

**STATE OF NEBRASKA
ATTESTATION REVIEW
OF THE
NEBRASKA DEPARTMENT OF
CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES
JULY 1, 2007 THROUGH JUNE 30, 2008**

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Issued on May 12, 2009

NEBRASKA DEPARTMENT OF CORRECTIONAL SERVICES
CORNHUSKER STATE INDUSTRIES
ATTESTATION REVIEW

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Independent Accountant's Report

Citizens of the State of Nebraska:

We have reviewed the Payroll, Inventory, Expenditures, and Revenues of the Nebraska Department of Correctional Services - Cornhusker State Industries (CSI) for the period July 1, 2007, through June 30, 2008. CSI's management is responsible for the Payroll, Inventory, Expenditures, and Revenues. We did not obtain a written assertion regarding such matters from management.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on the Payroll, Inventory, Expenditures, and Revenues. Accordingly, we do not express such an opinion.

Based on our review, nothing came to our attention that caused us to believe that the Payroll, Inventory, Expenditures, and Revenues are not presented, in all material respects, in conformity with the criteria set forth in the Criteria section.

In accordance with *Government Auditing Standards*, we are required to report findings of deficiencies in internal control, violations of provisions of contracts or grant agreements, and abuse that are material to CSI's Payroll, Inventory, Expenditures, and Revenues and any fraud and illegal acts that are more than inconsequential that come to our attention during our review. We are also required to obtain the views of management on those matters. We did not perform our review for the purpose of expressing an opinion on the internal control over CSI's Payroll, Inventory, Expenditures, and Revenues or on compliance and other matters; accordingly, we express no such opinions.

Our review disclosed no findings that are required to be reported under *Government Auditing Standards*. However, we noted certain other matters, and those findings, along with the views of management, are described below in the Summary of Results.

This report is intended solely for the information and use of the Citizens of the State of Nebraska, management of CSI, others within CSI, and the appropriate Federal and regulatory agencies; however, this report is a matter of public record, and its distribution is not limited.

Signed Original on File

Mike Foley
Auditor of Public Accounts

Don Dunlap, CPA
Assistant Deputy Auditor

May 11, 2009

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Background

Neb. Rev. Stat. § 83-150 (Reissue 2008) created the Correctional Industries Revolving Fund which is to be administered by the Department of Correctional Services and used to pay expenses incurred to operate the Nebraska Correctional Industries. Due to § 83-150, the Department of Correctional Services (Department) created Cornhusker State Industries (CSI) which is responsible for managing the industrial shops at the correctional facilities. Neb. Rev. Stat. § 83-145 (Reissue 2008) and Neb. Rev. Stat. § 81-1826 (Reissue 2008) provide guidance for the two purposes of Cornhusker State Industries. Neb. Rev. Stat. § 83-145 (Reissue 2008) requires, "All departments, institutions, and agencies of this state which are supported in whole or in part by taxation for state purposes and all counties and other political subdivisions of this state shall purchase from the Department of Correctional Services all articles required by them produced, printed, or manufactured by offenders confined in facilities of the Department of Correctional Services, or elsewhere, including products of any farms operated by the department unless such articles of equal quality and materials could be purchased from another supplier at a lesser cost." This statute dictates that CSI is to produce goods needed by state agencies and political subdivisions and allows them to sell these goods to charitable and nonprofit institutions. This statute also restricts CSI from selling their products to the general public. Neb. Rev. Stat. § 81-1826 (Reissue 2008) states, "The Department of Correctional Services shall, as far as possible, provide for the employment, eight hours per day, of confined persons by private businesses." In addition to providing a job to the inmate, CSI attempts to teach the inmate a skill so upon release the inmate can better find employment. These two statutes dictate the dual purpose of CSI which is to provide goods to governmental and nonprofit institutions as well as providing jobs to inmates.

CSI offers a broad range of goods and services including chairs, dry goods, dormitory and institutional furniture, picnic tables, filing cabinets, signage, janitorial products, license plates, printing services, braille transcription, laundry services, and furniture refinishing and re-upholstery. These products are produced at the various correctional facilities throughout the State. The Nebraska State Penitentiary (NSP) operates a Wood/Upholstery Shop, Janitorial Services Shop, Metal Fabrication Shop, Digital License Plate Shop, Housing Construction Shop, Braille Shop, Laundry Shop, and Private Venture Operations. The Lincoln Correctional Center (LCC) operates a Wood Shop, Private Venture Operations, and a Print Shop. The Nebraska Correctional Center for Women (NCCW) operates a Sewing Shop, Private Venture Operations, and a Data Entry Shop. The Omaha Correctional Center (OCC) operates a Wood Shop, Sewing Shop, and Private Venture Operations. The Tecumseh State Correctional Institution (TSCI) operates a Laundry Shop and Wood Shop. In addition, service crews are operated out of the Lincoln Community Corrections Center and the Omaha Community Corrections Center. These service crews provide services to the Nebraska Department of Roads, Nebraska Military Department, and the Lower Platte South Natural Resources District.

During the fiscal year ended June 30, 2008, CSI operated seventeen traditional shops, ten private venture operations, and four service work crews in addition to three cost centers which are used to support the other shops. These shops and cost centers can be broken into seven different

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types. These are Wood Shops, Laundry Shops, Support Services, Service Crews, Private Venture Operations, License Plate Shop, and Other Shops. The four Wood Shops manufacture products including desks, cabinets, bookshelves, and other wood products. The two Laundry Shops provide laundering services for the correctional facilities, not for profit hospitals, and political subdivisions. Support Services include the three cost centers which support the other CSI shops. These cost centers include the Administration staff, Sales staff, Warehouse staff, and other costs associated with these employees. The four types of Service Crews provide various services for the Department of Roads, Lower Platte South Natural Resources District, Military Department, and the Department of Correctional Services. The ten Private Venture Operations perform work for private industries for resale to the public under the Prison Industry Enhancement Certification Program, which is a Federal program. The License Plate Shop manufactures the license plates issued for Nebraska vehicles. The ten Other Shops include two Sewing Shops, the Braille Shop, the Janitorial Shop, Data Entry Shop, Print Shop, Metal Shop, Housing Construction Shop, Assembly Shop, and the Non-Manufactured Sales Shop.

The number of inmates employed by CSI can fluctuate throughout the year but as of June 30, 2008, CSI employed 573 inmates at the 31 shops, private venture operations, service work crews, and the three cost centers. Of the 573 inmates, 68 worked for the Service Crews, 125 worked for Private Ventures, and 380 worked in traditional shops and Support Service areas.

Each month, the Department's Central Accounting Office prepares financial statements for each CSI shop and CSI as a whole. This financial information begins with financial data stored in the Nebraska Information System (NIS), which is the official recordkeeping system for the State of Nebraska. Since the information in NIS is on the modified cash basis, the Central Accounting Office makes adjustments to the modified cash basis to arrive at the accrual basis. The adjustments required to get from the modified cash basis to the accrual basis include: adjustments to payables, accrued payroll, accrued revenues, and some additional minor adjustments. Once the financial statements are on the accrual basis, two allocations are made. The two allocations are for interest income and the Support Service expenses. These allocations are made based upon monthly shop revenues. Under this method, the shops with the greatest revenues during the month get the greatest portion of interest as well as the greatest share of the Support Service expenses. The figures included in the paragraphs and charts below came from the accrual figures presented in the financial statements prepared by the Department's Central Accounting Office. The Auditor of Public Accounts (APA) did not audit these figures.

As of June 30, 2008, CSI employed 73 employees with payroll costs of \$4,009,800 for the fiscal year ended June 30, 2008. Thirty-nine of these employees work in shops in a variety of functions. Thirty-four of these employees work in Support Services. The Support Services shop type consists of administrative, sales, and warehouse staff and expenses related to these operations. The CSI sales department sells products to State agencies, political subdivisions, and nonprofit entities and employed seven employees as of June 30, 2008, with payroll costs of \$377,513 for the fiscal year. The CSI warehouse operations maintain the CSI warehouse, stores raw materials and finished goods, delivers raw materials to the shops, transports finished goods from the shops to the warehouse and delivers finished goods to the customer and employed six

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employees as of June 30, 2008, with payroll costs of \$288,162 for the fiscal year. The CSI administrative staff is responsible for creating budgets, business office functions, long and short term planning, and other administrative type duties and employed 21 employees as of June 30, 2008, with payroll costs of \$1,368,156 for the fiscal year.

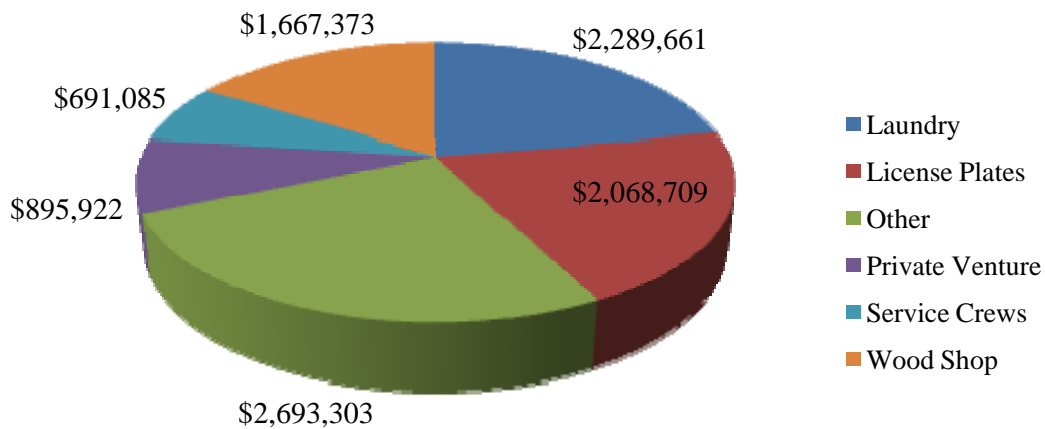
Below is a table showing the type of expenses for Support Services for the fiscal year ended June 30, 2008. Personal Services expense includes salaries and all benefits. The Services and Supplies expense includes payments for utilities, small item purchases and other miscellaneous expenses. Depreciation expense is for the depreciation of buildings and equipment used by the Support Services.

	Warehouse	Administration	Sales
Personal Services	\$ 288,162	\$ 1,368,156	\$ 377,513
Services and Supplies	\$ 179,316	\$ 1,333,968	\$ 58,718
Depreciation Expense	\$ 44,611	\$ 51,042	\$ 21,574
Total	\$ 512,089	\$ 2,753,166	\$ 457,805

In April 2008, CSI implemented a new integrated software system used to track both inventory and the cost to manufacture their products. After the switch, CSI began utilizing the Sales and Manufacturing module within NIS. Included in the \$1,333,968 Administrative Services and Supplies expense is approximately \$835,000 for costs incurred by CSI to switch from their old inventory system to the NIS module. This expense is a onetime cost and needs to be considered when looking at the performance of CSI during the fiscal year ended June 30, 2008.

Total revenues for the shops for the fiscal year ended June 30, 2008, totaled \$10,306,053. As can be seen in the chart below, more than 40% of CSI revenues are generated by the License Plate and Laundry shops. These two shop types account for total revenues of \$4,358,370.

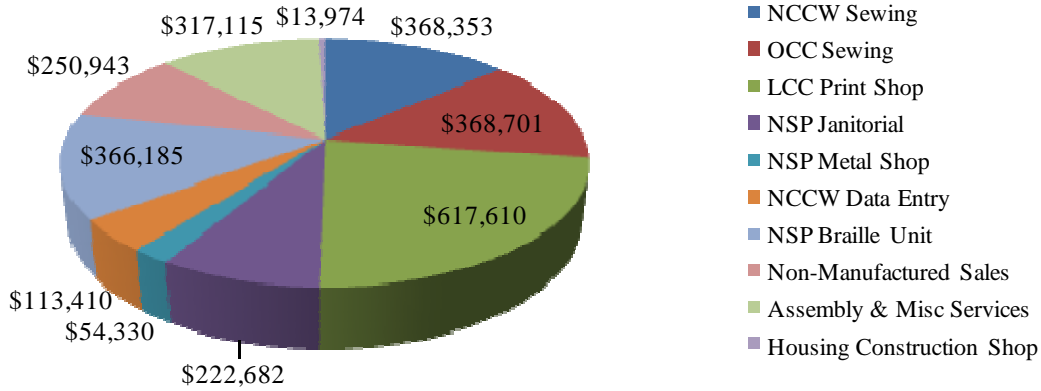
Revenues by Shop Type



The Other shop type contributed \$2,693,303 of revenues to CSI for the fiscal year ended June 30, 2008. The chart provided below provides a per shop breakdown of the revenues for the shops included in the Other shop type.

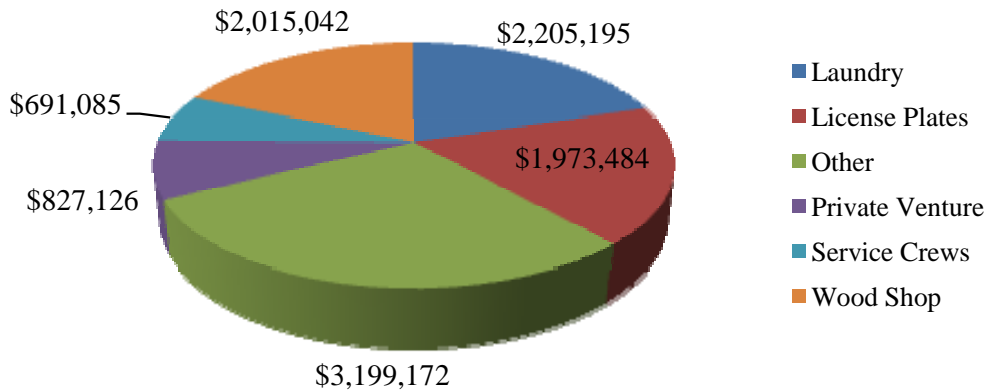
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Other Shop Type Revenue Breakdown



Total expenditures of the shops for the fiscal year ended June 30, 2008, totaled \$10,911,104. Similarly to CSI revenues, the majority of expenditures are for the License Plate, Laundry, Wood, and Other shop types.

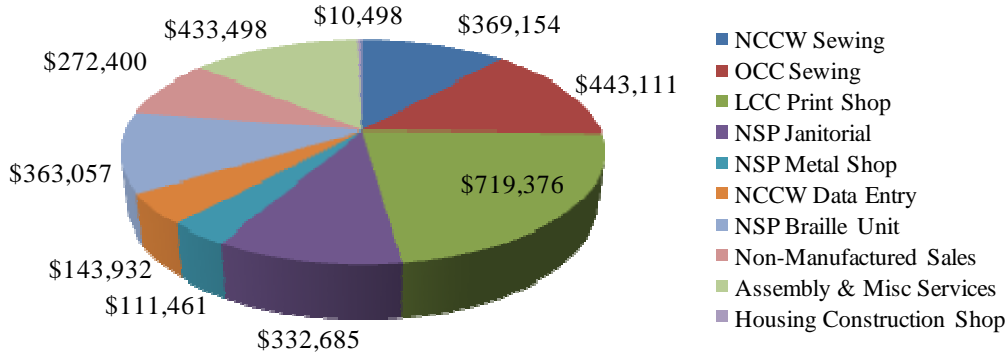
Expenses by Shop Type



The Other shop type incurred \$3,199,172 of expenses for the fiscal year ended June 30, 2008. The chart below shows the expenses for the shops making up the Other shop type.

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Other Shop Type Expenses Breakdown



In total, CSI lost \$605,051 for the fiscal year ended June 30, 2008, but this loss does include expenses of approximately \$835,000 for a new integrated software system CSI implemented during the fiscal year. The majority of the loss was caused by the Other and Wood Shop types. The License Plate, Laundry, and Private Venture Operations types all were profitable and earned \$95,225, \$84,466, and \$68,796, respectively. Below is a table showing the performance at the five shops that were the most and least profitable during the year.

5 Shops with Greatest Losses	
LCC Wood Shop	\$ (162,075)
NSP Reconditioned Furniture	\$ (130,059)
Assembly & Misc Services	\$ (116,383)
NSP Janitorial	\$ (110,003)
LCC Print Shop	\$ (101,766)

5 Shops with Greatest Profits	
NSP Digital License Plates	\$ 95,225
NSP Laundry	\$ 54,520
Sillosock Inc	\$ 31,374
TSCI Laundry	\$ 29,946
Tek @ LCC	\$ 24,981

The Wood Shops lost a total of \$347,669 for the fiscal year ended June 30, 2008. A total of \$505,869 was lost from the Other shop type. Below is a chart showing the profit/losses at the shops included within the Other shop type.

Other Shop Type Breakdown of Profit/(Loss)	
NCCW Sewing	\$ (801)
OCC Sewing	\$ (74,410)
LCC Print Shop	\$ (101,766)
NSP Janitorial	\$ (110,003)
NSP Metal Shop	\$ (57,131)
NCCW Data Entry	\$ (30,522)
NSP Braille Unit	\$ 3,128
Non-Manufactured Sales	\$ (21,457)
Assembly & Misc Services	\$ (116,383)
Housing Construction Shop	\$ 3,476

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In summary, CSI has two purposes, one of which is to employ inmates and the other is to produce goods for governmental entities and nonprofits. As of June 30, 2008, CSI employed 573 of 4,363 inmates and 69 probationers at the Work Ethic Camp, which was 13% of the inmate population. In addition, during the fiscal year ended June 30, 2008, CSI lost \$605,051. However, included in this loss was approximately \$835,000 of expenses for a new integrated software system implemented during the fiscal year. The integrated software system expenses were allocated to the shops as part of Support Services expenses.

Criteria

The criteria used in this attestation review were Nebraska State Statutes, Department of Correctional Services (Department) - Administrative Regulations, Department Operational Memorandums, and good internal controls.

Summary of Procedures

Pursuant to Neb. Rev. Stat. § 84-304 (Reissue 2008), the Auditor of Public Accounts (APA) conducted an attestation review of the Expenditures, Payroll, Inventory, and Revenues for the period July, 1, 2007, through June 30, 2008, in accordance with standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States. The APA's attestation review consisted of the following procedures:

The APA performed a number of procedures common to the subject matter identified. These procedures included gaining an understanding of internal controls, analytical procedures, and follow-up on prior year recommendations. Procedures performed unique to a certain subject matter are identified below.

Payroll

1. Selected a sample of inmates and traced the amount paid to support for hours worked and rate of pay.

Inventory

1. Traced a sample of raw material purchases into NIS.
2. Performed counts of inventory at the shops and compared them to the inventory recorded on NIS.
3. Selected a sample of inventory adjustments and traced these to support and managerial approval.

Expenditures

1. Selected a sample of purchases and tested them for compliance with various State statutes and regulations.

Revenues

1. Selected a sample of work orders for custom items and traced them to a sales order and ultimately to a payment.
2. Requested documentation to support the prices for the items purchased on the sales orders.
3. Selected a sample of work orders for stock items and then identified subsequent sales of these types of items to trace to a payment or a receivable report.

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Summary of Results

The summary of our attestation review noted the following findings and recommendations:

1. CSI Rate Documentation

CSI Operational Memorandum (OM) 119.01.10 Procedure V states, “The CSI Sales and Marketing Manager in collaboration with CSI Administration including production and Business Office as necessary, determines the sale price for competitive products via profit margin, per standard mark-up percentage.”

CSI OM 119.01.10 Procedure VI states, “It is the responsibility of the CSI Deputy Director in conjunction with the Business Manager to evaluate total CSI cost and current market cost and determines a profit margin/selling price. Profit margin is based on competitive analysis of like and comparable items within the open market and as compared to correctional industry programs in neighboring states.”

CSI OM 119.01.10 Procedure VII states, “The following formula shall be utilized when determining price, Raw Material Cost + Labor + Burden + Profit Margin = Selling Price.”

CSI produces both a standard product line and custom products. While CSI can set their prices using either Procedure V or VI, CSI did not have documentation to support the determination of the profit margin and adherence to OM 119.01.10. Below is a sample of products the APA selected for review, and the gross profit margin percentage the APA calculated. The APA was able to perform this calculation as NIS tracks the actual usage of raw materials and applies direct labor and factory overhead based upon pre-set rates. Using the cost data from NIS, the APA was able to compare the sales revenue for the sales order to the manufactured cost for the work order and determine the gross profit margin percentage. The APA expects different jobs performed at different times and at different shops to result in a different gross profit margin percentage. However, the APA requested documentation to support a standard gross profit margin for the product but CSI was unable to provide this documentation. A similar comment was included in our fiscal year ended June 30, 2005, examination of the Department of Correctional Services.

Item Number	Description	Cost to Manufacture Work Order	Sales Revenue	Gross Profit Margin Percentage
96172-G-BF-120-R	Braille, Tactile, Lit, SS, Reorder	\$ 2,018	\$ 6,463	69%
96172-G-BF-120-R	Braille, Tactile, Lit, SS, Reorder	\$ 740	\$ 2,525	71%
57034-F-LP-711	DMV – Lic. Plate, Mobile Home	\$ 285	\$ 602	53%
57034-F-LP-996	DMV – Lic. Plate, Apportioned Trailer	\$ 285	\$ 602	53%
42506-G-CR-194-956	Chair, Comfort RX, w/arms	\$ 881	\$ 1,138	23%
42506-G-CR-194-956	Chair, Comfort RX, w/arms	\$ 1,316	\$ 1,707	23%
42084-G-DK-112	Desk, Flat Top, w/Bkrk	\$ 10,906	\$ 19,694	45%

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Item Number	Description	Cost to Manufacture Work Order	Sales Revenue	Gross Profit Margin Percentage
20049-F-CL-600-2X	Sweat Shirt, Gray, 2x	\$ 1,022	\$ 1,425	28%
20049-F-CL-600-4X	Sweat Shirt, Gray, 4x	\$ 959	\$ 1,350	29%
42548-G-FR-999	Furniture, Custom	\$ 95	\$ 212	55%
42521-G-DK-999	Desk, Custom	\$ 438	\$ 1,065	59%
20049-F-CL-251-38	Pants, Khaki, 38w, Unhemmed	\$ 1,972	\$ 2,813	30%
85012-F-CL-046	Sheets, Flat, 46x88	\$ 2,574	\$ 2,925	12%

Note: Cost to Manufacture Work Order does not include the allocation for Support Services expenses.

The data listed in the table above was obtained from information recorded on NIS in the first 90 days of CSI implementing their new integrated software system. CSI Management expects the Cost to Manufacture Work Order amount, for the products in the table above, to be different in the future as CSI staff gains experience using the new integrated software system.

Our review of CSI operations also noted that CSI management had no written documentation on how the prices were set for products and services produced by two shops that generate significant cash flows for CSI. These two shops are the License Plate Shop at the State Penitentiary and the Tecumseh Laundry Shop. CSI produces the State license plates and sells them to the Department of Motor Vehicles (DMV) which are then purchased by Nebraska drivers. Neb. Rev. Stat § 83-123 (Reissue 2008) mandates the Department of Correctional Services manufacture and deliver license plates to county officials. The rates CSI charges DMV for license plates range from \$2.59 to \$3.60, depending on the plate, with the standard plate being priced at \$3.12. No written contract or agreement exists between CSI and DMV nor was other documentation provided to support how these rates were set. The Tecumseh Laundry Shop charges its customers various rates based upon a number of factors including distance from the facility, services provided, and quantity laundered. During the fiscal year ended June 30, 2008, CSI increased their base laundry rates from \$0.24 to \$0.32 per pound. The base rates are applied to the Department of Correctional Services (Department) and the Department of Health and Human Services (DHHS). Prior to the change, management prepared a profit and loss forecast of the two laundry facilities under assumptions of the base rate being \$0.24 a pound or \$0.32 a pound. In their forecasts, the \$0.24 resulted in losses for the facilities and \$0.32 resulted in profits for the laundry shops.

In addition to providing services to the Department and DHHS, CSI provides laundry services to nonprofit hospitals and county hospitals. These entities are charged different rates which exceed the base rate. Per our discussion with management, the rates charged to these entities is based upon a number of factors, including quantity of laundry (the more laundry the cheaper the rate will be), the distance from CSI (transportation costs), and other factors. CSI has agreements with these entities which state the amount that will be billed for each pound of laundry. CSI does not have documentation to support what factors were used and the value of those factors to arrive at the agreement rate from the base rate.

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Below are three tables. The first table shows the CSI Revolving Fund Cash Balance for the past five years. The second table shows the receipts, disbursements, and excess of receipts over disbursements for the License Plate Shop for the past five years. The third table shows the receipts, disbursements, and the excess of receipts over disbursements for the Tecumseh Laundry Shop over the past five years. Whereas the financial data provided in the Background above was on the accrual basis, the financial information below is on the modified cash basis. The main difference between the two is the data below does not include adjustments for payables and accrued payroll and allocations for interest income and the Support Services.

	FY2004	FY2005	FY2006	FY2007	FY2008
CSI Revolving Fund Cash Balance	\$ 4,756,143	\$ 8,190,599	\$ 9,565,585	\$ 7,344,073	\$ 6,217,411
CSI Revolving Fund Accounts Receivable	\$ 1,531,908	\$ 815,509	\$ 289,519	\$ 735,464	\$ 1,049,093

Digital License Plates	FY2004	FY2005	FY2006	FY2007	FY2008
Receipts	\$4,441,824	\$ 6,886,182	\$ 3,078,359	\$ 1,748,861	\$ 2,002,474
Disbursements	\$1,673,173	\$ 3,187,062	\$ 1,080,004	\$ 679,085	\$ 1,059,694
Excess	\$2,768,651	\$ 3,699,120	\$ 1,998,355	\$ 1,069,776	\$ 942,780

Tecumseh Laundry	FY2004	FY2005	FY2006	FY2007	FY2008
Receipts	\$1,135,556	\$1,299,523	\$ 1,385,920	\$ 1,518,138	\$ 1,992,999
Disbursements	\$ 830,384	\$1,203,227	\$ 840,498	\$ 878,675	\$ 1,033,989
Excess	\$ 305,172	\$ 96,296	\$ 545,422	\$ 639,463	\$ 959,010

Note: The Disbursement amount does not include depreciation or Support Services expense.

The data in these three tables supports that Digital License Plates and the Tecumseh Laundry facilities provide a significant amount of cash flow to CSI. For instance, the CSI Revolving Fund Cash Balance increased \$3,434,456 between fiscal year 2004 and fiscal year 2005. During this same time, the License Plate and Tecumseh Laundry Shops had receipts exceed disbursements by \$3,795,416. The cause for the significant increase in License Plate receipts, during the fiscal year ended June 30, 2005, was due to the new license plate cycle which began in calendar year 2005. Every six years the State of Nebraska gets new license plates and the first year of the most recent six year cycle occurred during calendar year 2005. The significant increase in the Tecumseh Laundry Shop receipts was due to the rate increase during the fiscal year ended June 30, 2008.

Without documentation to support CSI followed their price setting policies, there is an increased risk CSI will not achieve its desired profit margin. Not meeting planned profit margins increases the risk CSI will not be able to meet all of its obligations or its products and services maybe over or under priced.

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We recommend CSI maintain documentation to support their price setting process and adherence to their policies.

CSI's Response: CSI's pricing decisions are based on management's knowledge and experience. We believe our prices are fair and reflect the quality and guarantees of our products. Although CSI is a business, the primary function of CSI is to employ and train inmates not only in a job skill but in basic work expectations and responsibilities. CSI must balance their goals while ensuring that there is sufficient funding to maintain the operation.

APA's Response: The scope of our review did not include determining whether CSI's prices were fair or reflect the quality and guarantees of their products. Our scope did include requesting documentation to support the price setting process. CSI was unable to provide this documentation.

2. Accounts Receivable

Good internal controls require documented procedures to review, collect, and write-off outstanding balances.

Sound business practices require management to identify risk areas and implement procedures to adequately address these concerns.

It was noted in our fiscal year 2005 Nebraska Department of Correctional Services report that CSI did not have adequate procedures in place to track accounts receivable. While it appears CSI has implemented procedures to follow up on outstanding receivables, they have not documented these procedures in a formal process such as an Administrative Regulation or Operational Memorandum.

As of February 13, 2009, CSI had accounts receivable of \$964,887, of which \$214,607, 22%, was over 120 days old, with \$11,712 of the \$214,607 due from a nonprofit customer since July 2007. This instance appears to be caused by a unique circumstance; however, CSI should implement procedures to ensure customers are able to pay for the products they purchase prior to manufacturing the product. This is especially important when the product is custom made for the customer. Since many of CSI's customers are political subdivisions with the ability to raise funds through taxation or receive tax dollars, the likelihood of not collecting from these customers is small. However, since nonprofit entities are able to buy from CSI, procedures should be in place to ensure they will be able to pay.

Without established documented procedures regarding the review of accounts receivables there is an increased risk that overdue accounts will go uncollected. Manufacturing products for clients without knowledge of whether they would be able to pay increases the risk CSI will not receive payment for the goods they produce.

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We recommend the Department formally document their procedures to review, collect, and write-off overdue accounts receivables. The APA also recommends CSI implement procedures to ensure customers will be able to pay CSI for the products sold.

CSI's Response: DCS will document their accounts receivable processes in Administrative Regulation 113.01 in the next annual review cycle.

CSI has not experienced any significant issues with customers not paying for products sold.

3. CSI Support Services Expense Allocation

Sound business practices would require allocation of support service expenses (those expenses that are not chargeable directly to a specific function, or in the case of CSI, a specific shop because there are expenses that support the operation of more than one shop) on a basis that would be a reasonable estimate of support provided to a particular shop.

In our review of CSI's operations, and as noted in some detail in the background of this report, we noted that CSI had three areas where Support Services expenses were accumulated and then allocated to each shop. Those three areas were administrative, sales, and warehouse. Administrative costs are allocated to all traditional shops and customer model private ventures. CSI has two types of private ventures: a customer model, where CSI is responsible for paying inmate wages, and an employer model, where the private venture entity is responsible for paying inmate wages. Sales and warehouse costs are allocated to traditional shops and not private ventures or work crews. The total Support Services expenses allocated for these three areas was \$3,723,060 for the fiscal year ended June 30, 2008. The basis for the allocation was the reported revenue by each shop.

We believe revenue generated by a shop may be a sound basis for allocating Support Service expenses in some cases, however, an across the board allocation may not be appropriate. For example, the License Plate Shop manufactures State of Nebraska licenses plates for Nebraska motorists. The current allocation process for Support Service expense allocates a portion of the sales expense to the License Plate Shop but we understand there is little or no sales activity related to the manufacture of license plates, as the plates are manufactured and then delivered to the various county officials based on their plate orders. Since the License Plate Shop is one of the shops that generate a significant amount of revenue, and has little or no sales activity involved in its operations, we believe CSI is allocating more sales expenses to this shop than it should.

Without a proper allocation of Support Services expense, the CSI shop financial statements will not provide accurate and reliable data for management to make sound business decisions.

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We recommend CSI review their process for allocating support service expenses.

CSI's Response: CSI has reviewed the allocation process and will continue to review the process. We believe that the current process meets the needs of management.

Overall Conclusion

CSI does not have support for how prices for products are determined. This has been a recommendation from prior APA work and has not been corrected.

The APA staff members involved in this attestation review were:

Don Dunlap, CPA, Assistant Deputy Auditor

Zach Wells, Auditor-In-Charge

Tom Goeschel, Auditor II

Marty Adams, Auditor

If you have any questions regarding the above information, please contact our office.