Cornhusker State Industries and was qualified because the Nebraska Department of Correctional Services - Cornhusker State Industries did not maintain a listing of accounts receivable and accounts payable. 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 Industries' 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 4 (Written Travel Policy), Comment Number 6 (Expense Documentation), and Comment Number 7 (Petty Cash Authorization).

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Nebraska Department of Correctional Services - Cornhusker State Industries' 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. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Nebraska Department of Correctional Services - Cornhusker State Industries' ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. A reportable condition is described in the Comments Section of the report as Comment Number 1 (Accounts Receivable and Accounts Payable Documentation).

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, the reportable condition described above as Comment Numbers 1 (Accounts Receivable and Accounts Payable Documentation) is considered to be a material weakness. We also noted other matters involving internal control over financial reporting that we have reported to the management of the Nebraska Department of Correctional Services - Cornhusker State Industries in the Comments Section of the report as Comment Number 2 (Capital Assets), Comment Number 3 (Accounts Receivable Collections), and Comment Number 5 (Merchandise Inventory Count Procedures).

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

Don Dunlap CPA

April 28, 2003 Assistant Deputy Auditor