

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF CORRECTIONS
CORRECTIONAL INDUSTRIES ACCOUNT AND
VOCATIONAL TRAINING ACCOUNT**

**FINANCIAL AND COMPLIANCE
AUDIT REPORT
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF CORRECTIONS
CORRECTIONAL INDUSTRIES ACCOUNT AND
VOCATIONAL TRAINING ACCOUNT**

TABLE OF CONTENTS

| | <u>PAGE</u> |
|---|--------------------|
| INTRODUCTORY SECTION | |
| Reporting Entity And Scope | 1 |
| Organization..... | 1 |
| Responsibilities | 2 |
| Funding | 2 |
| Capital Assets..... | 2 |
| Prior Audit | 3 |
| Audit Objectives And Scope..... | 3 |
| CONSTRUCTIVE SERVICE COMMENTS SECTION | |
| Auditor’s Report On Internal Control Over Financial Reporting And On Compliance And Other Matters | 4 |
| <i>Internal Control Comments</i> | |
| <i>Reportable Conditions</i> | |
| 1. Control Environment Should Be Strengthened..... | 6 |
| 2. Department’s Organizational Structure Should Be Formalized | 7 |
| 3. Internal Auditor Findings Should Be Integrated Into Control Structure | 8 |
| 4. Formal Risk Assessment Policies And Procedures Should Be Established | 9 |
| 5. Control Monitoring Efforts Should Be Improved..... | 11 |
| 6. Formal Fraud Risk Mitigation Efforts Should Be Developed And Implemented | 12 |
| 7. Accounting Policies And Procedures Should Be Established For Correctional Industries And Vocational Training..... | 13 |
| 8. Control Procedures Should Be Updated For Changes In Responsible Personnel | 14 |
| 9. Controls Should Be Established For Inmate-Developed Computer Programs | 15 |
| 10. Policies And Procedures For Lapsing Profits Should Be Established..... | 17 |
| 11. Financial Statements Should Be Prepared Timely..... | 18 |
| 12. Cost Accounting System Should Be Improved | 19 |
| 13. Inmate Pay Policy And Procedure Directive Should Be Clarified For Correctional Industries | 21 |
| 14. Controls Over Inmate Payroll Should Be Improved..... | 22 |
| 15. Policies And Procedures For The Control And Reporting Of Correctional Industries Materials Inventory Should Be Improved..... | 23 |
| 16. Efficient Inventory Levels Should Be Established | 24 |
| 17. Controls Over Vocational Training Inventories Should Be Improved | 25 |
| 18. Control Over Receipt Of Ordered Goods Should Be Improved | 27 |
| 19. Controls Over The Initial Receiving Process For Ordered Materials Should Be Improved | 28 |

| | |
|--|-----------|
| 20. Policy Requiring Customer Project And Information Worksheets Should Be Adhered To..... | 29 |
| 21. Correctional Industries Project Control Procedures Should Be Consistently Applied..... | 30 |
| 22. Controls Over Pricing Of Correctional Industries Goods And Services Should Be Improved | 31 |
| 23. Controls For Tracking Vocational Training Purchases To Customer Invoices Should Be Employed | 32 |
| 24. Adjustments To Accounts Receivable Should Be Subject To Management Approval Process | 33 |
| 25. State Equipment Control Policies And Procedures Should Be Followed..... | 34 |
| Auditor’s Report On Management Issues | 36 |
| <i>Management Issues Comments</i> | |
| 26. Inventory Account Should Be Included In State’s Operating Budgets | 37 |
| 27. Business Plan Should Be Established For Correctional Industries And Vocational Training | 38 |
| FINANCIAL SECTION | |
| Independent Auditor’s Report..... | 40 |
| Financial Statements | |
| <i>Governmental Fund Financial Statements</i> | |
| Balance Sheets | 42 |
| Statements Of Revenues, Expenditures, And Changes In Fund Balances | 43 |
| Notes To The Financial Statements | 44 |
| Supplementary Information | |
| Budget To Actual (Non-GAAP Budgetary Basis) Schedule Correctional Industries Account | 50 |
| Budget To Actual (Non-GAAP Budgetary Basis) Schedule Vocational Training Account..... | 51 |
| Note To The Supplementary Information - Budgetary Reporting..... | 52 |
| APPENDIX - Current Status Of Prior Audit Findings | 55 |

This report can be accessed in its entirety on-line at www.gencourt.state.nh.us/lba.

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF CORRECTIONS
CORRECTIONAL INDUSTRIES ACCOUNT AND
VOCATIONAL TRAINING ACCOUNT**

Reporting Entity And Scope

The reporting entity and scope of this audit and audit report is the financial operations of the Correctional Industries Account and the Vocational Training Account of the New Hampshire Department of Corrections for the fiscal year ended June 30, 2006.

At June 30, 2006, the Correctional Industries Account included the operations of nine shop programs including: plate, print, wood, information technology, sign, engraving, furniture, upholstery, and farm at the State Prison for Men in Concord; three programs including: information technology, wood, and furniture shops at the Northern N.H. Correctional Facility in Berlin; and one program identified as an information technology shop in the State Prison For Women in Goffstown. In addition, that shop performs various other activities, such as assembling and sewing. At June 30, 2006 Correctional Industries operated with 22 full-time employees and one part-time employee funded from the Correctional Industries Account.

At June 30, 2006, the Vocational Training Account included the operations of six shop programs at the State Prison for Men in Concord including: auto body, auto mechanics, building trades, culinary, horticulture and small engines repair. While these Vocational Training programs operated with seven full-time employees, the personnel and other costs related to these employees are not charged to the Vocational Training Account and therefore are not included within the scope of this audit and audit report. Vocational Training Account financial activities consist mainly of the purchase of parts, supplies, and materials used in shop activities. The cost of these parts, supplies, and materials are marked up 10% to cover incidentals and are charged to customers receiving shop services.

The following report describes the financial activity of the Correctional Industries Account and the Vocational Training Account, as it existed during the period under audit. Auditee responses were prepared by the Department of Corrections.

Organization

The Department of Corrections (Department) was established on July 1, 1983 pursuant to RSA 21-H. The Department is charged with maintaining and administering correctional facilities and programs for the benefit and rehabilitation of inmates. In addition, the Department is responsible for the supervision of all individuals placed on probation or released on parole and acts as an advisor to law enforcement agencies and communities in the prevention of crime.

The Department is headed by a Commissioner who is appointed by the governor and serves as the Department's chief administrative officer. The Commissioner is responsible for the management of all Department operations, including the administration and enforcement of all laws by which the Department is governed.

The Office of the Commissioner is responsible for the overall administration and operation of the Department. The Office oversees the three Divisions of Administration, Field Services, and Medical and Psychiatric Services. Correctional Industries is an organization within the Division of Administration (also known as Department's business office). The Vocational Training program during fiscal year 2006 was not specifically identified in the Department's organization structure under any of the three divisions.

Responsibilities

The Correctional Industries' mission states, "The mission of Correctional Industries is to provide meaningful job skills and training to incarcerated inmates within the State of New Hampshire. This is accomplished by providing a variety of work programs where inmates have an opportunity to obtain various job and life skills in a hands-on, real world environment."

Per the Department of Corrections' Policy and Procedure Directive 7.02 for the Vocational Training Program, "The primary function of the Vocational Training Program is to provide inmates with a course of study leading to a certificate of competency in a given skill area."

Funding

The financial activity of the Correctional Industries and Vocational Training Accounts are accounted for in the General Fund of the State of New Hampshire.

The following table summarizes the fiscal year 2006 revenues and expenditures in the Correctional Industries Account and the Vocational Training Account.

**Correctional Industries Account And Vocational Training Account
Summary Of Revenues And Expenditures - General Fund
For The Fiscal Year Ended June 30, 2006**

| | |
|--|---------------------|
| Total Revenues | \$ 2,209,449 |
| Total Expenditures | <u>2,632,989</u> |
| Excess (Deficiency) Of Revenues Over (Under) Expenditures | <u>\$ (423,540)</u> |

Capital Assets

Capital assets used in governmental activities, defined by State accounting policy as assets having an original cost of \$10,000 or more and a useful life of one year or more, are not current financial resources and therefore are not reported in the fund financial statements that follow in this report. Capital asset activity related to the Correctional Industries programs for the fiscal year ended June 30, 2006 is presented in the following table. No assets used in the Vocational Training Account programs met the State's definitions of capital assets.

| | Balance | | | Balance |
|---|----------------------------|---------------------------|-------------------------|-----------------------------|
| | <u>July 1, 2005</u> | <u>Additions</u> | <u>Deletions</u> | <u>June 30, 2006</u> |
| Capital Assets Being Depreciated: | | | | |
| Building Improvements | \$ 194,737 | \$ -0- | \$ -0- | \$ 194,737 |
| Capital Equipment | <u>870,342</u> | <u>-0-</u> | <u>-0-</u> | <u>870,342</u> |
| Total Capital Assets Being Depreciated | <u>1,065,079</u> | <u>-0-</u> | <u>-0-</u> | <u>1,065,079</u> |
| Less Accumulated Depreciation For: | | | | |
| Building Improvements | 48,684 | 9,736 | -0- | 58,420 |
| Capital Equipment | <u>730,605</u> | <u>44,489</u> | <u>-0-</u> | <u>775,094</u> |
| Total Accumulated Depreciation | <u>779,289</u> | <u>54,225</u> | <u>-0-</u> | <u>833,514</u> |
| Depreciable Capital Assets, Net | <u>\$ 285,790</u> | <u>\$ (54,225)</u> | <u>\$ -0-</u> | <u>\$ 231,565</u> |

Prior Audit

The most recent prior financial and compliance audit of the Correctional Industries, including Vocational Training, was for the nine months ended March 31, 1995. The appendix to this report on page 55 contains a summary of the current status of the observations contained in that report. Copies of the prior audit report can be obtained from the Office of Legislative Budget Assistant, Audit Division, 107 North Main Street, State House Room 102, Concord, NH 03301-4906.

Audit Objectives And Scope

The primary objective of our audit is to express an opinion on the fairness of the presentation of the financial statements of the Correctional Industries Account and Vocational Training Account for the fiscal year ended June 30, 2006. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we considered the effectiveness of the internal controls in place over the Correctional Industries Account and the Vocational Training Account and tested compliance with certain provisions of applicable State laws and regulations related to the Correctional Industries and Vocational Training Account. Major accounts or areas subject to our examination included, but were not limited to, the following:

- Revenues and Accounts Receivable,
- Expenditures and Liabilities,
- Cash,
- Inventory, and
- Capital Assets.

Our reports on internal control over financial reporting and on compliance and other matters and on management issues, the related observations and recommendations, our independent auditor's report, and the financial statements of the Correctional Industries Account and Vocational Training Account are contained in the report that follows.

Auditor's Report On Internal Control Over Financial Reporting And On Compliance And Other Matters

To The Fiscal Committee Of The General Court:

We have audited the accompanying financial statements of the Correctional Industries Account and the Vocational Training Account of the New Hampshire Department of Corrections as of and for the fiscal year ended June 30, 2006, as listed in the table of contents, and have issued our report thereon dated January 9, 2007, which was qualified with respect to the lack of sufficient evidence to support the year-end inventory balances reported on the Correctional Industries Account and the Vocational Training Account balance sheets. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the internal control over financial reporting of the Correctional Industries Account and the Vocational Training Account in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. 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 Department of Corrections' ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in Observations No. 1 through No. 25 of this report.

A material weakness is a reportable 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 caused by error or fraud 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, we believe that none of the reportable conditions described above is a material weakness.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the financial statements of the Correctional Industries Account and the Vocational Training Account are free of material misstatement, we performed tests of the Department of Correction's compliance with certain provisions of laws, rules, and regulations, 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 or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain other management issues, which are described in Observations No. 26 and No. 27, that we reported to the management of the Department of Corrections in a separate letter dated January 9, 2007.

This auditor's report on internal control over financial reporting and on compliance and other matters is intended solely for the information and use of the management of the Department of Corrections and the Fiscal Committee of the General Court and is not intended to be and should not be used by anyone other than these specified parties.

Office Of Legislative Budget Assistant

January 9, 2007

Internal Control Comments
Reportable Conditions

Observation No. 1: Control Environment Should Be Strengthened

Observation:

The control environment at the Department, including Correctional Industries and Vocational Training, needs improvement. A weak control environment within the Department as it applies to Correctional Industries and Vocational Training has exacerbated many of the comments identified in this report.

The control environment sets the tone of an organization and is the foundation for all other components of internal control. Management is responsible for establishing and maintaining effective internal controls. In doing so, management determines the control environment and sets the “tone at the top”. The control environment encompasses a number of factors that have a pervasive influence on the way an entity’s activities are structured, objectives are established, and risks are assessed. The control environment includes such factors as management’s philosophy, operating style, organizational structure, and assignment of authority and responsibility. It defines the overall attitude, awareness, and actions of management concerning the importance of control and its emphasis in the entity. When there is constant change, lack of policy direction from management, or lack of response to questions or requests from subordinates, controls tend to lose their effectiveness.

A well-established control environment enables an organization to operate in a manner that minimizes the deleterious effects of operating in crisis conditions.

During audit fieldwork, we observed instances where controls at Correctional Industries and Vocational Training were negatively impacted by a seeming lack of policy direction from Department management and, as noted in Observation No. 2, the lack of clear lines of authority and responsibility within the Department. Reportedly, there were instances of confusion amongst employees as to their, and others’, responsibility and authority.

Recommendation:

The Department should address the weakness in its control environment. Department management should reassert its responsibility for setting an appropriate tone at the top that includes reemphasizing its commitment to the importance of controls within the Department and effectively communicate this to its employees through well-developed written policies and procedures.

The Department should establish and ensure the communication of clear lines of authority and responsibilities. Employees, including mid-level managers, should be aware of what they are responsible for, to whom they are responsible, and where direction and guidance should be obtained.

Auditee Response:

We concur in part. While we agree that top management sets the tone for the control environment, the Department is continuously reviewing and updating its policies and procedures, and emphasizes ethical conduct in initial training and mandatory annual training. We anticipate that adoption of the proposed revised organizational structure will clarify the lines of authority.

Observation No. 2: Department's Organizational Structure Should Be Formalized

Observation:

The Department has been operating under a plan of reorganization that has not been presented to the General Court for its consideration. Certain Department employees are working in a different capacity than their current job titles identified under the current laws. For example, at June 30, 2006:

- The Warden for the Northern N.H. Correctional Facility was acting as the Director of Operations, a newly created position, and was also covering the duties and responsibilities of the Director of Division of Field Services.
- The Director of Division of Field Services was acting as the Warden for Northern N.H. Correctional Facility.

Per Chapter 177, Section 183, of the Laws of 2005, "The commissioner of the department of corrections shall develop a plan to reorganize the department, which shall be filed with the speaker of the house of representatives and president of the senate no later than November 1, 2005." The Department has not filed the plan required by the chapter law, yet it appears the Department has enacted portions of a reorganization plan.

The Department could not provide a current organizational chart describing the operations of the Department during fiscal year 2006, the period covered by the audit. A primary component of an organization's control environment is an organizational structure that establishes clear areas of authority and responsibility and establishes appropriate lines of reporting. The organizational structure provides the framework within which its activities for achieving entity-wide objectives are planned, executed, controlled, and monitored. Employees must have an understanding of the structure in order to effectively operate in the control activities and monitoring efforts of the organization. Confusion over the operational structure of the Department during fiscal year 2006 may have played a role in some of the conditions cited in the observations resulting from the audit.

Recommendation:

The Department should formalize its organizational structure and report a plan to reorganize the Department as required by Chapter 177, Section 183, of the Laws of 2005.

Once approved, the Department should train its employees on how changes in the Department's organizational structure affect the operations of the Department's controls, including control activities, information and communication, and monitoring efforts.

Auditee Response:

Please see our response to Observation No. 1 above. Once approved, our revised organizational structure will be formally promulgated to all employees.

Observation No. 3: Internal Auditor Findings Should Be Integrated Into Control Structure

Observation:

The Department has not effectively integrated its internal audit function into its control and process improvement structures.

The Department has not established policies and procedures for its internal audit function including sharing the results of the audits with the operating units subject to the audits. Specifically, the Department has not established policies and procedures for how to report findings, how to determine whether to implement findings, and how to review and discuss the findings within and amongst the Department's management so that appropriate actions can be taken. Because the Department has not made it a practice to share internal audit findings with the subject areas of the audits, opportunities for timely consideration of the findings and for taking corrective actions have been lost to the Department.

Prior to the current LBA audit, the Department of Corrections' internal auditor had performed an audit titled "Survey of Accounting and Business Practices, New Hampshire Department of Corrections Industries", dated April 24, 2006; and an audit of the inmate payroll system, titled "Evaluation of Offender Pay System Procedures" dated August 19, 2005. These reports identified internal control, policy directive compliance, and efficiency issues. Many of the comments in the internal auditor's reports were similar to the findings in this current audit. The reports were submitted to the Commissioner's office for review and approval. Reportedly, no actions on the recommendations have taken place. Findings and recommendations in the internal auditor's reports have not been communicated to the Department's Director of Administration or to the Correctional Industries Administrator, employees who would normally be considered point people for instituting corrective actions on these audit findings.

Internal auditing, as defined by the Institute of Internal Auditors (IIA), is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Internal auditors are expected to provide recommendations for improvement in those areas where opportunities or deficiencies are identified. While management is responsible for internal controls, the internal audit activity provides assurance to management that internal controls are effective and working as intended. In short, an effective internal audit activity is a valuable resource for management to make improvements within its organization.

The IIA recommends that an entity have a dual reporting structure for its internal auditors. If a dual reporting structure is not in place, management may be able to unduly influence the audit

plan, scope, whether issues are reported appropriately, and whether the issues ultimately get resolved.

Recommendation:

The Department should make the most effective use of its internal audit function. The Department should establish policies and procedures for the operation of the internal audit function to include the:

1. Selection and scope of audits,
2. Methods and channels of communication, including to whom the internal audit reports will be issued and who will respond to comments,
3. Process for instituting corrective actions, and the
4. Development and maintenance of methods to continuously monitor corrective action results.

Auditee Response:

We concur. The Department of Corrections has submitted a reorganization plan to the Legislature that will combine audit and investigative activities under a newly created Inspector General. When this plan is approved and implemented, the structure, objectives, and authority of internal audit will be outlined in a new Policy and Procedure Directive, as well as procedures to establish responsibility for documenting consideration of internal audit findings, and monitoring significant conditions disclosed by audit reports.

Observation No. 4: Formal Risk Assessment Policies And Procedures Should Be Established

Observation:

The Department, Correctional Industries, and Vocational Training have not established formal risk assessment policies and procedures for recognizing and responding to risks potentially affecting the operations of Correctional Industries and Vocational Training.

Management's assessment of and response to risks facing the organization is an integral component of internal control. The purpose of an entity's risk assessment efforts is to identify, analyze, and where appropriate, respond to risks and thereby manage risks that could affect the entity's ability to reach its objectives. Effective risk assessment practices should be a core element of management's planning activities and should be an ongoing activity.

Correctional Industries and Vocational Training do not have formal policies and procedures in place for periodically reviewing operations for risks that could jeopardize their ability to continue to function as management intends. Currently, when risks are identified, Correctional Industries and Vocational Training may respond with a change in procedure or other action; however, there are no formal policies and procedures to continuously review operations for risks. A lack of understanding of risks generally pushes an entity toward a reactive mode when significant risks are realized or occur. A reactive mode may compromise the efficiency and

effectiveness of a response due to the lack of prior identification and understanding of the risks and ramifications.

An entity faces many risks. Risk can be defined as the threat that an event or action will adversely affect an entity's ability to achieve its objectives. Risk can be classified in many ways. These include:

External risks - threats from broad factors external to the entity including changes in the political arena, statutes and rules, competition from other sources, and illegal activity external to but affecting the organization.

Operational risks - threats from ineffective or inefficient processes for acquiring and providing goods and services, as well as loss of physical, financial, or information assets.

Information risks - threats from the use of poor quality information for operational, financial, or strategic decision-making within the entity and providing misleading information to others.

A continuous review of the Correctional Industries and the Vocational Training processes and activities using a risk-based mindset would promote effective planning and assist in resource allocation decision-making. Risks identified should be analyzed to determine whether current internal controls mitigate risk to a level desired by management or whether other actions are required in response to the risk.

Recommendation:

The Department, Correctional Industries, and Vocational Training should formalize a risk assessment process for Correctional Industries and Vocational Training. A formal risk assessment process is a necessary tool the organizations need to assist in the effective management of risks. Identifying risks significant to the Department, Correctional Industries, and Vocational Training operations, and strategies to mitigate those risks, should enhance the effectiveness of the operations' planning, resource allocation, and control processes.

Auditee Response:

We concur in part. While the Department has not formalized all of its risk assessment and monitoring activities in a single policy statement, various risk assessment procedures are being performed as regular procedures. The most significant risks the Department faces involve the security of the public, staff, and inmate populations. Security is monitored continuously, and incorporates all the accreditation standards promulgated by the American Correctional Association, who regularly audits our processes as part of the certification process. Operational risks are likewise acknowledged and managed on a daily basis. Strict compliance with State health and safety regulations safeguard the physical plant and well being of both staff and inmates. Risks in the areas of tool control and fire and health safety are managed through a highly structured process. Risk management is also apparent in the process by which Correctional Industries safeguards its electronic information. System electronic backups are conducted daily, with weekly backups stored offsite. Any catastrophic occurrence would retain all electronic data no longer than a maximum of a week old. Security audits are routinely conducted and any deficiencies identified and corrected. We understand that the risk assessment

process is a helpful tool and will continue to analyze and attempt to mitigate risks as time and resources allow.

Observation No. 5: Control Monitoring Efforts Should Be Improved

Observation:

Monitoring ensures that internal controls continue to operate effectively and as intended by management. This involves the regular assessments by appropriate personnel of the design and operation of controls, including control procedures, and taking timely and necessary actions to ensure the controls operate as intended.

As noted in observations in this report, the Department did not actively monitor the performance of its controls at Correctional Industries and Vocational Training. The Department did not take action when, as noted in Observation No. 11, financial statements were not prepared in a timely manner and when, as noted in Observations No. 25 and Nos. 15 and 17, physical inventories of equipment and materials, respectively, were not taken and reported. Because all of these control activities are reported through the Department, the Department should have recognized when these activities were not performed and should have taken action.

Management's lack of apparent reaction to control failures can result in employees coming to understand that management is not committed to control activities. This understanding can result in a diminution of the control environment and further lack of control compliance.

Recommendation:

As noted in this and other observations in this report, the Department should strengthen the controls over the Correctional Industries and Vocational Training programs. For this effort to be fruitful, the Department will also need to increase its control monitoring efforts over these programs. The Department should take the appropriate measures to ensure that it is able to react effectively when its control monitoring efforts indicate that established controls at Correctional Industries and Vocational Training are not operating as intended.

As part of this effort, the Department should develop and establish procedures to monitor that the Department is operating and resources are being used as management intended. Procedures should include performing regular periodic analytical and other tests on information reported by the operations. While monitoring to ensure that control activities such as the preparation of financial statements and reports of inventories are performed is important, it is also important to monitor to ensure that the information reported by these activities is consistent with the planned operations of the programs and with other available information.

Auditee Response:

We concur. Monitoring procedures will be described in the updated Accounting Policy and Procedures Manual that is being prepared.

Observation No. 6: Formal Fraud Risk Mitigation Efforts Should Be Developed And Implemented

Observation:

The Department has not established a formal fraud assessment, prevention, deterrence, and detection program and has not established a fraud reporting policy.

Fraud encompasses an array of irregularities and illegal acts characterized by intentional deception. Persons outside or inside the organization can perpetrate it for the benefit of or to the detriment of the organization. Fraud runs the spectrum from minor employee theft and unproductive behavior to misappropriation of assets, fraudulent financial reporting, and intentional noncompliance with a law or rule leading to an undue benefit.

Management is responsible for assessing the risk of fraud and implementing measures to reduce the risks of fraud to an organization. Fraud assessment, prevention, deterrence, and detection are crucial to the controlled operations of an organization.

- Assessment is critical since risks can only be effectively managed if risks are identified.
- Prevention reduces opportunities. Preventative methods are typically part of the organization's internal control – tone at the top and control procedures.
- Deterrence consists of those actions taken to discourage the perpetration of fraud and limit the exposure if fraud does occur. The principal mechanism for deterring fraud is the establishment of effective controls that persuade employees that fraud will be detected and perpetrators punished. Management has the primary responsibility for establishing and maintaining these controls.
- Detection consists of identifying indicators of fraud sufficient to warrant recommending an investigation. These indicators may arise as a result of controls established by management, tests conducted by internal auditors, and other sources both within and outside the entity.

Management is also responsible for assisting in the deterrence and detection of fraud by examining and evaluating the adequacy and effectiveness of controls, commensurate with the extent of the potential exposure or risk in the various segments of an entity's operations.

The attributes of an effective fraud reporting policy include:

- The policy is in writing,
- The policy describes fraudulent activities and the activities and actions required when fraud is suspected or detected,
- The policy is communicated to all employees, and
- Management obtains written assurance from each employee that the policy and related reporting mechanism is understood.

The effectiveness of a fraud reporting policy is enhanced when employees have a clear understanding of fraud indicators and what constitutes a fraudulent act. It is important that the reporting procedure is non-threatening for the reporter and provides for the reasonable protection of all parties.

Recommendation:

The Department should establish formal fraud risk mitigation policies to help limit the Department's exposure to fraud and to promote timely detection.

The Department should establish a formal fraud assessment, prevention, deterrence, and detection policy to help limit the Department's exposure to fraud and to promote early detection of fraud that might occur. The Department should take measures to foster a high degree of control consciousness among its employees and ensure that its employees understand that adhering to controls is a primary concern of management.

The Department should establish a fraud reporting policy and provide its employees with periodic fraud awareness training. The Department should take measures to ensure that the policy facilitates and encourages reporting and protects all parties involved.

Auditee Response:

We concur in part. While the Department's existing policies address unethical and illegal conduct, and provide for reporting such conduct, a directive specifically defining fraudulent acts and procedures in reporting allegations of fraud will be considered. Training in ethical conduct begins with initial training for all Department employees, and is reemphasized in annual training, since it is so fundamental to insuring the integrity and success of the Corrections mission.

Observation No. 7: Accounting Policies And Procedures Should Be Established For Correctional Industries And Vocational Training

Observation:

The Department has not established financial accounting and reporting policies and procedures for Correctional Industries and Vocational Training.

Department management has not established sound accounting policies and procedures required for the preparation of consistent and accurate monthly and fiscal year-to-date financial statements for Correctional Industries and Vocational Training. Lacking Department direction, the accountants have prepared the monthly and annual financial statements based upon their understanding and judgment, increasing the risk that limitations in the employees' experience or training could prevent the accurate and consistent completion of these critical control functions, and also increasing the risk of Correctional Industries and Vocational Training becoming dependent upon these employees for the continued performance of these functions.

Examples of decisions that appear to be made ad hoc by employees without the benefit of established policies and procedures include: what equipment to capitalize and related depreciation periods, the valuation of inventories including the use of estimates for inventory balances, and allowance for doubtful accounts valuation.

Recommendation:

The Department should establish formal accounting policies and procedures for Correctional Industries and Vocational Training, including financial accounting and reporting policies and procedures.

Once established, Department management should continually monitor employee adherence to the policies and procedures and should also regularly review the policies and procedures for continued adequacy and relevance.

Auditee Response:

We concur. Currently a comprehensive Accounting Policy and Procedures Manual is being compiled and updated covering all aspects of the business function including depreciation method, inventory valuation method and reporting form and content. It is expected that this formalized document will have input of the Agency Auditor and Senior Management.

Observation No. 8: Control Procedures Should Be Updated For Changes In Responsible Personnel

Observation:

The Department, including Correctional Industries and Vocational Training, has not provided timely notification to banks of changes in authorized account signatories.

Department personnel reported the Department did not notify their banks of changes in authorized account signatories and, as a result, prior employees remained as authorized signatories on the Correctional Industries and the Vocational Training bank accounts. The fact that prior employees continued to be listed as individuals authorized to access the accounts at June 30, 2006 was confirmed through documentation received from the banks, which indicated two prior employees remained as authorized signatories several years after leaving State service.

The failure to update account control information in a timely manner is a significant control deficiency. The fact that current employees were aware that prior employees remained on the account, yet the account records were not corrected, is also troubling.

Recommendation:

The Department, including Correctional Industries and Vocational Training, must immediately update the account records with the banks.

The Department, including Correctional Industries and Vocational Training, should establish policies and procedures to ensure that the effects of personnel changes on the control system are addressed in a timely manner. The effect on controls caused by changes in employee job responsibilities or other changes in employment status should be periodically monitored and reviewed.

The Department, including Correctional Industries and Vocational Training, should review with its employees the importance of controls. Employees should be reminded it is their responsibility to report to appropriate management apparent control failures or weaknesses. It is management's responsibility to address those failures and weaknesses in a timely manner.

Auditee Response:

We concur. The Department of Corrections Fiscal Management Bureau has been tasked with developing procedures for regular review of bank accounts and signatories, and to delete signature authority when employees have duty changes, or leave the Department.

Observation No. 9: Controls Should Be Established For Inmate-Developed Computer Programs

Observation:

There are no policies and procedures to require the independent review and acceptance of inmate-developed computer programs prior to the implementation of the programs into Correctional Industries and other systems.

Correctional Industries does not have formal policies and procedures for the secure use of computer programs developed by inmate workers. Inmates in the Correctional Industries Information Technology shop have developed computer programs used by Correctional Industries, the Department, and other State agencies. While the programs appear to operate as intended, there is no system of independent and knowledgeable review of the application, code, and related documentation to ensure that the programs are secure and will continue to operate as intended.

Examples of inmate-developed programs include:

- Inmate Payroll System used by the Department to process Department-wide inmate payroll. Correctional Industries was not aware of any available documentation to evidence the program's development, testing, and revisions. No documentation was presented to show the program was subject to inspection and review for unnecessary and inappropriate code.
- Correctional Industries Inventory System for the Print, Sign, and Wood shops. Correctional Industries was not aware of any available documentation to evidence the program's development, testing, and revisions. No documentation was presented to show the program was subject to inspection and review for unnecessary and inappropriate code.
- Correctional Industries Inventory Systems for Furniture shop. The system in place during fiscal year 2006 only accounted for balances and did not account for the receipts and disbursement of inventory. As a result, the furniture shop developed its own system that tracks inventory activity as well as balances. The newly developed system went into operation without the knowledge of the Correctional Industries Administrator. The Concord Upholstery shop also uses this system.
- Various programs have been developed for other State agencies. While, presumably, these agencies have tested the programs to ensure they operate as intended, Correctional Industries

does not perform a technical review of the security of the code prior to releasing the programs to the customers.

According to Correctional Industries, the technical programming abilities of some of the inmates are sufficiently developed to present the risk that an inmate could intentionally or unintentionally develop a program with harmful code that might not be detected and corrected prior to release to a customer. Currently, there is no system in place to ensure that a Correctional Industries employee with sufficient related expertise reviews inmate-developed programs for problem code.

Lack of documentation to support the development, testing, and changes to the programs may also make future program troubleshooting and updating more difficult.

Recommendation:

Correctional Industries should establish policies and procedures over the review, use, approval, and implementation of inmate-developed programs. Correctional Industries should ensure that a documented independent review and evaluation of the programs, including security reviews, are performed prior to the release of inmate-developed programs to consumers.

Correctional Industries should establish an appropriate system of controls over the implementation of, and changes to, computer programs. The system should include the primary change management steps of: 1) approval/authorization of changes, 2) documentation of systems and changes made to systems, 3) thorough testing of changes, 4) and approval of the implementation of changes by appropriate levels of management prior to the implementation being made. Programs should not be placed into operation without the knowledge and approval of management.

Auditee Response:

We concur.

Comment From The Office Of Information Technology:

The Office of Information Technology (OIT) concurs with the finding and believes that a two-step process should be implemented to deal with current and future applications. First, Department of Corrections senior management, with consultation from OIT, should determine if a proposed new information technology application or service is appropriate for delivery by Correctional Industries. Second, applications delivered by Correctional Industries (existing or future) should be reviewed for technical soundness and scanned with appropriate tools to evaluate the security posture of the application.

Observation No. 10: Policies And Procedures For Lapsing Profits Should Be Established

Observation:

The Department of Corrections and the Department of Administrative Services have been inconsistent in determining how to quantify whether there is profit in the operations of Correctional Industries subject to a statutory lapse requirement.

RSA 622:28-a, III, states:

“The commissioner of corrections shall prepare a monthly profit and loss statement and at the end of each fiscal year shall file a report with the commissioner of administrative services in such format and containing such information as the commissioner of administrative services shall require. The commissioner of administrative services at the end of each fiscal year shall cause any profit which accrued during that year to lapse to the general fund.”

While the transfer of profits did not come into play during fiscal year 2006 as a result of an operating loss, past transfers to the General Fund were reportedly based on the fiscal year end available balances reported in the State’s accounting system (NHIFS) and not necessarily on a determination of profits at the fiscal year-ends. Because the NHIFS available balance does not consider the value of available inventory because the available balance is also reduced for amounts that have been encumbered prior to expenditure, the NHIFS available balance is not a good measure of profit.

Correctional Industries indicated that using the fiscal year-end available balance to determine the amount of profits for transfer was a method proposed by a former Department internal auditor. The method was discussed with and reportedly accepted by the Department of Administrative Services.

Recommendation:

The Department, Correctional Industries, and the Department of Administrative Services should review the accounting for the Correctional Industries’ operations and establish policies and procedures for the timely reporting of profits at year-end. The policies and procedures should provide clear direction so that amounts to be lapsed in accordance with RSA 622:28-a, III, can be determined in a consistent manner from year to year.

Auditee Response:

We concur in part. Correctional Industries has not had a profit recently and expects losses to continue in the near term. Agreement on distribution of profits is therefore moot in the near term. In the longer term we will be following the advice of the LBA in Observation No. 26 to attempt to facilitate the inclusion of Corrections Industries’ revolving account in the state’s operating budget.

Observation No. 11: Financial Statements Should Be Prepared Timely

Observation:

Correctional Industries did not prepare timely financial statements during fiscal year 2006.

The following table illustrates the timing of the preparation of the monthly financial statements during fiscal year 2006.

| Financial Statement Period | Month Completed | Months Out |
|----------------------------|----------------------|------------|
| July | December | 5 |
| August | December | 4 |
| September | December | 3 |
| October | December | 2 |
| November | February | 3 |
| December | March | 3 |
| January | March | 2 |
| February | May | 3 |
| March | August | 5 |
| April | August | 4 |
| May | August | 3 |
| June | October | 4 |
| Fiscal Year 2006 | Not Complete at 1/07 | |

By not preparing timely financial statements, Correctional Industries runs an increased risk that decisions affecting operations will be made based on incomplete or inaccurate information. Without having timely and sufficient information available, decisions may be based on perceptions of how the shops are performing and not on the reality of the operations.

According to the Correctional Industries business office, staffing issues hindered the timely preparation of financial statements during fiscal year 2006. Business office personnel reportedly regularly filled in for absent shop managers to keep shops operating. In addition, the business office reported that other responsibilities were given higher priority than the preparation of the statements.

Recommendation:

The Department should establish policies and procedures for the timely preparation of monthly and annual financial statements. The policies and procedures should include timeframes defining timely preparation and also guidance on the distribution of the financial statements to ensure that appropriate decision makers are provided with the information. Financial statements should be in a prescribed format that is appropriate to ensure that users of the statements are provided with relevant information in a consistent manner and format. The annual report should be prepared and submitted in such a format and containing such information as the Commissioner of Administrative Services prescribes in compliance with RSA 622:28-a, III.

Auditee Response:

We concur in part. We plan to streamline the monthly reports to eliminate detail that is not useful to end-users, which will enable us to prepare the statements in a more timely fashion. The biggest obstacle to being timelier has been inadequate staffing. Correctional Industries has seen a 20% reduction in staffing since fiscal year 2003 due to hiring freezes and position eliminations. Some shops operate with a single staff person. When shop staff is absent due to sickness, vacation, or training requirements, administrative staff is temporarily assigned to keep a shop operating. We have made the continuing operation of shops our first priority because of the negative impact of closing a shop and idling inmates, as well as the slowing of production and cash flow that results. When administrative staff is unavailable, preparation of reports is delayed. Profit reporting is also delayed by the incompatibility of different shop accounting systems, which must be reconciled for accounting purposes. The streamlining of the accounting systems, which has been adopted as a long-term goal, will further improve the timeliness of reporting.

Observation No. 12: Cost Accounting System Should Be Improved

Observation:

The Department and Correctional Industries have not established a comprehensive and consistent cost accounting system, including relevant policies and procedures, for the Correctional Industries shops.

The cost accounting systems currently used by the Correctional Industries shops are informal, having been established over a period of time with few formal guiding policies and procedures. The result has been that individual shops have developed and are now operating cost accounting systems that may seemingly suit the needs of the individual shops but that are not sufficiently sophisticated and comprehensive to provide meaningful comparable information on which to base management action. The Correctional Industries business office, fully cognizant of the limitations of the information, takes the available shop information and incorporates it into monthly financial statements.

For example:

- The Correctional Industries shops inconsistently track raw materials inventory used in specific jobs/projects. The Print, Sign and Wood shops use job tickets to track materials used and inmate labor hours worked on each job. The information is input onto a monthly profit analysis worksheet to account for a work-in-process inventory. Other shops do not track work-in-process and generally do not have sufficient detailed information to allow the establishment and analysis of profit or loss by job.
- The Concord Wood shop does not accumulate or record actual inmate labor hours worked on each job. When a job is complete, the labor hours are “plugged” on the job ticket with labor cost being reported as the net of the sales price less materials and profit, regardless of the hours worked on the project. During our testing we noted one example where the labor hours on a job were recorded as a negative 1.07 hours in order to provide for the sales price to equal the material costs plus profit margin and labor costs.

- As noted in Observation No. 22, the Correctional Industries shops have been provided little guidance on pricing products. Information necessary for establishing cost of production, including overhead costs, is not regularly provided to the shops and the shops do not necessarily include consideration of these costs in their pricing models. In addition, Correctional Industries does not have a clear and consistent understanding and practice of what costs are to be covered by operating revenues of the shops and what costs are to be supported by general prison-budgeted operations.

In order for the Department and Correctional Industries to have sufficient information to evaluate the operations of Correctional Industries shops, including costs of operations, actual profit by category of business and product, etc., the shops need to be provided with an accounting system, including policies and procedures, that accurately and consistently reports the financial activity of the shops. Management is responsible for establishing appropriate accounting systems and relevant policies and procedures.

Recommendation:

The Department and Correctional Industries should provide the Correctional Industries shops with a sufficiently sophisticated cost accounting system that allows for the controlled accumulation and reporting of relevant accounting information necessary for the regular evaluation and analysis of shop operations.

The system should provide for the proper accounting and reporting of resources used on jobs, including materials, labor hours, and overhead and also provide sufficient policies and procedures guidance to allow for the shops' successful implementation and continued operation of the system.

Pending implementation of a new system, the Department and Correctional Industries must become more involved in the current financial accounting and reporting activities of the shops. The current system should be reviewed and revised where appropriate to provide for the controlled gathering, summarizing, and reporting of shop financial activity to ensure that the shops are operating as management intended. The Department and Correctional Industries should also review the policies and procedures used by each shop to determine and accumulate relevant financial information and either ratify the current process or revise the policies and procedures as appropriate, including what costs should be considered as shop operating costs subject to inclusion in product pricing models. Once the policies and procedures are established as controlling, Correctional Industries should monitor shop compliance with the policies and procedures.

Auditee Response:

We concur. We will review and revise the current accounting system, and develop a plan for a new cost accounting system as personnel and financial resources permit.

Observation No. 13: Inmate Pay Policy And Procedure Directive Should Be Clarified For Correctional Industries

Observation:

Certain aspects of the Department's Policy and Procedure Directive (PPD) related to inmate payroll are open to differing interpretations and are inconsistently applied.

PPD 3.01, *Resident Pay System*, governs inmate pay practices. Section IV, B defines the optimum workday for all residents as seven hours, and the workweek as five days. Base pay and bonus pay are both defined in section IV, K, (5) in terms of per day worked. Base pay is \$1.50 per workday and bonus pay scales up to \$2.00 per workday. This section also states that incentive pay of \$1.00 per shift may be authorized for up to three inmates per shift. In its discussion of resident pay, the PPD appears to make a distinction between workday and shift.

Examples of potential inconsistency in application of the PPD during fiscal year 2006 include:

- The Department, including Correctional Industries, paid inmates based on a three-hour shift and not a seven-hour day. Inmates who worked two shifts a day earned \$3.00 for base pay plus up to an additional \$4.00 for bonus pay, per six hours of work in a calendar day. Any incentive pay would also be paid on a shift basis per the PPD.
- Correctional Industries shops were inconsistent in how they paid inmate incentive pay. While it appears from the PPD that an inmate's incentive pay was intended to be limited to \$1.00 per shift, certain shops interpreted the PPD to allow a daily incentive payment of up to \$6.00 to one inmate.

Inconsistent application of a PPD can result in confusion as to what is accepted practice and also result in inconsistent adherence to other PPDs, if employees and others interpret inconsistent application of PPDs as lack of management commitment to established policies and procedures.

Recommendation:

The Department and Correctional Industries should review its inmate payroll PPDs to ensure the policies and directives provided for the operation of the inmate work programs are operating in a controlled manner as intended by management. Policies and procedures, like all other control components, are most effective when they are clear, understood by those affected, and consistent in theory and application.

Vague or unclear PPDs should be revised to promote employee acceptance and adherence.

Auditee Response:

We concur. A revision of the inmate pay policy is in process. The revision process has been deliberate due to security concerns involved with alteration of established inmate pay procedures.

Observation No. 14: Controls Over Inmate Payroll Should Be Improved

Observation:

Controls over inmate payroll are weakened by a lack of segregation of incompatible functions and by ineffective control procedures and monitoring efforts.

Inmates, including inmates working in Correctional Industries shops, are paid for their work. During fiscal year 2006, inmates were paid \$1.50 per work shift and were also eligible to receive bonus and incentive pay.

- Inmates in the Correctional Industries Information Technology (IT) shop designed, developed, and maintain the computer program code for the inmate payroll system and also process the payroll, resulting in the inmates in the IT shop having incompatible duties. There are only limited management controls over the computerized inmate payroll system and no periodic independent verification of the continued secure operation of the payroll program and system.
- The inmate payroll system operates on a pay-event exception basis. An inmate is paid for a day's work unless there is an exception posted indicating that the inmate did not work for the day. The payroll system generates a report of all payroll exceptions processed each month, but the report is not compared to the original exception documents to verify that all exceptions were properly processed.

The combination of risks resulting from inmates performing incompatible payroll-related duties in the IT shop with only limited management oversight in place, including no independent verification of the inputs to the source documents, places inmates in a position to both commit and conceal errors and fraud in the inmate payroll.

Recommendation:

The Department and Correctional Industries should recognize the limited controls in place over inmate payroll. While much of the risk is due to the inmates' original and continuing involvement in the design and operation of the computerized payroll program and may not be easily avoided, reasonable efforts to mitigate that risk should be taken.

- IT shop management must become as knowledgeable as possible of the operation of the inmate payroll program and system. All reasonable efforts should be taken to ensure that the inmate payroll system is subject to as many of the accepted general and application controls as are possible in the IT shop's operating environment.
- The importance of the review and approval of inmate payroll reports by shop managers and other supervisors should be emphasized as a required control procedure that is documented and subject to monitoring by management.
- Pay exception records should be reconciled to periodic inmate pay system reports to ensure that all pay exceptions are accurately posted.

Auditee Response:

We concur. We will seek to develop a summary output report that will be returned to each supervisor for review and validation. A report of incomplete exception reports will be prepared monthly for review of the Correctional Industries Administrator.

Observation No. 15: Policies And Procedures For The Control And Reporting Of Correctional Industries Materials Inventory Should Be Improved

Observation:

The Department and Correctional Industries have not established policies and procedures for the control and reporting of materials inventories.

- There is a lack of segregation over the custody and reporting of shop inventory as the shop managers perform physical counts of inventory and also authorize inventory transactions and maintain custody of the inventory. Variances between perpetual records and physical counts generally are not investigated to determine and correct the cause of the variances.
- By practice, raw materials inventory is valued at replacement cost. While there is no Department policy on the valuation of raw materials inventory, State policy is to value consumable inventory at average cost. There is no Department policy or directive on the valuation of work in process and finished goods inventory.
- There are no reliable controls in place to ensure that materials placed into and taken from inventory are accurately accounted for and reported. While some shops use job tickets to list inventory used in a job or project, the job tickets are not consistently used and when used are not consistently accurate, leading to variances between the perpetual records and physical inventory on hand.
- There are no policies and procedures regarding obsolete inventory or other impairments to inventory and shops are carrying stale or obsolete items in inventory. Based on inquiry of shop managers, it appears all shops are carrying some impaired inventory. Managers reported impaired inventory ranging in cost value from a few hundred to thousands of dollars.

At June 30, 2006, Correctional Industries reported a total inventory balance of \$644,000. The balance was made up of \$532,000 of materials inventory and \$112,000 of work in process and finished goods inventory.

The June 30 reported balance of \$644,000 reflected a \$129,000 write-down adjustment resulting from the fiscal year 2006 physical inventory counts.

Recommendation:

The Department and Correctional Industries should establish policies and procedures for the control and reporting of materials inventory.

- The annual physical inventory should include an independent verification of physical counts. While it may be necessary to substantially rely upon the shop managers for the physical

counts, having other Department or Correctional Industries personnel perform test counts, independent observation, or other control activities could increase reliability of the inventories. Also, determining and correcting the cause of significant variances between physical inventory and perpetual records should be a part of all physical inventory procedures.

- Policies and procedures should be implemented for valuing raw materials, work in process, and finished goods inventory.
- Policies and procedures should be implemented to promote the consistent, accurate, and timely recording of transactions in the perpetual inventory records.
- Policies and procedures should include guidelines for evaluating inventory obsolescence.

Auditee Response:

We concur. The recommended policies and procedures will be developed and implemented. We have already initiated a review of Corrections Industries control processes to determine which efficiencies can be realized. At the completion of this review we will design and implement an inventory management system to best meet the needs of Industries.

Observation No. 16: Efficient Inventory Levels Should Be Established

Observation:

Correctional Industries has not established effective policy guidance to assist shops in determining efficient inventory levels. According to Correctional Industries, shop managers are encouraged by unofficial policy to keep approximately three months of high-use materials in inventory and to order infrequently used materials as needed for a job.

At June 30, 2006, Correctional Industries reported it had approximately \$644,000 of materials inventory. This represented approximately nine months of materials inventory on hand, three times the amount recommended by the unofficial policy.

While the Correctional Industries business office reported that it periodically reviews the reported inventory levels for the shops that maintain a perpetual inventory record of materials (Wood, Sign, and Print shops), when asked, it was unaware of the relative extent of materials inventory on hand.

By holding excess materials inventory, Correctional Industries increases its risk that significant quantities of inventory may become lost, damaged, or obsolete. In addition, holding excess materials inventory increases the costs of operations due to additional storage, security, and other handling costs. Discounts available to Correctional Industries for buying larger quantities may be more than offset by the risk that the materials may not be put to use and by additional handling costs.

Recommendation:

Correctional Industries should establish policies and procedures to assist shop managers in establishing and maintaining efficient shop inventory levels. The policies and procedures should

guide shop managers in determining efficient inventory levels with due consideration of expected usage and efficient ordering points and quantities.

Correctional Industries should regularly monitor shop inventory levels to minimize risks associated with shops maintaining inappropriate inventory levels.

Auditee Response:

We concur. Steps to address this recommendation will be taken in conjunction with the actions outlined in our response to Observation No. 15 above.

Observation No. 17: Controls Over Vocational Training Inventories Should Be Improved

Observation:

Controls over the Vocational Training inventories are not robust. There is ineffective monitoring of the inventory control process including lack of effective monitoring and review of the results of annual physical inventory observations.

At June 30, 2006, the Vocational Training shops reported \$64,000 of inventory. Inventory included building materials, automotive supplies, and small engine parts and supplies.

The following issues were noted in Vocational Training's controls over inventory.

1. There is a lack of segregation of duties over inventory control and reporting as shop managers are responsible for conducting and providing the physical count of inventory in their possession. The control provided by accurate physical counts does not include a monitoring component to promote the performance and reporting of complete and accurate counts.
2. The Vocational Training business office has not provided sufficient instructions to the Vocational Training shops to ensure that the physical inventories are performed in a manner consistent with the business office's directions.
 - Building Trades conducts a physical inventory observation count at year-end but does not consistently update its perpetual inventory records with the results of the inventory. The perpetual records are provided to and used by the business office in compiling the Vocational Training financial statements. There has been a significant variance between actual inventory on hand and the inventory per the perpetual records. For example:
 - A \$20,000 adjustment was made to reduce the Building Trades perpetual inventory records as a result of the June 30, 2004 Building Trades physical inventory observation. According to available records, \$5,000 of the adjustment reflected inventory used for shop renovations and \$15,000 reflected adjustments for other inventory shortages.
 - The perpetual inventory was not adjusted for the results of the June 30, 2005 physical inventory observation.

- A \$26,000 adjustment was made to reduce the Building Trades perpetual inventory records as a result of the June 30, 2006 Building Trades physical inventory observation. As the inventory had not been adjusted at the end of fiscal year 2005, this adjustment reflected a net inventory reduction for shortages that occurred in the twenty-four months ended June 30, 2006.
3. Secure storage facilities are not provided for Building Trades inventory. While inventory is stored in a yard behind a locked gate, access to the yard is not sufficiently restricted to prevent the unauthorized removal of materials after operating hours or on weekends.
 4. Perpetual inventory records are maintained on shop computers. Access is not restricted and backups of the data are not performed for Building Trades.
 5. The Vocational Training business office does not report year-end shop inventory to the Department of Administrative Services. According to State policy, agencies are to report year-end consumable and other inventories balances and activity to the Bureau of Financial Reporting.

Less than robust controls over inventory increases the risk that errors or frauds in accounts involving inventory including sales revenue, purchasing, and inventory can occur and not be detected.

Recommendation:

The Department and Vocational Training should strengthen its control activities and implement a monitoring component to its controls over inventories maintained by the Vocational Training shops. The Department and Vocational Training should establish guidance in the form of policies and procedures to assist shop instructors in establishing, maintaining, controlling, and reporting efficient shop inventory levels.

1. Vocational Training should improve its physical inventory process to include procedures that monitor the accurate completion of the physical observation counts. Controls over the inventory process would be strengthened if individuals otherwise independent of inventory control procedures and responsibilities either performed the annual physical counts or were sufficiently involved in the counts to be able to monitor the accuracy and completeness of the inventory counts.
2. Vocational Training should provide detailed instructions for conducting the year-end physical inventories. Instructions should include how to incorporate the results of the inventory counts into the perpetual records as well as instructions for researching and establishing possible reasons for significant adjustments.
3. Inventory storage areas should be secure and properly safeguarded to minimize the risk of materials being lost or stolen.
4. Systems used for maintaining perpetual inventory records should be secured. Automated systems should be regularly backed up and access to those systems should be restricted.

5. Inventory should be reported as required by State policy.

Auditee Response:

We concur. All recommendations will be included in the comprehensive Accounting Policy and Procedures manual being compiled by Correctional Industries and Vocational Training. Since most inventories are physically secure inside prison facilities, we do not consider the risk of loss or theft high. The risk of loss for the Vocational Training building trades program, which is located outside with minimal physical security, will be minimized by following the PPD requirement to order material on a per job basis.

Observation No. 18: Control Over Receipt Of Ordered Goods Should Be Improved

Observation:

Correctional Industries controls for the acceptance of delivered purchased goods are not consistently operating as designed.

We noted ten instances (38%) in a sample of 26 expenditure items tested where the shop manager had not signed the *Shipment Verification Report*, a Department-designed receiving and inspection report, to document the quantity and quality of the shipment of goods received by the shop. There was no documentation provided to indicate that the business office noted the incomplete status of the receiving report and otherwise established the shop managers' satisfaction with the complete delivery of the shipment, prior to paying the related vendor invoice.

The Department has no formal policies and procedures addressing the completion of the *Shipment Verification Report*.

Effective controls require consistent application and monitoring to ensure effectiveness. Inconsistent application of controls can lead employees to assume that management regards control compliance as optional, impairing the effectiveness of the control procedures and the overall control environment.

Recommendation:

Compliance with Department control procedures for the receipt of delivered goods should be improved.

The Department should establish policies and procedures for its control activities, including the completion of the *Shipment Verification Report*.

Employees should be reminded of the importance of compliance with controls and trained in applying the controls. Observed noncompliance should be brought to the attention of a suitable level of management to allow for management's involvement with potential corrective action.

Auditee Response:

We concur. The observation noted above involved a single shop with a relatively new manager. While the shop manager was generating the Shipment Verification Report and distributing them to the appropriate staff, he had neglected to sign off. This breakdown in process has been corrected and the proper process will be further defined and documented in the updated Accounting Policy and Procedures Manual.

Observation No. 19: Controls Over The Initial Receiving Process For Ordered Materials Should Be Improved

Observation:

Correctional Industries is not taking advantage of an available inventory and purchasing control activity for materials inventory initially received on its behalf at the Department's warehouse.

The Department's warehouse does not consistently provide receiving and inspection reports to the Correctional Industries business office when it receives vendor deliveries of materials ordered by the Correctional Industries shops. The business office relies upon the shop managers to notify it when the warehouse subsequently delivers the materials to the shops.

Relying upon the shop managers to provide notification of the receipt of purchased inventory presents a segregation of duties risk, as the shop managers also have custody of the materials inventory. This also increases the risk that the business office may not be notified timely of the effective receipt of a vendor's delivery of ordered materials.

Controls over the receipt and acceptance of materials inventory are an essential part of controls over inventory and purchasing. An effective purchased goods receipt and acceptance system provides for segregation between the responsibilities of authorization, custody, and recording of the related transactions. Allowing the individual responsible for the custody of inventory to also be responsible for recording the receipt of deliveries of the inventory increases the risk that inventory-related errors or fraud that may occur will not be detected in a timely manner.

By utilizing control activities available in the warehouse's receiving activity, Correctional Industries can mitigate some of its inventory and purchasing risks.

Recommendation:

Correctional Industries should request the warehouse consistently provide direct notification of the receipt and inspection of deliveries accepted on Correctional Industries' behalf. The business office should compare and agree the inspection and receiving reports received from the warehouse to similar reports prepared by the shops upon their receipt of the materials from the warehouse. This comparison of independent information will help insure that all materials ordered are delivered, accepted as complying with items requested, ultimately included in the shops' inventory systems, and that vendors are paid as expeditiously as practical.

Auditee Response:

We concur in part. All materials and supplies for Correctional Industries come through the central warehouse that acknowledges receipt. In addition, the central warehouse distributes product to the North Yard and requires acknowledgement from the specific shop manager that they are in receipt of the product. This process is effective in ensuring that the order was received from the vendor and was properly received by the individual shop managers. Industries accounting staff have been instructed to make payment only after confirmation from the shop manager that the shipment is correct and acceptable in terms of quality and quantity. We will incorporate a procedure to periodically sample and compare warehouse receiving documents to shop acceptance documents to insure that no materials are being diverted between the warehouse and shops.

Observation No. 20: Policy Requiring Customer Project And Information Worksheets Should Be Adhered To

Observation:

Not all Vocational Training shops consistently employ a Department control intended to ensure that all Vocational Training projects are properly considered for acceptance prior to commitment with the customer.

Department Policy And Procedure Directive (PPD) 7.02 states all vocational training projects must be approved in advance by the appropriate Vocational Training Instructor to determine if the job is consistent with the scope of work experience, inmate needs, and shop capacity. Approval will be given in written form on the Customer Project & Information Worksheet (Worksheet). After acceptance of the project, the individual or agency involved must sign a waiver that appears on the bottom of the Worksheet. This indicates they understand that student inmates will perform the work described on the Worksheet and that the State is not liable for any subsequent damages that may result from or during the service or storage of the item left to be repaired or built. The waiver will also state the terms of payment and the work being done is for personal use only and not for resale.

In addition to documenting this customer understanding, the Worksheet also provides an area to document a description of the work to be performed and the customer's agreement to the scope of work, limiting the likelihood of subsequent disagreements.

Six projects out of 20 (30%) selected for testing did not have a completed Worksheet. Five of those six sample projects (83%) without a Worksheet were Building Trades projects and represented all of the Building Trade projects selected for this testing. There were no alternative documents used for these projects to evidence an understanding between the Vocational Training shops and the customers.

Recommendation:

The Department should require the Vocational Training shops to document an understanding of project scope, potential impact of student workers, limitation of liability, and other relevant aspects of all projects undertaken for customers.

The Department should review to ensure that the Worksheet described in PPD 7.02 continues to effectively and efficiently serve this purpose and revise the Worksheet if appropriate. The Worksheet should be completed with sufficient detailed description of the work to be performed to protect both Vocational Training and the customer from claims that the completed work was not as agreed to.

Auditee Response:

We concur. Compliance with PPD 7.02 has been reviewed, and procedures to improve compliance with the PPD and monitor future compliance have been initiated. An update of PPD 7.02 to document an understanding of project scope, potential impact of student workers, limitation of liability and other relevant project parameters will be evaluated.

Observation No. 21: Correctional Industries Project Control Procedures Should Be Consistently Applied

Observation:

Controls intended to ensure that all Correctional Industries projects are properly accounted for are not consistently applied.

Correctional Industries manufacturing shops use job tickets to track projects including materials and labor used to complete the projects. The job tickets are prenumbered control forms used to ensure in part that all projects are accurately billed. Based on observations and discussions with Correctional Industries, job tickets are not consistently used and, when they are used, they are not consistently posted to or numerically controlled to ensure that all jobs processed through the shops are properly billed to customers. There is no other similar project billing control process used by Correctional Industries shops in lieu of the job ticket.

While receiving a tour of a Correctional Industries shop, we inquired about a project that was being worked on. The shop manager informed us that he would be doing the work personally and that the job was for a Department employee. Later, when a copy of the project's job ticket was requested for documentation purposes, a "non-standard" job ticket was provided after some delay. The Correctional Industries accountant informed us that he was unfamiliar with that form.

The inconsistent application of the job-ticket control process increases the risk that the costs for projects will not be properly accumulated, as all materials, supplies, and labor included in the project may not be recorded, and also that certain projects may not be billed, as the Correctional Industries business office may not be aware of all of the work performed by the shops.

Recommendation:

All Correctional Industries shops should consistently use a project billing control process such as the job ticket.

The Department and Correctional Industries should review the use of job tickets to ensure that the form and format of the tickets remain appropriate for their control purposes.

The Department and Correctional Industries should require and monitor compliance with all control processes.

Auditee Response:

We Concur. All shop managers have been reminded of the requirement to document each job with a job ticket, and a procedure is being written for regular testing of compliance with the requirements.

Observation No. 22: Controls Over Pricing Of Correctional Industries Goods And Services Should Be Improved

Observation:

Correctional Industries has not established formal costing and pricing policies for its shops. Correctional Industries relies upon its shop managers to establish pricing for products and services with little monitoring or oversight performed by the business office to determine whether the prices charged for products fully reflect the actual cost of production.

Per the Correctional Industries business office, pricing guidelines were given to all shops as recently as fiscal year 2001. However, the overhead and direct labor rates needed to employ the guidelines were originally provided to only the Print, Sign, and Wood shops. These rates have not been regularly updated to reflect changes in the costs of operations. It is not clear whether the guidelines were used by any of the shops during fiscal year 2006 to establish prices. While the business office does review a profit analysis by project spreadsheet for the Print, Sign, and Wood shops, the analyses do not necessarily reflect the actual cost of production as they do not include accurate overhead and direct labor rates and the direct hours reported for Wood shop products are not the actual hours used in the project.

The Correctional Industries business office expressed concern that establishing a stringent pricing policy would create a rigid environment that would prevent Correctional Industries from being able to revise its prices as needed to stay competitive.

Recommendation:

Correctional Industries should provide a more formal cost and pricing structure to its shops. Not until the shops have an accurate understanding of their costs can they become more effective and efficient in establishing the price of products and services. In setting price structures it is necessary to understand costs to help determine what products to produce, how to produce them,

and what prices should be charged. If the shops determine that prices should be discounted to generate greater levels of shop activity or training opportunities, the shops should recognize the discount amounts and the potential effects of the discounts, so that these decisions are based upon facts and their effects become quantifiable.

The business office should require the shops to provide accurate analyses of costs and prices that allow for management's review and monitoring of shop operations including activity and profitability.

More cost and price information should not be regarded as necessarily limiting shop manager's flexibility in shop operations. This information should be supportive of the manager's decisions.

Auditee Response:

We concur. Pricing methodologies of the various shops have been reviewed, and consistent pricing policies will be promulgated. The accuracy of pricing is highly dependant on the reliability of available cost data. The upgrade of the various shop cost accounting systems and procedures has been adopted as a long-term goal, and as more accurate and consistent cost data becomes available, pricing will be reevaluated.

Observation No. 23: Controls For Tracking Vocational Training Purchases To Customer Invoices Should Be Employed

Observation:

Not all Vocational Training shops consistently employ a Department control intended to ensure that all Vocational Training purchases are properly allocated for customer billing purposes.

Department Policy and Procedure Directive (PPD) 7.02.B.5 states the customer invoice number must be written on vendor invoices to reflect parts or supplies purchased for the project. Cross referencing materials purchased for a customer's project to the customer's invoice is intended to ensure that all materials used for a project are ultimately billed to the customer. Generally, Vocational Training customers are charged the cost of materials and supplies used in the project plus a 10% markup.

According to the Director of Vocational Training, not all Vocational Training shops are consistently adhering to PPD 7.02.B.5. Shop instructors are not consistently writing the customer invoice number on vendor invoices to reflect parts or supplies specifically purchased for projects, and the Building Trades program pre-buys inventory for future projects making the tracking of purchases of materials and supplies to customer invoices problematic. While using an inventory of stock materials to operate the Building Trades may be efficient for the program, no documentation was provided to support that Building Trades was authorized to operate in a manner in apparent conflict with PPD 7.02.B.5. In addition, problems with tracking the utilization and assignment of Building Trades inventory to projects were apparent in the results of Building Trades year-end physical inventory. An adjustment of \$26,000 was necessary to restate the June 30, 2006 Building Trades inventory from its initial value of \$74,000 to the actual value of \$48,000.

Recommendation:

Vocational Training should require shop compliance with PPD 7.02.B.5 and require instructors to properly allocate the purchase of materials and supplies to customer projects for ultimate billing to the customer.

Vocational Training and the Department should review the current PPD to determine whether it continues to suit the needs of the Vocational Training programs. The need to operate programs efficiently using an inventory of stock should be considered and, if appropriate, incorporated in a PPD or other control.

Auditee Response:

We concur. All shop supervisors have been instructed to comply with PPD 7.02.B.5, and procedures have been adopted to monitor compliance.

Observation No. 24: Adjustments To Accounts Receivable Should Be Subject To Management Approval Process

Observation:

A lack of segregation of duties over adjustments to Correctional Industries accounts receivable increases the risk that account balances owed to Correctional Industries could be improperly adjusted without management's approval.

One business office clerk is primarily responsible for posting the receipt of customer payments to the accounts receivable ledger. This clerk also has the responsibility for posting other credits (reductions of accounts receivable) to the ledger. While the receipt of customer payments is reconciled to the State's accounting system (NHIFS) to review for posting accuracy, there is no similar review and approval for other credit adjustments posted by this clerk. The lack of a control procedure over accounts receivable credit adjustments increases the risk that an error or fraud that may occur in the account will not be detected in a timely manner.

During fiscal year 2006, approximately \$4,700 of credit adjustments were posted to Correctional Industries' accounts receivable.

Recommendation:

The Department should establish controls over credit adjustments to accounts receivable. Policies and procedures should be established requiring a review and approval of adjustments to customer accounts to ensure that only those adjustments that have been authorized by management are made to customer accounts. Policies and procedures should include a requirement for documentation of the reasons for, and management's authorization of, the adjustment.

Auditee Response:

We concur. The need for a credit adjustment can come about for a number of reasons, such as, billing error, invoicing a wrong customer, or allowing for damaged or incorrect product. We have introduced an additional approval and reporting process that will ensure two different staff employees independently review all credits.

Observation No. 25: State Equipment Control Policies And Procedures Should Be Followed

Observation:

The Department has not established an internal control structure over long-term assets that provides reasonable assurance of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. The State's equipment controls are not in place over equipment used by Correctional Industries and Vocational Training.

- The Department does not have a system in place to properly record and maintain accurate records of the equipment held by Correctional Industries and Vocational Training. The Department's equipment inventory listing (form P-16) has not been updated for at least two years to reflect the additions and disposals of the Correctional Industries and the Vocational Training equipment.
- The Department has not provided identification tags for new equipment, resulting in some Correctional Industries and Vocational Training equipment not being tagged as State-owned.
- Neither Correctional Industries nor Vocational Training during the last five years has performed the annual physical inventory of equipment required by State policy.

At June 30, 2006, Correctional Industries reported that it had \$930,000 of equipment and Vocational Training reported that it had no equipment meeting the State's \$10,000 financial reporting criteria. Audit adjustments reduced the reported Correctional Industries balance at June 30, 2006 to \$870,000. Neither Correctional Industries nor Vocational Training could report the amount of owned equipment that met the Department of Administrative Services P-16 reporting criteria of \$100.

The State's *Long Term Asset Policy and Procedure Manual* issued by the Department of Administrative Services requires all agencies to establish internal controls over long-term assets including equipment. According to section I of the manual, "Agencies should have procedures in place so that assets are adequately safeguarded from loss or theft, that adequate documentation is maintained to support the cost of the assets, proper approvals are used for acquisitions, physical inventories are taken annually, and proper segregation of duties exist."

Recommendation:

The Department must reestablish appropriate internal controls over equipment used by Vocational Training and Correctional Industries. In addition to establishing an appropriate control environment over these activities, at a minimum, standard State control activities including identifying and tagging, counting, and reporting equipment meeting the State's

equipment criteria should be established and monitored for continuing effective operation. In addition to standard control activities, the Department may require additional accountability controls due to the nature of operating in a prison environment.

Auditee Response:

We concur. Procedures will be adopted to reestablish appropriate internal controls that conform to State criteria. Pending issuance of official equipment tags by DOC Fiscal, Vocational Training and Correctional Industries are independently tagging their equipment with temporary tamperproof labels.

Auditor's Report On Management Issues

To The Fiscal Committee Of The General Court:

We have audited the accompanying financial statements of the Correctional Industries Account and the Vocational Training Account of the New Hampshire Department of Corrections as of and for the fiscal year ended June 30, 2006, as listed in the table of contents, and have issued our report thereon dated January 9, 2007, which was qualified with respect to the lack of sufficient evidence to support the year-end inventory balances reported on the Correctional Industries Account and the Vocational Training Account balance sheets.

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.

In planning and performing our audit of the financial statements of the Correctional Industries Account and the Vocational Training Account as of and for the fiscal year ended June 30, 2006, we noted issues related to the operation of the Correctional Industries Account and the Vocational Training Account that merit management consideration but do not meet the definition of a reportable condition as defined by the American Institute of Certified Public Accountants, and were not issues of noncompliance with laws, rules, regulations, and contracts.

Those issues that we believe are worthy of management consideration but do not meet the criteria of reportable conditions or noncompliance or other matters are included in Observations No. 26 and No. 27 of this report.

This auditor's report on management issues is intended solely for the information of the management of the Department of Corrections and the Fiscal Committee of the General Court and is not intended to be and should not be used by anyone other than these specified parties.

Office Of Legislative Budget Assistant

January 9, 2007

Management Issues Comments

Observation No. 26: Inventory Account Should Be Included In State's Operating Budgets

Observation:

The Correctional Industries Inventory Account is operated and reported as a revolving account in the State's accounting system (NHIFS) and is not included as a budgeted account in the State's operating budget. During fiscal year 2006, the Inventory Account reported approximately \$2 million of revenue and \$2.4 of expenditure activity.

RSA 9:4, I requires departments of the State government to furnish the Department of Administrative Services estimates of their expenditure requirements for administration, operation, maintenance expenditure, and program services for inclusion in a tentative budget to be submitted to the governor.

RSA 622:28-a established the Industries Inventory Account as of July 1, 1980 primarily to fund the Correctional Industries operations. Since its inception, the financial activity of the Account has been subject to the normal State control processes operating at the Department of Administrative Services, such as purchasing controls, and controls at the State Treasury, such as cash receipt controls, but the Account has not been subject to appropriation controls that would be provided by the inclusion of the Account in the State's operating budget. Additionally, a budget provides a plan to manage spending and provide accountability for certain activities within an entity's organization.

Recommendation:

The Correctional Industries Inventory Account should be submitted for inclusion in the State's operating budget.

Because the financial activity recorded in the Industries Inventory Account is both reasonably anticipated and reoccurring, the Department should be able to submit a budget request for the Account's financial activity in a program appropriation unit format. The budget request for Account expenditures should include allocation to appropriate expenditure classes based upon the anticipated category of expenditures such as personnel, current expense, equipment, benefits, travel, etc.

Auditee Response:

We concur in part. As a self-funding revolving account, the Department of Administrative Services has never interpreted RSA 9:4, I as requiring inclusion in the Department appropriation requests. We are actively seeking to resolve the conflict created by budget footnotes, which partially change the requirements of RSA 622:28-a, and the RSA requirement that permanent staff salaries not be paid by the Industries revolving account. We expect that discussions with the Department of Administrative Services, and proposed legislation, will rationalize the Correctional Industries budgeting and finance issues. If the final resolution of the funding issues

is to include the Corrections Industries revenues and expenditures in the overall Department of Corrections budget, we will do so at that time.

Observation No. 27: Business Plan Should Be Established For Correctional Industries And Vocational Training

Observation:

The Department, Correctional Industries, and Vocational Training have not established business plans for the operation of the Correctional Industries and Vocational Training programs. While Correctional Industries developed a five-year strategic plan in 2004, the plan was not sufficiently developed to be classified as a business plan and has not been updated since that time.

The mission of New Hampshire Correctional Industries is to provide meaningful job skills and training to incarcerated inmates within the State. This is accomplished by providing a variety of work programs where inmates have an opportunity to obtain various job and life skills in a hands-on, real world environment. In meeting its mission, Correctional Industries offers nine programs at the Concord Prison, one program at the Goffstown State Prison for Women, and three programs at the Northern N.H. Correctional Facility. The Correctional Industries programs generally involve the sale of products and services to governmental, commercial, and private citizen customers.

There are six Vocational Training shop programs offered at the Concord Prison. The Department does not offer Vocational Training programs at the other facilities. The Vocational Training shop programs generally involve the sale of products and services to private citizen customers.

A business plan is a summary of how a business intends to organize and operate activities sufficient for the venture to succeed. It is a written explanation of an enterprise's business model including business concepts, financing needs, marketing plan, and pro-forma financial statements generally considering both short-term and long-term timeframes. The business plan should encompass the enterprise's mission and goals, as appropriate, and also provide a realistic plan for meeting the mission and goals. While business plans are noted for often quickly becoming out of date, the continual process of planning provides managers with a greater understanding of the business and the options available to it.

Recommendation:

The Department, in conjunction with Correctional Industries and Vocational Training, should develop written strategic business plans for the Correctional Industries and the Vocational Training operations. The business plans should include operational and financial goals, the actions management intends to take to meet those goals, methods to measure progress toward the goals, and accurate reporting of results.

Topics that should be addressed by the plans include but should not be limited to: 1) determining the lines of business the operations should pursue, including whether to enter new ventures and discontinue other ventures, what products or services will be offered, to whom and through what channels they will be directed, and how the decisions related to lines of business are to be

determined, and 2) determining needed resources, including equipment replacements and the use of new or alternative technologies. The plan would need to incorporate the consideration of available funding sources and expected revenues, costs, and profits/losses from operations generally provided in a business plan in the form of pro-forma financial statements.

Monitoring progress toward goals is essential; without it a business plan has little value. The business plan should be periodically reviewed and updated to reflect changing operating conditions.

In considering and developing its business plans, the Department, Correctional Industries, and Vocational Training will need to consider the resources and costs of operations that will need to be covered by the business operations. Currently, there is not a clear and consistent understanding and practice of what costs are to be covered by operating revenues of the shops and what costs are to be supported by general prison-budgeted operations.

Auditee Response:

We concur. It is essential to have a comprehensive business plan that encompasses the mission and vision of the Department and provides for the support and resources to achieve it. The Department is committed to working with the affected parties in a collaborative effort to develop a plan, provide support and resources and implement a process of measurement and feedback.

Independent Auditor's Report

To The Fiscal Committee Of The General Court:

We have audited the accompanying financial statements of the Correctional Industries Account and the Vocational Training Account of the New Hampshire Department of Corrections as of and for the fiscal year ended June 30, 2006, as listed in the table of contents. These financial statements are the responsibility of the Department of Corrections' management. Our responsibility is to express opinions on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audits 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department of Corrections' internal control over financial reporting. Accordingly, we express no such opinion. 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 opinions.

Management has not instituted a system that adequately accounts for all inventory activities, including valuation and completeness. As a result we were unable to perform efficient and effective procedures to determine that inventory is fairly stated in all material respects as reported on the Balance Sheets for the Correctional Industries Account and the Vocational Training Account.

As discussed in Note 1, the financial statements of the Correctional Industries Account and the Vocational Training Account are intended to present certain financial activity of only that portion of the financial activities of the Department of Corrections and the State that is attributable to the transactions of the Correctional Industries Account and the Vocational Training Account. They do not purport to, and do not, present fairly the financial position of the Department of Corrections or the State of New Hampshire as of June 30, 2006, and the changes

in its financial position for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, except for the matter referred to in the third paragraph, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Correctional Industries Account and the Vocational Training Account as of June 30, 2006, and the respective changes in financial positions thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

The Budget To Actual (Non-GAAP Budgetary Basis) Schedules on pages 50 and 51 are not a required part of the financial statements but are supplementary information. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated January 9, 2006 on our consideration of the Department of Corrections' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, rules, and regulations, and other matters related to the Correctional Industries Account and the Vocational Training Account. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Office Of Legislative Budget Assistant

January 9, 2007

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF CORRECTIONS
CORRECTIONAL INDUSTRIES ACCOUNT AND
VOCATIONAL TRAINING ACCOUNT**

**BALANCE SHEETS
JUNE 30, 2006**

| | Correctional Industries Account | Vocational Training Account |
|---|--|--|
| | <u> </u> | <u> </u> |
| <u>ASSETS</u> | | |
| Current Assets: | | |
| Cash And Cash Equivalents | \$ 10,972 | \$ 51,456 |
| Receivables | 89,759 | 6,656 |
| Inventories | 644,223 | 63,674 |
| Other Current Assets | 7,560 | -0- |
| Total Assets | <u><u>\$ 752,514</u></u> | <u><u>\$ 121,786</u></u> |
| <u>LIABILITIES</u> | | |
| Current Liabilities: | | |
| Accounts Payable | \$ 41,923 | \$ 22,870 |
| Accrued Payroll | 72,200 | -0- |
| Deferred Revenue | -0- | 4,600 |
| Due To Primary Government | 336,330 | -0- |
| Total Liabilities | <u><u>450,453</u></u> | <u><u>27,470</u></u> |
| <u>FUND BALANCE</u> | | |
| Reserved For Encumbrances | 42,747 | 22,186 |
| Reserved For Inventories | 644,223 | 63,674 |
| Reserved For Unexpended Appropriations | -0- | -0- |
| Unreserved, Undesignated | (384,909) | 8,456 |
| Total Fund Balance (Deficit) | <u><u>302,061</u></u> | <u><u>94,316</u></u> |
| Total Liabilities And Fund Balance | <u><u>\$ 752,514</u></u> | <u><u>\$ 121,786</u></u> |

The accompanying notes are an integral part of this financial statement.

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF CORRECTIONS
CORRECTIONAL INDUSTRIES ACCOUNT AND
VOCATIONAL TRAINING ACCOUNT**

**STATEMENTS OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

| | Correctional Industries Account | Vocational Training Account |
|--|--|--|
| <u>Revenues</u> | | |
| Sales | \$ 1,956,431 | \$ 253,018 |
| Total Revenues | <u>1,956,431</u> | <u>253,018</u> |
| <u>Expenditures</u> | | |
| Salaries And Benefits | 1,086,345 | -0- |
| Inmate Labor | 255,844 | -0- |
| Materials | 834,229 | 239,665 |
| Current Expense | 163,516 | 14,994 |
| Equipment | 21,078 | 3,381 |
| Travel | 7,779 | 325 |
| Other | 5,833 | -0- |
| Total Expenditures | <u>2,374,624</u> | <u>258,365</u> |
| Excess (Deficiency) Of Revenues | | |
| Over (Under) Expenditures | <u>(418,193)</u> | <u>(5,347)</u> |
| Fund Balance - July 1 | <u>720,254</u> | <u>99,663</u> |
| Fund Balance - June 30 | <u>\$ 302,061</u> | <u>\$ 94,316</u> |

The accompanying notes are an integral part of this financial statement.

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF CORRECTIONS
CORRECTIONAL INDUSTRIES ACCOUNT AND
VOCATIONAL TRAINING ACCOUNT**

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Correctional Industries Account and Vocational Training Account have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and as prescribed by the Governmental Accounting Standards Board (GASB), which is the primary standard-setting body for establishing governmental accounting and financial reporting principles.

A. Financial Reporting Entity

The Department of Corrections is an organization of the primary government of the State of New Hampshire. The accompanying financial statements report the financial activity of the Correctional Industries Account and Vocational Training Account of the Department of Corrections. For fiscal year 2006 the Correctional Industries Account reported all operational activities of the Correctional Industries programs, except a portion of indirect cost of the State and the Department of Corrections, Correctional Industries staffing at the Northern New Hampshire Correctional Facility and the State Prison for Women, utilities, and building costs and maintenance that are reported as part of the prison operations of the Department of Corrections. The Vocational Training Account reports the sales and purchases of materials and incidental items (supplies, tools, and small equipment) related to the Department's operation of the Vocational Training shop programs.

The financial activities of the Correctional Industries Account and the Vocational Training Account are accounted for and reported in the General Fund in the State of New Hampshire's Comprehensive Annual Financial Report (CAFR). Assets, liabilities, and fund balances are reported by fund for the State as a whole in the CAFR.

B. Fund Financial Statements

Fund Financial Statements

Separate financial statements are provided for the governmental fund. The Department of Corrections' Correctional Industries Account and Vocational Training Account are reported in the State of New Hampshire's General Fund.

The Balance Sheet presents the reporting entity's current assets and liabilities, with the difference reported as fund balance. Fund balance is reserved when constraints placed on it are either externally imposed or are imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as reserved fund balance.

The Statement of Revenues, Expenditures, and Changes in Fund Balance demonstrates the degree to which expenditures are offset by revenues. Revenues are classified by source and expenditures are classified by character.

C. Measurement Focus And Basis Of Accounting

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay the liabilities of the current period. For this purpose, the State generally considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to compensated absences and claims and judgments are recorded only when payment is due.

D. Financial Statement Presentation

The financial activity of the Correctional Industries Account and the Vocational Training Account is accounted for and reported in the State's Governmental Funds in the State of New Hampshire's Comprehensive Annual Financial Report (CAFR). Assets liabilities, and fund balances are reported by fund for the State as a whole in the CAFR.

The activities of the Department of Corrections' Correctional Industries Account and Vocational Training Account are recorded in the State's General Fund, which is a separate accounting entity with a set of self-balancing accounts. Fund accounting is designed to report the financial position and the results of operation, to demonstrate legal compliance, and to aid financial management by segregating transactions related to certain government functions or activities. Capital assets and long-term liabilities are not recorded in the governmental fund, but are recorded in the government-wide financial statements of the State of New Hampshire, and therefore are not reflected in these financial statements.

E. Receivables

Receivables represent amounts due to the Correctional Industries Account and the Vocational Training Account at June 30, recorded as revenue, which will be collected sometime in the future and consist primarily from the sale of Correctional Industries and Vocational Training products and services. In the governmental fund financial statements, receivables represent amounts due to the Correctional Industries Account and the Vocational Training Account deemed available within 60 days after year-end.

F. Fund Balances

Fund balances for all governmental funds are either reserved or unreserved. Reserved fund balances reflect either 1) assets, which, by their nature, are not available for appropriations (Reserve for Inventories); 2) funds legally segregated for a specific future use (Reserve for Encumbrances); or 3) segregated by legal restrictions. Certain reserve accounts are further described below:

G. Encumbrances

Contracts and purchasing commitments are recorded as encumbrances when the contract or purchase order is executed. Upon receipt of goods or services, the encumbrance is liquidated and the expenditure recorded. Unliquidated encumbrances are reported in the Reserved for Encumbrances account as a component of fund equity for the governmental fund.

H. Reserved For Unexpended Appropriations

This account represents amounts of unexpended appropriations legally carried forward and available for expenditures in the succeeding year.

I. Budget Control And Reporting

General Budget Policies

The statutes of the State of New Hampshire require the Governor to submit a biennial budget to the Legislature for adoption. This budget, which includes a separate budget for each year of the biennium, consists of three parts. Part I is the Governor's program for meeting all expenditure needs and estimating revenues. There is no constitutional or statutory requirement that the Governor propose, or that the Legislature adopt, a budget that does not resort to borrowing. Part II is a detailed breakdown of the budget at the department level for appropriations to meet the expenditure needs of the government. Part III consists of draft appropriation bills for the appropriations made in the proposed budget.

The operating budget is prepared principally on a modified cash basis and adopted for the governmental and proprietary fund types with the exception of the Capital Projects Fund. The Capital Projects Fund budget represents individual projects that extend over several fiscal years. Since the Capital Projects Fund comprises appropriations for multi-year projects, it is not included in the budget and actual comparison schedule in the State of New Hampshire CAFR.

In addition to the enacted biennial operating budget, the Governor may submit to the Legislature supplemental budget requests to meet expenditures during the current biennium. Appropriation transfers can be made within a department without the approval of the Legislature; therefore, the legal level of budgetary control is at the department level.

Additional fiscal control procedures are maintained by both the Executive and Legislative Branches of government. The Executive Branch, represented by the Commissioner of the Department of Administrative Services, is directed to continually monitor the State's financial operations, needs, and resources, and to maintain an integrated financial accounting system. The Legislative Branch, represented by the Joint Legislative Fiscal Committee, the Joint Legislative Capital Budget Overview Committee, and the Office of Legislative Budget Assistant, monitors compliance with the budget and the effectiveness of budgeted programs.

Unexpended balances of appropriations at year-end will lapse to undesignated fund balance and be available for future appropriations unless they have been encumbered or legally defined as non-lapsing, which means the balances are reported as reservation of fund balance. The balance of unexpended encumbrances is brought forward into the next fiscal year. Capital Projects Fund

unencumbered appropriations lapse in two years unless extended or designated as non-lapsing by law.

Contracts and purchasing commitments are recorded as encumbrances when the contract or purchase order is executed. Upon receipt of goods or services, the encumbrance is liquidated and the expenditure and liability are recorded. The Correctional Industries Account's and the Vocational Training Account's unliquidated encumbrance balances at June 30, 2006 were \$42,747 and \$22,186, respectively.

A Budget To Actual (Non-GAAP Budgetary Basis) Schedule - General Fund is included as required supplemental information.

J. Use Of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

NOTE 2 – CASH AND CASH EQUIVALENTS

Cash and cash equivalents in the Correctional Industries Account, and the Vocational Training Account as of June 30, 2006 consist of the following:

| <u>Cash And Cash Equivalents</u> | Correctional Industries Account | Vocational Training Account |
|---|--|--|
| Cash And Cash Equivalents With State Treasury | \$ -0- | \$ 47,490 |
| Cash In Bank (carrying amount) | 9,506 | -0- |
| Deposits In Transit | 1,466 | 3,466 |
| Petty Cash | <u>-0-</u> | <u>500</u> |
| Total Cash And Cash Equivalents | <u>\$ 10,972</u> | <u>\$ 51,456</u> |

Cash and cash equivalents with the State Treasury are commingled with all other State cash. Accordingly, bank balances and risk categories specific to the Correctional Industries Account and the Vocational Training Account cannot be determined.

Correctional Industries maintains a non-interest bearing account used as a receipt account for processing credit card sales at the retail store. Sales are deposited daily into the account through a credit card processing company and transferred monthly by Correctional Industries via check to State Treasury.

RSA 6:7 establishes the policy the State Treasurer must adhere to when depositing public monies. All depositories used by the State must be approved at least annually by the Governor and Executive Council.

RSA 6:11 establishes depositing procedures and procedures for making payments to State Treasury accounts. All accounts opened by departments require the State Treasurer's concurrence. RSA 6-B:2 requires the State Treasurer to submit quarterly financial reports to the Governor and Executive Council, the Commissioner of Administrative Services, and the Legislative Fiscal Committee.

The Treasury Department examines the financial condition of its depositories quarterly. The State Treasurer is not required to collateralize bank deposits. Correctional Industries' bank deposits are subject to insurance from the Federal Deposit Insurance Corporation for up to \$100,000.

NOTE 3 - EMPLOYEE BENEFIT PLANS

New Hampshire Retirement System

The Department of Corrections, as an organization of the State government, participates in the New Hampshire Retirement System (Plan). The Plan is a contributory defined-benefit plan and covers substantially all full-time employees of the Department. The Plan qualifies as a tax-exempt organization under Sections 401 (a) and 501 (a) of the Internal Revenue Code. RSA 100-A established the Plan and the contribution requirements. The Plan, which is a cost-sharing, multiple-employer public employee retirement system, is divided into two membership groups. Group I consists of State and local employees and teachers. Group II consists of firefighters and police officers. All assets are in a single trust and are available to pay retirement benefits to all members.

Group I members at age 60 qualify for a normal service retirement allowance based on years of creditable service and average final compensation (AFC). The yearly pension amount is 1/60 (1.67%) of AFC multiplied by years of creditable service. AFC is defined as the average of the three highest salary years. At age 65, the yearly pension amount is recalculated at 1/66 (1.5%) of AFC multiplied by years of creditable service. Members in service with ten or more years of creditable service who are between ages 50 and 60 or members in service with at least 20 or more years of service, whose combination of age and service is 70 or more, are entitled to a retirement allowance with appropriate graduated reduction based on years of creditable service.

Group II members who are age 60, or members who are at least age 45 with at least 20 years of creditable service can receive a retirement allowance at a rate of 2.5% of AFC for each year of creditable service, not to exceed 40 years.

Members of both groups may qualify for vested deferred allowances, disability allowances, and death benefit allowances subject to meeting various eligibility requirements. Benefits are based on AFC or earnable compensation, service, or both.

The Plan is financed by contributions from the members, the State and local employers, and investment earnings. During the fiscal year ended June 30, 2006, Group I and II members were required to contribute 5% and 9.3%, respectively, of gross earnings. The State funds 100% of the employer cost for all of the Department of Corrections employees enrolled in the Plan. The annual contribution required to cover any normal cost beyond the employee contribution is determined every two years based on the Plan's actuary.

The Department of Corrections charged the Correctional Industries Account for normal contribution costs for the fiscal year ended June 30, 2006, which amounted to 6.8% of the covered payroll for its Group I employees and 14.9% of the covered payroll for its Group II employees paid from the Correctional Industries Account. The total normal contribution paid from the Correctional Industries Account for the fiscal year ended June 30, 2006 was \$84,624. There are no employees paid from the Vocational Training Account so there were no normal contributions charged to the Vocational Training Account for the year ended June 30, 2006.

A special account was established by RSA 100-A:16, II (h) for additional benefits. The account is credited with all the earnings of the account assets in the account plus the earnings of the remaining assets of the plan in excess of the assumed rate of return plus $\frac{1}{2}$ of 1%.

The New Hampshire Retirement System issues a publicly available financial report that may be obtained by writing to them at 54 Regional Drive, Concord, NH 03301 or from their web site at <http://www.nh.gov/retirement>.

Health Care Insurance For Retired Employees

In addition to providing pension benefits, RSA 21-I:30 specifies that the State provide certain health care insurance benefits for retired employees and their spouses within the limits of the funds appropriated at each legislative session. These benefits include group hospitalization, hospital medical care, and surgical care. Substantially all of the State's employees who were hired on or before June 30, 2003 may become eligible for these benefits if they reach normal retirement age while working for the State and receive their pensions on a periodic basis rather than in a lump sum. During fiscal year 2004, legislation was passed that requires State Group I employees hired after July 1, 2003 to have 20 years of State service in order to qualify for health insurance benefits. These and similar benefits for active employees are authorized by RSA 21-I:30 and are provided through the Employee Benefit Risk Management Fund, which is the State's self insurance fund implemented in October 2003 for active state employees and retirees. The State recognizes the cost of providing benefits by paying actuarially determined insurance contributions into the fund. The New Hampshire Retirement System's medical premium subsidy program for Group I and Group II employees also contributes to the fund. The cost of the health benefits for the Correctional Industries Account's retired employees and covered dependents is a budgeted amount paid from an appropriation made to the administrative organization of the New Hampshire Retirement System. Accordingly, the cost of health benefits for retired Correctional Industries' employees and covered dependents is not included in the Correctional Industries Account or in the Vocational Training Account financial statements.

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF CORRECTIONS
SUPPLEMENTARY INFORMATION**

**CORRECTIONAL INDUSTRIES ACCOUNT
BUDGET TO ACTUAL (NON-GAAP BUDGETARY BASIS) SCHEDULE
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

| | <u>Budgeted Amounts</u> | | <u>Actual Amounts</u> | Favorable/ (Unfavorable) |
|--|-------------------------|------------------|--------------------------|-------------------------------------|
| | <u>Original</u> | <u>Final</u> | <u>(Budgetary Basis)</u> | <u>Variance - Final</u> |
| <u>Revenues</u> | | | | |
| Correctional Industries Account | \$ 60,577 | \$ 60,577 | \$ 1,317,142 | \$ 1,256,565 |
| Total Revenues | <u>60,577</u> | <u>60,577</u> | <u>1,317,142</u> | <u>1,256,565</u> |
| <u>Expenditures</u> | | | | |
| Correctional Industries Account | -0- | -0- | 1,857,061 | (1,857,061) |
| Total Expenditures | <u>-0-</u> | <u>-0-</u> | <u>1,857,061</u> | <u>(1,857,061)</u> |
| Excess (Deficiency) Of Revenues | | | | |
| Over (Under) Expenditures | <u>\$ 60,577</u> | <u>\$ 60,577</u> | <u>\$ (539,919)</u> | <u>\$ (600,496)</u> |

The accompanying note is an integral part of this schedule.

**STATE OF NEW HAMPSHIRE
DEPARTMENT OF CORRECTIONS
SUPPLEMENTARY INFORMATION**

**VOCATIONAL TRAINING ACCOUNT
BUDGET TO ACTUAL (NON-GAAP BUDGETARY BASIS) SCHEDULE
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

| | <u>Budgeted Amounts</u> | | <u>Actual Amounts</u> | <u>Favorable/ (Unfavorable)</u> |
|--|-------------------------|------------------|--------------------------|-------------------------------------|
| | <u>Original</u> | <u>Final</u> | <u>(Budgetary Basis)</u> | <u>Variance - Final</u> |
| <u>Revenues</u> | | | | |
| Vocational Training Account | \$ 411,941 | \$ 411,941 | \$ 228,853 | \$ (183,088) |
| Total Revenues | <u>411,941</u> | <u>411,941</u> | <u>228,853</u> | <u>(183,088)</u> |
| <u>Expenditures</u> | | | | |
| Vocational Training Account | 350,000 | 350,000 | 243,997 | 106,003 |
| Total Expenditures | <u>350,000</u> | <u>350,000</u> | <u>243,997</u> | <u>106,003</u> |
| Excess (Deficiency) Of Revenues | | | | |
| Over (Under) Expenditures | <u>\$ 61,941</u> | <u>\$ 61,941</u> | <u>\$ (15,144)</u> | <u>\$ (77,085)</u> |

The accompanying note is an integral part of this schedule.

Note To The Supplementary Information - Budgetary Reporting For The Fiscal Year Ended June 30, 2006

The biennial budget for the State of New Hampshire and the Department of Corrections is prepared principally on a modified cash basis and adopted for governmental funds. The “actual” results column of the Budget To Actual Schedule is presented on a “budgetary basis” to provide a meaningful comparison to budget.

The budget is composed of the initial operating budget, supplemented by additional appropriations. These additional appropriations and estimated revenues from various sources are authorized by Governor and Council action, annual session laws, and existing statutes which require appropriations under certain circumstances. For reporting purposes, the original budget is equal to the initial operating budget plus any balances brought forward, additional appropriations, and other legally authorized legislative and executive changes made before the beginning of the fiscal year. The final budgeted amount includes the original budget plus supplemental appropriation warrants and transfers made throughout the fiscal year.

The variance column on the Budget to Actual Schedule highlights differences between the final budget and actual revenue and expenditures. For revenue, a favorable variance is caused by actual revenue exceeding budget. For expenditures, a favorable variance results from actual expenditures being less than the amount budgeted for the fiscal year. Because the Correctional Industries Account is accounted for in the State’s accounting system as a revolving account and is not included in the State’s biennial budget, a negative expenditure variance results.

Budgetary vs. GAAP Basis

Because the budget is prepared on a budgetary basis and not in accordance with generally accepted accounting principles (GAAP) there are differences in the revenue and expenditures amounts reported in the Statement of Revenues and Expenditures and the Budget To Actual Schedule. The major differences between the budgetary basis and the GAAP basis are:

- Expenditures are recorded when cash is paid or committed (budgetary), rather than when the obligation is incurred (GAAP). In addition, revenue based on these accruals is adjusted on a GAAP basis only.

The following schedule reconciles the differences between budgetary accounting methods and the GAAP basis accounting principles for the fiscal year ended June 30, 2006.

**RECONCILIATION OF BUDGETARY TO GAAP
FOR THE FISCAL YEAR ENDED JUNE 30, 2006**

| | Correctional Industries Account | Vocational Training Account |
|--|--|--|
| | <u> </u> | <u> </u> |
| Excess (Deficiency) Of Revenues | | |
| Over (Under) Expenditures (Budgetary Basis) | \$ (539,919) | \$ (15,144) |
| Adjustments: | | |
| To Record The Net Effect Of Encumbrances | 42,747 | 22,186 |
| To Record Net Accrued Salaries And Benefits | | |
| And Other Accounts Payable | 55,865 | (24,817) |
| To Record Accounts Receivable | <u>23,114</u> | <u>12,428</u> |
| Net Adjustments | <u>121,726</u> | <u>9,797</u> |
| Excess (Deficiency) Of Revenues Over | | |
| (Under) Expenditures (GAAP Basis) | <u><u>\$ (418,193)</u></u> | <u><u>\$ (5,347)</u></u> |

THIS PAGE INTENTIONALLY LEFT BLANK

APPENDIX - CURRENT STATUS OF PRIOR AUDIT FINDINGS

The following is a summary, as of January 9, 2007, of the current status of the observations contained in the audit report of the Department of Corrections, Correctional Industries for the nine months ended March 31, 1995. A copy of the prior report can be obtained from the Office of Legislative Budget Assistant, Audit Division, 107 North Main Street, State House Room 102, Concord, NH 03301-4906.

| | <u>Status</u> | | |
|---|---------------|---|---|
| <i>Internal Control Comments</i> | | | |
| <i>Reportable Conditions</i> | | | |
| 1. Lack Of Internal Controls Over Accounts Receivable Allowing Overdue Account Balances | ● | ○ | ○ |
| 2. Correctional Industries' Equipment And Depreciation Accounts (<i>See Current Observation No. 25</i>) | ○ | ○ | ○ |
| 3. Control Over Report Of Shipment Documents | ● | ● | ● |
| 4. Independent Count Of The Consumable Inventory (<i>See Current Observation No. 15</i>) | ○ | ○ | ○ |
| 5. Review Of The History File – Consumable Inventory EDP System | ● | ● | ● |
| 6. Vocational Training Trust Fund Purchasing Of Parts And Materials (<i>See Current Observation No. 23</i>) | ● | ○ | ○ |
| 7. Receipt Of Inventory And Posting Related Accounts Payable | ● | ● | ● |
| 8. Endorsement Of Checks Upon Receipt | ● | ● | ● |
| <i>State Compliance Comments</i> | | | |
| 9. Collection Of Penalties For Delinquent OHRV Registration Fees | ● | ● | ● |
| 10. Timely Deposit Of Receipts | ● | ● | ● |
| 11. Correctional Industries Advisory Board | ● | ● | ● |
| <i>Management Issues Comments</i> | | | |
| 12. Vendor Discounts | ● | ○ | ○ |
| 13. Employees Working 44 Hour Work Weeks | ● | ● | ● |
| 14. Actual Labor Hours Not Reported On The Wood Shop Job Tickets (<i>See Current Observation No. 12</i>) | ● | ○ | ○ |
| 15. Documenting The Policy For Charging Shipping Fees | ● | ● | ● |
| 16. Projects Accepted From Commercial Businesses | ○ | ○ | ○ |
| 17. Inefficiencies In The Accounting Process | ● | ● | ● |
| 18. Vocational Training Trust Fund Checking Account | ● | ● | ● |

| <u>Status Key</u> | ● | ● | ○ | <u>Count</u> |
|------------------------|---|---|---|--------------|
| Fully Resolved | ● | ● | ● | 11 |
| Substantially Resolved | ● | ● | ○ | 0 |
| Partially Resolved | ● | ○ | ○ | 4 |
| Unresolved | ○ | ○ | ○ | 3 |

THIS PAGE INTENTIONALLY LEFT BLANK