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DEPARTMENT OF CORRECTIONS

COLORADO CORRECTIONAL INDUSTRIES



JANUARY 2015

PERFORMANCE AUDIT

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January 7, 2015

DIANNE E. RAY, CPA
—
STATE AUDITOR

Members of the Legislative Audit Committee:

This report contains the results of a performance audit of Colorado Correctional Industries within the Department of Corrections. The audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government. The report presents our findings, conclusions, and recommendations, and the responses of the Department of Corrections.

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REPORT HIGHLIGHTS



COLORADO CORRECTIONAL INDUSTRIES PERFORMANCE AUDIT, JANUARY 2015

DEPARTMENT OF CORRECTIONS

CONCERN

Colorado Correctional Industries (CCI) has earned little or no profits from its industries operations in recent years, needs to improve its controls to ensure that it is financially independent from the Department of Corrections (Department), and could improve the information it collects to monitor its operations and measure performance.

KEY FACTS AND FINDINGS

- Although statute requires CCI to operate in a profit-oriented manner, CCI's industries operations earned profit margins on average of less than 1 percent from Fiscal Years 2009 through 2014 and do not reimburse the General Fund for the cost of inmates' incarceration. In addition, CCI lacks long-term profit goals and adequate processes to achieve and improve profitability.
- The Department and CCI need to improve controls to ensure that CCI is only funded through its business revenue as required by statute. For Fiscal Years 2009 through 2014 CCI received funding totaling about \$12 million from the Department through training agreements without clear evidence that CCI was providing a service to the Department. As a result, it is unclear that this funding is legitimate business revenue for CCI.
- CCI did not report some information required by statute and its own policies to stakeholders. For example, written business proposals provided to the Correctional Industries Advisory Committee did not address the businesses' potential impact on the private sector and annual reports and budget requests lacked required information, such as projections on the number of inmates employed and production and sales estimates.
- During Fiscal Year 2014 the Department sold about \$283,000 in goods and services to the general public through inmate vocational training programs without statutory authority.
- Contrary to statute and Department regulations, CCI's charges to inmates and their families for phone service were about \$1.5 million higher than necessary to cover the costs for providing the service during Fiscal Year 2014.
- Since Fiscal Year 1982, CCI has not provided the Department with laundry, food, facilities maintenance, and vehicle maintenance services as required by statute.

BACKGROUND

- CCI's statutory purpose is to provide offenders with employment and training, and operate on a financially profitable basis to reimburse the General Fund.
- CCI employs about 1,600 inmates and operates 37 industries shops at state correctional facilities.
- During Fiscal Year 2014 CCI had earned revenues of \$47 million from its industries shops and about \$17.4 million from its canteen.
- State agencies are required to purchase certain goods and services from CCI, such as furniture, license plates, and road signs.
- CCI is authorized to sell goods and services to the general public and enter into partnerships with private entities, but must follow statutes intended to prevent unfair competition with private businesses.

KEY RECOMMENDATIONS

CCI and the Department should:

- Set long term profitability goals and strategies, develop metrics for evaluating the financial and non-financial benefits provided by shops, and follow policies requiring corrective plans for unprofitable shops.
- Improve controls to ensure that CCI operates on a self-supporting basis.
- Report all required information to stakeholders and provide the Advisory Committee with regular updates on approved businesses.
- Evaluate transferring responsibility for laundry, food, and maintenance from the Department to CCI and seek statutory change as deemed necessary.

CCI and the Department generally agreed with these recommendations.



RECOMMENDATION LOCATOR

AGENCY ADDRESSED: DEPARTMENT OF CORRECTIONS

REC. NO.	PAGE NO.	RECOMMENDATION SUMMARY	AGENCY RESPONSE	IMPLEMENTATION DATE
1	30	Improve the financial performance of CCI industries by (a) establishing long-term profitability targets and strategies and procedures for regularly evaluating profitability, (b) developing processes and metrics for evaluating all benefits provided by shops and requiring unprofitable shops to develop plans to improve performance, (c) adjusting accounting practices to track the finances of each shop and allocate overhead costs to each shop in profit-and-loss statements used by management, and (d) based on the process outlined in parts “a” through “c,” making changes necessary to ensure that shops operate in a cost-effective manner.	A AGREE B AGREE C AGREE D AGREE	A SEPTEMBER 2015 B DECEMBER 2015 C DECEMBER 2015 D DECEMBER 2015

AGENCY ADDRESSED: DEPARTMENT OF CORRECTIONS

REC. NO.	PAGE NO.	RECOMMENDATION SUMMARY	AGENCY RESPONSE	IMPLEMENTATION DATE
2	42	Ensure that CCI operates as a financially independent entity by (a) developing a written policy to define Department and CCI financial responsibilities, (b) amending the agreement between CCI and the Department for training programs to ensure that all payments are for clearly defined programs that CCI would not otherwise provide, (c) implementing contract monitoring procedures for the agreement between CCI and the Department for training programs, (d) implementing procedures to ensure that CCI pays or reimburses the Department for all CCI expenses, and (e) seeking guidance from the State Attorney General's Office regarding using inmate pay deductions under the federal Prison Industries Enhancement Program to fund CCI operations.	A AGREE B AGREE C AGREE D AGREE E AGREE	A DECEMBER 2015 B MARCH 2015 C JUNE 2015 D JUNE 2015 E MARCH 2015
3	52	Improve CCI's reporting practices by (a) reporting all statutorily required information in its budget requests, annual reports, and financial reports or seeking statutory change as needed, and (b) providing the Correctional Industries Advisory Committee with information necessary to evaluate new CCI industries, notice of major changes to its operations, and updates on ongoing businesses.	A AGREE B AGREE	A JULY 2016 B APRIL 2015
4	60	Ensure that CCI's inmate pay plan is uniform and equitable by (a) working with the Department to capture information on average daily or hourly wages paid to inmates in each shop, and (b) implementing a policy and regular process for monitoring average inmate pay.	A AGREE B AGREE	A APRIL 2015 B JULY 2015

AGENCY ADDRESSED: DEPARTMENT OF CORRECTIONS

REC. NO.	PAGE NO.	RECOMMENDATION SUMMARY	AGENCY RESPONSE	IMPLEMENTATION DATE
5	70	Ensure that goods and services are only sold to the private sector in accordance with statute by (a) including information on potential competition with the private sector in CCI business proposals provided to the Correctional Industries Advisory Committee, and (b) working with the General Assembly to establish appropriate statutory authority for selling goods and services through the Department's educational training programs not currently administered by CCI.	A AGREE B AGREE	A APRIL 2015 B MAY 2016
6	82	Improve the management of training programs offered to CCI-employed inmates by (a) developing and updating strategic objectives, goals, and performance measures for its training programs, (b) monitoring training programs offered in CCI shops, including centrally tracking information on the scope of training and inmate participation and completion data, and (c) reporting strategic objectives, goals and measures, and data on its progress each year.	A AGREE B AGREE C AGREE	A JULY 2015 B JULY 2016 C JULY 2015
7	92	Ensure that the rates charged for inmate phone services are reasonable and based on costs by (a) renegotiating the contract with the inmate phone service provider to lower the calling rates so they are only based on the cost to provide phone services, and (b) implementing a regular process for reviewing the phone service contract to ensure that rates continue to be reasonable, based on costs and in compliance with state and federal laws.	A PARTIALLY AGREE B PARTIALLY AGREE	A FEBRUARY 2016 B FEBRUARY 2015
8	98	Ensure that facility maintenance, vehicle maintenance, and food and laundry services are operated in a cost-effective manner and in accordance with statute by (a) evaluating the cost-effectiveness of reassigning these services to CCI, and (b) either transferring responsibility for these services to CCI or seeking legislative change to allow for the division of responsibilities that the Department determines would be most beneficial to the State.	A AGREE B AGREE	A JULY 2016 B DECEMBER 2016



CHAPTER 1

OVERVIEW OF COLORADO CORRECTIONAL INDUSTRIES

Colorado Correctional Industries (CCI) operates a number of business-like enterprises that provide work opportunities for inmates in state correctional institutions. Established as a division within the Department of Corrections (Department), CCI's purpose as defined in statute (Section 17-24-101 et seq., C.R.S.) includes providing employment to as many inmates as possible and training them in job skills that increase their employment prospects upon release.

In addition, CCI is charged with operating in a “profit-oriented” manner to partially reimburse the General Fund for the costs of inmates’ incarceration.

As an entity with enterprise status under Article X, Section 20 of the State Constitution, CCI is required to be financially independent from the Department and to sustain its operations through cash fund revenues it generates through the sale of goods and services.

ADMINISTRATION AND BUSINESS OPERATIONS

CCI’s director is appointed by the executive director of the Department and is responsible for administering CCI, which employs about 183 full-time equivalent (FTE) staff and 1,600 inmates. Although it must operate on a financially independent basis, CCI is integrated within the State’s prison facilities and works closely with Department staff to share facilities and land, coordinate inmate schedules, and ensure security when planning its business operations. In addition to working with the Department, CCI must report to the Correctional Industries Advisory Committee (Advisory Committee) created by Section 17-24-104(2)(a), C.R.S. The Advisory Committee is responsible for reviewing all new industries proposed by CCI and making recommendations to CCI’s director on the feasibility of new industries, although its recommendations are not binding on CCI.

Statute (Sections 17-24-113 and 126, C.R.S.) requires CCI to separately administer two key operational areas, which we refer to throughout the report as “industries” and “canteen” operations. Although both employ inmates, statute and Department regulations provide different requirements and expectations for their operations.

INDUSTRIES OPERATIONS. Statute [Sections 17-24-102(1)(a) and 17-24-113(3), C.R.S.] requires CCI industries to be “profit-oriented” and establishes the Correctional Industries Account, which is funded by the sale of CCI industries goods and services and surplus state

property. CCI must pay for all of the expenses for its industries operations from the Correctional Industries Account, and if it earns a profit (i.e., its revenues exceed expenses), it is expected to transfer some of this funding to the General Fund to offset the cost of inmates' incarceration.

CCI manages a diverse array of 37 businesses within its industries operations, known as "shops" at correctional facilities around the state. CCI's shops sell a wide variety of goods and services to the Department, state and local agencies, the federal government, and the general public, and provide training opportunities to inmates. The shops are divided into the following sectors, which employed about 1,600 inmates from 16 of the 20 state-owned correctional facilities and centers during Fiscal Year 2014 (SEE APPENDIX B for a table of facilities and shops):

- **MANUFACTURING.** Shops in this sector produce a wide variety of goods including office and dorm furniture, license plates, state flags, fishing rods, metal products, canoes, and fiberglass products.
- **AGRICULTURAL.** CCI's agricultural shops include cow, goat and water buffalo dairies; a fish farm; greenhouses; wild horse and burro care and training; and fruit and vegetable farming.
- **SERVICES.** Inmates working in service-sector shops provide auto repair, furniture delivery and installation, canine training, computer-aided design and geographic information system services, and landscaping.

In addition to authorizing CCI to establish operations in a variety of business sectors, statute (Sections 17-24-106.6, 109, and 111, C.R.S.) requires CCI to provide several products and services to state agencies. For example, CCI is required to produce license plates and tags for the Department of Revenue and to provide for the sale or disposal of surplus property. Also, statute generally requires state agencies, except institutions of higher education, to purchase office furniture and systems from CCI, and agencies that do not have their own printing operations are required to purchase printing services from CCI.

Although CCI is authorized to make a profit from its sales to state agencies, it must generally sell to state agencies at wholesale prices.

CANTEEN OPERATIONS. In addition to its industries operations, statute requires CCI to operate a canteen to sell items to inmates in, and visitors to, the Department’s correctional facilities. Through the canteen, inmates can purchase food, personal items, and phone time using personal accounts maintained by the Department. During Fiscal Year 2014 about 85 inmates at a time were employed by the two canteen warehouses. CCI must price items in the canteen to cover its costs and allow for a reasonable profit. Statute [Section 17-24-126, C.R.S.] requires that CCI account for the canteen separately from its industries operations and establishes a separate Canteen, Vending Machine, and Library Account (Canteen Account) for depositing all revenues generated through the canteen. Unlike profits in the Correctional Industries Account, profits deposited into the Canteen Account cannot be transferred to the General Fund and must be used to pay for inmate benefits programs, such as recreation, education, and entertainment, or to supplement direct inmate needs. The following exhibit shows revenue and expenditures for CCI’s two main accounts for Fiscal Years 2010 through 2014.

EXHIBIT 1.1. CORRECTIONAL INDUSTRIES & CANTEEN ACCOUNT REVENUE AND EXPENDITURES FISCAL YEARS 2010 THROUGH 2014 (MILLIONS)						
	2010	2011	2012	2013	2014	CHANGE
CORRECTIONAL INDUSTRIES ACCOUNT						
Revenue	\$40.1	\$46.0	\$50.7	\$46.7	\$47.1	17%
Expenditures	39.3	45.5	50.3	46.2	47.1	20%
Ending Balance ¹	22.1	22.6	23.0	23.5	23.5	6%
CANTEEN, LIBRARY, AND VENDING MACHINE ACCOUNT²						
Revenue	\$16.9	\$17.4	\$16.8	\$16.7	\$17.9	6%
Expenditures	18.5	21.7	16.5	16.3	17.1	-8%
Ending Balance ¹	7.8	3.5	3.8	4.2	5.0	-36%

SOURCE: Colorado Financial Reporting System (COFRS).
¹Includes cash and other assets, such as inventory, equipment and buildings.
²Includes revenues and expenses for educational and recreational programs not administered by CCI that operate from this account.

INMATE EMPLOYMENT

In order to work for CCI, inmates must have graduated from high school or obtained a GED. All inmates, regardless of security classification, are eligible for CCI jobs unless they are in administrative segregation, have health issues preventing work, or are housed at facilities that do not operate CCI shops, which include Colorado State Penitentiary, Centennial Correctional Facility, San Carlos Correctional Facility, Denver Reception and Diagnostic Center, and the state's four privately managed facilities. CCI cannot force inmates to work; however, CCI management indicates that inmates consider working for CCI to be a privilege and CCI is able to staff its shops with inmates who have requested work. During Fiscal Year 2013, CCI estimated that about 11,800 inmates met the conditions for a work assignment.

With some exceptions, federal courts have held that prison inmates are not considered employees under the U.S. Fair Labor Standards Act and therefore do not have to be paid a minimum wage; however, according to CCI management, it is important to provide inmates with wages sufficient to encourage productivity. Thus, CCI pays inmates at rates that are calculated based on their skills and experience and the productivity within each shop, which can vary from month to month. For example, during the month of May 2014, the average inmate employed by CCI was paid about \$3.95 per day. According to CCI management, jobs in its shops are desirable to inmates and can be used as an incentive by Department staff to encourage good behavior, since inmates can lose their CCI jobs for violating prison rules.

Inmates working for CCI shops receive general job skills training, such as following directions and working on a team, and can also receive specialized training through apprenticeships, certification programs, and community college courses. According to a 2011 Department study, inmates who worked for CCI were more likely to find jobs upon release and had lower recidivism rates than other inmates who were released.

AUDIT PURPOSE, SCOPE AND METHODOLOGY

This report includes the results of our performance audit of the Division of Correctional Industries within the Department of Corrections. We conducted this audit pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions and agencies of state government. The audit was prompted by a legislative request which expressed concerns regarding CCI's profitability and its procedures to avoid unfair competition with private businesses. Audit work was performed from January 2014 through December 2014.

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

We planned our audit work to assess the effectiveness of those internal controls that were significant to our audit objectives. Our conclusions on the effectiveness of those controls are described in the audit findings and recommendations. The key objectives of the audit were to determine whether CCI:

- Operates on a thoroughgoing business basis, including whether it realizes sufficient revenues to cover expenses and partially reimburse the General Fund, maintains financial independence from the Department, and accurately tracks and reports financial benefits.
- Has adequate processes in place to ensure that it does not unfairly compete with private industry by offering products and services below market value and that it provides the Advisory Committee with

sufficient information to assess the impact of new ventures on private industry.

- Provides employment to all offenders who are able to work to the extent possible.
- Offers training and skills development opportunities to help inmates find employment after being released and to reduce recidivism.

TO ACCOMPLISH OUR OBJECTIVES, WE:

- Performed an analysis of CCI's overall profitability from Fiscal Year 2009 through 2014 and a shop-level analysis that included an allocation of overhead costs to each shop for Fiscal Years 2011 through 2014.
- Reviewed CCI's policies and procedures and interviewed management regarding its financial review and planning processes.
- Reviewed the sources of CCI revenues and expenses to evaluate whether CCI maintained financial independence and funded its operations solely through the sale of goods and services as required.
- Reviewed annual reports, budget documents, and business plans to assess whether CCI adequately reports financial and operational information to policy makers and the general public.
- Observed an Advisory Committee meeting in January 2014 and reviewed all new business proposals that CCI submitted to the Advisory Committee between July 2010 and January 2014, as well as Committee meeting minutes for July 2010 through August 2014.
- Compared the price of a sample of five products that CCI sells to the public to similar products sold by private businesses and reviewed CCI's method for setting prices on a sample of seven products that are either custom-made to order or produced under contract for specific

private venture partners to assess whether CCI's procedures result in prices that are set at market levels as required by statute.

- Assessed controls within the Department's vocational programs to ensure that the programs do not improperly sell goods and services to the public, except under the administration of CCI, as required by statute.
- Observed CCI industries and canteen operations at six facilities located in Denver and the Cañon City area.
- Evaluated the rate structure for the inmate phone system, which is managed by CCI, and compared it to federal, state, and Departmental requirements.
- Reviewed CCI data on inmate employment and assessed CCI's efforts to employ all offenders to the fullest extent possible.
- Assessed CCI's policies, procedures, and data related to setting inmate wages and incentivizing productivity.
- Reviewed CCI and the Department's data on inmate participation in training programs offered by CCI, including vocational courses, apprenticeships, and job skills certifications, and interviewed management regarding its methods for tracking and planning training programs.

CHAPTER 2

BUSINESS OPERATIONS

Colorado Correctional Industries (CCI) is required to operate much like a private enterprise. According to statute [Section 17-24-102(1)(c), C.R.S.], the General Assembly intends for CCI to provide an environment “that closely resembles the environment for the business operations of a private corporate entity.” Further, Section 17-24-113(2), C.R.S., requires “that the operation of industries be conducted on a thorough-going business basis.” Similar to a private business, statute requires that CCI:

- Be profit-oriented (Section 17-24-102, C.R.S.).
- Sustain its operations through the sale of goods and services and without financial assistance from the Department of Corrections (Department) (Sections 17-24-104 and 113, C.R.S.).
- Report its financial performance to stakeholders (Section 17-24-113, C.R.S.).

Statute (Sections 17-24-111 and 24-113-103, C.R.S.) also authorizes CCI to market and sell its products to the Department, state agencies, local and federal governmental agencies, private businesses, and the general public. However, to ensure that CCI does not unfairly compete with private businesses, statute (Sections 17-24-112 and 104, C.R.S.) requires that it sell its products at the prevailing market price and present all new industries under consideration for approval by the Correctional Industries Advisory Committee (Advisory Committee), which is required to consider the potential impact of the industries on existing private businesses.

CCI manages 37 shops within its industries operations, some of which include several distinct business operations. For example, the cow dairy shop includes bucking bull and bighorn sheep sheltering, pheasant farming, white bison breeding, and composting businesses. A shop supervisor and staff members employed by CCI oversee each of these business centers and provide supervision and on-the-job training to inmates.

Consistent with statute, CCI's shops sell products and services to both public and private customers. As shown in Exhibit 2.1, CCI's primary source of revenue is from other state agencies, which accounted for 59 percent of revenue in Fiscal Year 2014.

EXHIBIT 2.1. CCI REVENUE SOURCES FISCAL YEAR 2014 (MILLIONS)		
	REVENUE	PERCENT
STATE AGENCIES	\$28.0	59%
Higher Education	9.1	19%
Department of Corrections	6.5	14%
Department of Revenue	5.7	12%
OTHER STATE AGENCIES	6.7	14%
NON-STATE CUSTOMERS¹	19.1	41%
TOTAL REVENUE	\$47.1	100%
SOURCE: Auditor analysis of COFRS data and information provided by CCI.		
¹ Includes revenue from donations and sales to federal and local government agencies, non-profits, private venture partners, and the general public.		

With the exception of institutions of higher education, state agencies are required by Sections 17-24-109 and 111, C.R.S., to purchase furniture and certain other goods, such as license plates and highway signs, from CCI. Agencies that do not have their own printing operations are also required to purchase printing services from CCI. For sales to the private sector, CCI sells goods and services to other manufacturers and retailers and to the general public through its website and two retail stores in Cañon City and Colorado Springs. In addition, CCI has entered into several venture partnership agreements with private businesses. Under these agreements, CCI typically provides workspace and inmate labor and relies on its private partners to provide equipment and materials and market the finished products. These ventures include a tilapia farm, a goat dairy, and a stone cutting shop.

In this chapter we provide our findings related to CCI's management of its business operations. As discussed in the following sections, we identified the following issues: (1) CCI has made little or no profits in recent years and could improve its business planning process to ensure that it is profit-oriented, (2) CCI and the Department lack adequate controls to ensure that CCI operates as a financially independent entity, (3) CCI does not report all required information to stakeholders, (4) CCI management lacks information necessary to monitor inmate pay, and (5) CCI and the Department need to improve their controls to ensure that CCI and other vocational training

programs, which in some cases sell goods and services, do not improperly compete with private businesses.

PROFITABILITY

CCI has been given a unique charge by the General Assembly: unlike most other state agencies, CCI is mandated to operate similarly to a private company and to produce a profit, with the goal of returning funds to the State General Fund as reimbursement for the use of inmate labor and the expense of correctional services. In evaluating CCI's profitability, it is important to understand its business environment, which differs significantly from a private business. These differences can impact profitability both positively and negatively. For example, by using inmate labor, CCI's labor costs are lower than those of a typical business operating in the state, which beginning in January 2015 would be required to pay at least a minimum wage of \$8.23 per hour, compared to CCI's average wage of 49¢ per hour as of May 2014. In addition, state agencies are statutorily mandated to purchase certain products, such as license plates, highway signs, and furniture, from CCI. Such sales on average provided CCI with at least \$10.5 million in annual revenues during Fiscal Years 2012 through 2014 that was not subject to competition with private industry.

CCI also faces significant constraints on its operations and added costs which limit its ability to make a profit and which private businesses outside of prisons do not experience. For example, in addition to being profitable, statute provides that a key purpose of CCI is to employ and train as many inmates as possible. According to management, accomplishing this purpose can run counter to making a profit because it is often necessary to operate similar businesses in several locations across the state in order to provide meaningful work opportunities at each correctional facility, which can increase equipment, staffing, and shipping costs. In addition, management reports that CCI's costs are increased by the inherent constraints of operating in a prison environment. For example, to maintain security, CCI must employ more supervisory staff than a private company

would likely need for running similar operations. Also, CCI must maintain a rigorous system of head counts, tool control procedures, and inspections, which reduces productivity and increases shipping time. Further, CCI's inmate labor pool often lacks skills that would be available to private business when hiring employees and is subject to turnover due to releases, transfers between prisons, and violations of prison rules. Thus, CCI shop supervisors must devote more time to training and educating workers, which decreases productivity and increases costs. In addition, CCI management reports that legislative changes, such as House Bill 11-1301 which exempted institutions of higher education from the requirement to purchase furniture from CCI, can impact its revenues and profitability.

As discussed in CHAPTER ONE, we conducted this audit in response to a request from the Joint Budget Committee that expressed concern about whether CCI operates in a "profit-oriented" manner, as required by statute. In the following sections, we address this question and recommend improvements to CCI's planning, monitoring, and management practices to better ensure that its industries aim towards profitability.

WHAT AUDIT WORK WAS PERFORMED AND WHAT WAS THE PURPOSE?

The purpose of the audit work was to determine whether CCI's industries and business ventures are financially profitable. We examined financial information pertaining to CCI that the Department included in its budget request for Fiscal Year 2015 (submitted in November 2013), as well as annual reports that CCI provided to stakeholders for Fiscal Years 2011, 2012, and 2013. In addition, we analyzed CCI financial data recorded on the State's accounting system, COFRS, for Fiscal Years 2009 through 2014, and calculated and analyzed the net profits and losses for CCI as a whole in each of these years. We also interviewed CCI management and staff, reviewed CCI's written policies, and examined internal planning information to understand how CCI tracks and monitors the profitability of its

industries and how it prioritizes the need to produce profits in relation to other programmatic mandates expressed in statute.

Applying a method we developed in consultation with CCI staff, we allocated overhead expenses to each of CCI's 37 industry shops and the canteen operations for Fiscal Years 2011 through 2014 to analyze the profitability of each shop. Specifically, we allocated several overhead expense categories on the basis of the amount of revenue earned in each shop. In addition, on the basis of information provided by CCI staff, we used other operational data to allocate certain expense categories. For example, we allocated transportation costs to each shop on the basis of actual transportation trip records. We allocated expenses for sales and customer service solely to the furniture, seating, and warehouse shops, since those functions primarily involve sales of furniture products that are manufactured in these shops. Also, we allocated expenses related to managing employees and employee benefits on the basis of the number of full-time equivalent staff (FTE) assigned to each shop.

HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

The legislative declaration for the Correctional Industries Act states that the intent of the Act included creating a division of correctional industries that is “profit-oriented,...generates revenue for its operations and capital investments,...[and] partly reimburses the General Fund for the expense of correctional services” [Section 17-24-102(1)(a), C.R.S.]. Accordingly, CCI's mission statement provides that part of CCI's mission is “to operate in a business-like manner so that earnings are realized each year to meet the on-going capital equipment, working inventory, and operating cash needs of the Division and to partially reimburse the General Fund for the cost of incarcerating offenders.” To monitor profitability, CCI's operational policies require that each of its shops undergo a profitability review each year. For shops that do not generate a profit in a given year, CCI's policy requires the shop supervisor and the manager over the

business sector to prepare a business plan that includes corrective measures. CCI's director is responsible for approving and monitoring the implementation of the corrective plans.

Given the statutory intent for CCI and its mission statement, we reviewed whether CCI's industries and canteen operations generate sufficient profits to cover their ongoing funding needs, contribute to the General Fund, and support inmate programs. We also reviewed CCI management's financial planning process to determine whether the process is "profit-oriented" and includes controls necessary to operate on a financially profitable basis, such as setting profitability goals and monitoring profitability. Because statute [Sections 17-24-113(3) and 17-24-126, C.R.S] requires CCI to account for its industry operations separately from canteen operations and restricts the use of profits from canteen operations to inmate benefits programs, we assessed each independently.

WHAT PROBLEM DID THE AUDIT WORK FIND?

We found that CCI's industries collectively operate close to a break-even point with gains from profitable shops being mostly offset by losses in unprofitable shops. As shown in Exhibit 2.2, CCI's industries collectively earned a profit margin of 1 percent in Fiscal Years 2012 and 2013 and lost about \$10,000 in Fiscal Year 2014. By contrast, CCI's canteen operations realized profit margins between 19 and 20 percent during the same period. Further, this performance is consistent with prior years, with CCI industries collectively averaging a profit margin of 1 percent and the canteen operations averaging about 20 percent from Fiscal Year 2009 through 2014.

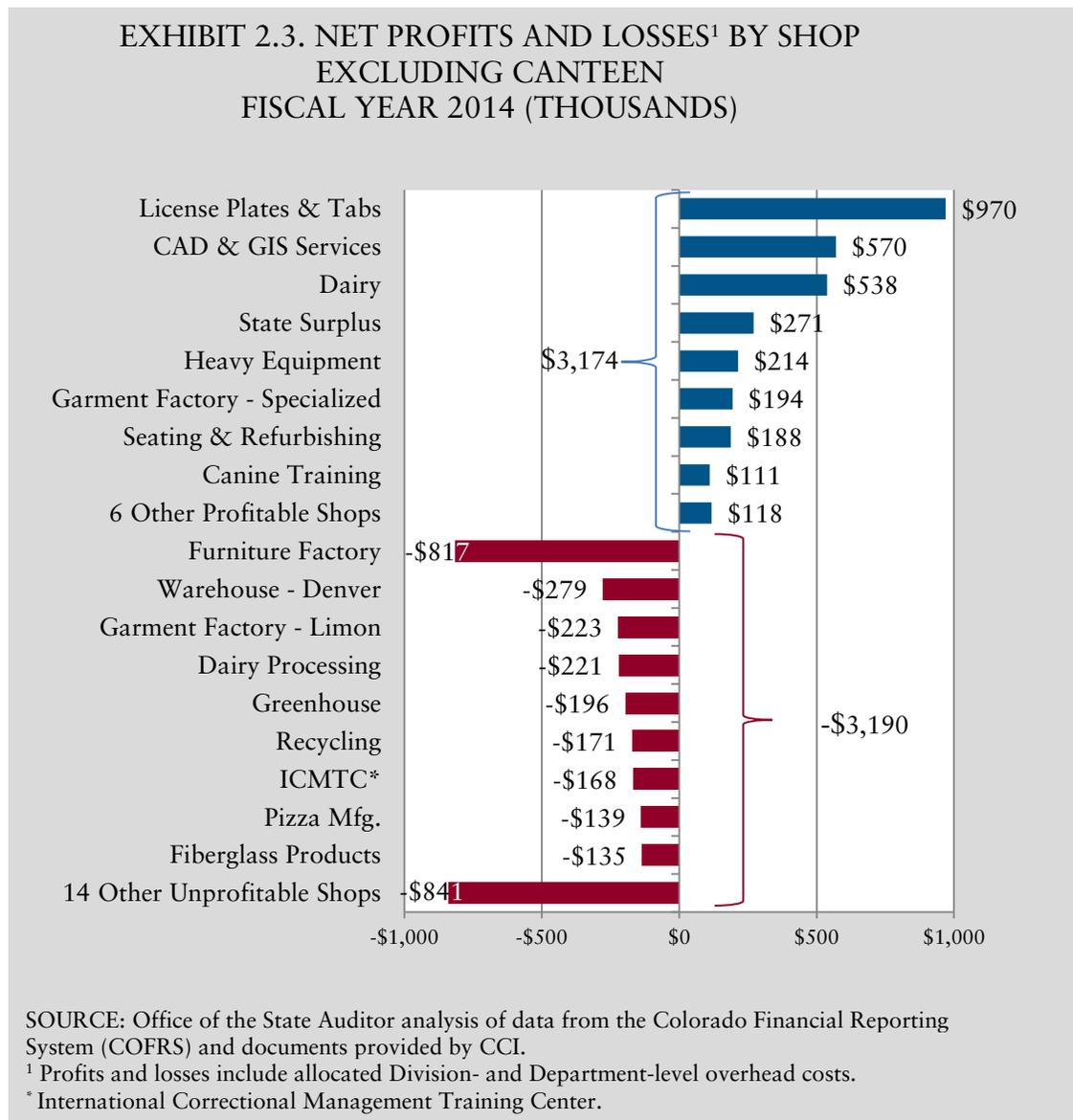
EXHIBIT 2.2. CCI NET PROFITS FISCAL YEARS 2012–2014 (MILLIONS)						
	CCI INDUSTRIES ¹			CCI CANTEEN ²		
	2012	2013	2014	2012	2013	2014
Earned Revenue ³	\$50.77	\$46.66	\$47.04	\$16.45	\$16.26	\$17.41
Cost of Goods Sold ⁴	\$45.43	\$42.25	\$43.01	\$13.18	\$13.12	\$13.84
Other Operating Expenses ⁵	\$4.84	\$3.95	\$4.04	\$0.06	\$0.07	\$0.11
Net Profit ⁶	\$0.50	\$0.46	-\$0.01	\$3.21	\$3.07	\$3.46
Net Profit Margin (Profit/Revenue)	1%	1%	0%	20%	19%	20%

SOURCE: Office of the State Auditor's analysis of COFRS data.
¹Includes 36 shops operating from the correctional industries account, plus the federal surplus shop, which operates from a separate account.
²Includes the inmate phone system and excludes transactions for recreational and educational inmate benefit programs that operate from the same enterprise fund.
³Sales of goods and services.
⁴Includes direct and indirect costs of production, such as raw materials, staff and inmate wages, shop-level overhead, utilities, and transportation costs.
⁵Includes costs for Department- and Division-level administration, sales, customer service, and marketing, net of revenue from donations and investments.
⁶Excludes increases and decreases to the fund balances due to unrealized gains and losses on investments.

In addition, our review of CCI's revenues and expenditures indicates that its industries operations did not return any funds to the General Fund during Fiscal Years 2009 through 2014 other than to pay for its portion of statewide cost recoveries and administrative expenses incurred by the Department on behalf of CCI, such as salaries for accounting personnel. By contrast, nearly \$24 million in profits earned through CCI's canteen operations were used to fund inmate benefits programs from Fiscal Year 2009 through 2014, potentially offsetting costs that the Department would have otherwise funded using general funds. As mentioned, although CCI's canteen operations are profitable, these funds cannot be used to reimburse the General Fund.

Although CCI's industries collectively have a relatively small overall profit margin, we found that several of CCI's shops make a significant profit; however, most of these profits are being offset by losses in unprofitable shops. Specifically, based on our analysis of revenues and

expenditures for each shop, which included an allocation of overhead expenditures to each for Fiscal Years 2011 through 2014, we found that 14 industry shops were profitable during Fiscal Year 2014 and earned about \$3.2 million; however, this amount was completely offset by about \$3.2 million in losses from 23 unprofitable shops. The following exhibit provides information on profits and losses we calculated for CCI's shops. (SEE APPENDIX A for the profits and losses for each of CCI's shops.)



In addition to losing money in Fiscal Year 2014, we found that some shops shown in the exhibit above have been consistently unprofitable

for multiple years. After allocating overhead expenses to each shop in our analysis, we found the following 12 shops were unprofitable from Fiscal Year 2012 through 2014: Furniture Factory, Dairy Processing, Goat Dairy, Greenhouse, Fish Processing, Recycling, HVAC Filter Manufacturing, Fiberglass Products, Garment Factory (Limon), Fleet Services, International Correctional Management Training Center, and Warehouse (Denver). These 12 shops account for \$2 million in losses for Fiscal Year 2014 alone.

WHAT CAUSED THE PROBLEM TO OCCUR?

Overall, we found that CCI could improve its processes used to evaluate its financial performance. As discussed in the following sections, we found that CCI: (1) lacks long-term profitability goals, (2) has not followed its procedures for evaluating the performance of unprofitable shops, (3) does not have procedures and metrics to use to evaluate benefits, other than profits, that shops provide, and (4) could improve the information that management uses to track shops' financial performance.

CCI HAS NOT DEVELOPED ANY LONG-TERM PROFITABILITY GOALS TO GUIDE ITS BUSINESS PLANNING PROCESS. Based on our review of CCI's annual report and internal planning documents and interviews with management, we found that CCI has not established any long-term profitability goals and has not used a sufficiently "profit-oriented" approach to planning its industries operations, as intended by statute. Specifically, each fiscal year in planning its business operations, CCI projects revenues, expenditures, and profits and losses for each shop on the basis of factors that include expected order volumes, sales goals, and costs. However, CCI does not develop these projections with the goal of achieving any overall profit target or improving future profit margins, and management has not clearly articulated any long-term profit expectations for its industries operations or given directives to shop supervisors or business sector managers on how to incorporate profit targets into business-planning processes. Instead,

management reports that, in its day-to-day financial decision-making, it is primarily guided by the objective of ensuring that CCI's shops collectively generate enough revenue to cover their costs. This objective is similar to a budget-oriented approach used by other cash-funded state agencies, but is not "profit-oriented."

CCI HAS NOT FOLLOWED ITS OWN POLICIES INTENDED TO IMPROVE THE PERFORMANCE OF BUSINESSES THAT OPERATE AT A LOSS. Specifically, CCI policy requires managers of unprofitable shops to prepare business plans, which must be approved by the CCI director, to improve the shops' performance. These plans are required to include corrective actions, such as market expansion, price adjustments, staffing and inmate employment changes, and other efficiency measures, that shop managers plan to take to improve profitability. However, despite having 22 shops that operated at a loss in Fiscal Year 2013, CCI shop managers were not required to prepare any formal corrective plans as specified in CCI's operational policy. Instead, CCI management reported that it had verbal discussions regarding the profitability of its shops with shop managers, but did not enforce the policy of having the managers prepare written plans to document strategies to improve performance and hold shop managers accountable. We found that 18 of the 22 shops that were unprofitable in Fiscal Year 2013 continued to be unprofitable during Fiscal Year 2014.

CCI LACKS A PROCESS FOR ASSESSING THE COST-EFFECTIVENESS OF UNPROFITABLE SHOPS. According to CCI management, in some cases it operates unprofitable shops because they provide other benefits that are consistent with CCI's overall mission, for example to provide jobs and training opportunities for inmates. According to information provided by CCI management, the Department saves an estimated \$3,750 per year for every inmate CCI employs, because during the time these inmates are working they are supervised by CCI staff, thereby reducing the Department's staffing needs. In addition, management reports that CCI jobs provide long-term benefits by providing skills and training to inmates that reduce the likelihood of recidivism. Further, management reported that some shops that

generate a loss support Departmental operations. For example, CCI operates the greenhouse shop at Arrowhead Correctional Center because it is integrated into the Department's therapeutic communities program, which provides special education and training for inmates with substance abuse or mental health issues. In another example, CCI lost money on its dairy shop because it has an agreement with the Department to provide milk at a fixed price, which reduces Department costs but causes CCI to lose money in years like 2013, when the price of hay goes up.

Employing inmates is a key aspect of CCI's statutory purpose and realizing non-financial benefits by employing inmates in unprofitable shops may outweigh the losses the shops generate. However, we found that CCI lacks a systematic process for determining when a loss is acceptable and ensuring the losses do not exceed the benefits achieved. Specifically, CCI's policy for annually reviewing the financial profitability of the shops does not provide a framework for taking these other benefits into account or for determining acceptable loss thresholds for businesses that are not expected to earn profits. Further, CCI management has not developed quantifiable metrics, such as the acceptable level of loss per inmate job provided or the value shops provide to the Department's therapeutic communities, to use when evaluating the profitability of its shops.

CCI'S ACCOUNTING PRACTICES DO NOT PROVIDE MANAGEMENT WITH COMPLETE INFORMATION. Each quarter, CCI management reviews the performance of the shops using profit-and-loss statements prepared by staff. We reviewed CCI's internal profit-and-loss statements for Fiscal Years 2009 through 2014 and found they did not accurately represent the shops' financial performance because they did not fully account for overhead costs. Specifically, the statements do not allocate overhead costs, such as utilities, transportation, marketing, and costs associated with the CCI director's office, to the cost centers for each individual shop, which would provide a more accurate presentation of profitability. Instead, because the Department uses separate cost centers to account for these overhead costs, CCI's profit-and-loss statements show them on separate lines that apply to the whole

Division, distinct from the costs associated with the individual shops. In Fiscal Year 2014, this resulted in about \$6.2 million in net costs not being allocated to individual shops, making each appear more profitable on the year-end profit-and-loss statement than it actually was. In fact, as shown in Exhibit 2.4, we found that when overhead costs are included, nine shops that appeared profitable on the profit-and-loss statements used by CCI management actually operated at a loss.

EXHIBIT 2.4. PROFITABILITY OF NINE SHOPS BEFORE AND AFTER ALLOCATING OVERHEAD EXPENSES FISCAL YEAR 2014 (THOUSANDS)			
SHOP NAME	NET PROFIT BEFORE OVERHEAD	ALLOCATED OVERHEAD	NET LOSS AFTER OVERHEAD
Modular Office Systems	\$1,210	\$1,266	-\$56
Wild Horse Inmate Program	\$224	\$239	-\$15
Metal Fabrication	\$120	\$128	-\$8
Goat Dairy	\$83	\$85	-\$2
Fleet Services	\$71	\$143	-\$72
Wildland Firefighting (Buena Vista)	\$30	\$62	-\$32
Dairy Processing	\$11	\$232	-\$221
Delta Farm Program	\$8	\$17	-\$9
Water Buffalo Operations	\$7	\$56	-\$49

SOURCE: Office of the State Auditor's analysis of data from COFRS and documents provided by CCI.

As shown in the preceding exhibit, not allocating overhead presents management with a distorted picture of the shops' financial performance. CCI managers report that they compensate by monitoring the overhead expenses separately, paying close attention to the overall bottom-line for the whole Division. This approach does not allow the managers to identify which individual shops lack revenue to cover their expenses and develop written corrective action plans as required by CCI policy.

In addition, we found that CCI could improve its ability to monitor the performance of individual shops by changing accounting practices to allow tracking of distinct businesses within the shops on profit-and-loss statements. Specifically, some of CCI's shops include several

diverse businesses, making it difficult to judge the profitability of each business independently. For example, the greenhouse shop includes an apple orchard, a vineyard, lobster farming, tractor refurbishing, fly rod production, honey, and musical instruments. Similarly, the license plate shop also customizes motorcycles and makes signage, while the shop for license plate tabs also recycles printer cartridges and makes banners and vehicle graphic wraps. CCI does not track the finances for each business within these shops separately, for example by assigning separate codes within the state's new accounting system, CORE. These concentrations of businesses may be useful for administrative purposes; however, combining their revenues and expenditures diminishes management's ability to track their financial performance.

WHY DOES THIS PROBLEM MATTER?

Because CCI lacks long-term profitability targets and a systematic process for assessing the costs and benefits associated with operating each shop, there is a risk that it will continue to generate little to no profit, will not be able reimburse the General Fund as intended by statute, and will not maximize the overall benefit it provides to the State. For example, as previously mentioned, when inmates work for CCI, the Department realizes substantial cost savings, because inmates are supervised by CCI staff who are paid from CCI's revenues, not the Department's appropriation. Based on staffing costs, CCI management estimates that it would cost the Department about \$6 million per year to supervise the 1,600 inmates that currently work for CCI, or about \$3,750 per year per inmate. However, we found that in Fiscal Year 2014, not counting one shop that was new that year, nine shops generated losses that exceeded \$3,750 per inmate employed. These nine shops together incurred total losses of \$2 million in Fiscal Year 2014. Thus, if CCI had not operated these nine shops, it could have increased its profits for the year by up to \$2 million, the value of the losses, which would have improved its profit margin from around 0 percent to 4 percent. Although the 224 inmates who worked at the shops would then have needed to be supervised by Department staff at a cost of approximately \$3,750 per inmate, this would have only

increased costs by about \$840,000, producing a potential net financial benefit to the State of up to \$1.2 million.

In addition to employing inmates, CCI management reported that it has other reasons for continuing to operate shops that do not generate profits. For example, management expects some shops, such as the water buffalo dairy, to become more profitable in the future, and other shops provide specific training and education programs and support Department operations. However, without quantifiable metrics to evaluate performance it is not possible to fully evaluate whether operating the unprofitable shops is beneficial to the State. Further, without written business plans outlining CCI's profitability targets and the steps that management intends to take to improve shops' performance, it is difficult to assess the potential of shops to improve performance in the future.

Ultimately, CCI has been charged with developing self-supporting, profit-oriented businesses to employ as many inmates as possible, provide cost savings to the State, and reimburse the General Fund for the cost of inmates' incarceration. By not having processes in place to fully evaluate the financial performance and other benefits each shop provides, profits that otherwise could be used to expand operations, invest in new business ventures, or be returned to the General Fund may be depleted by unprofitable businesses and CCI may not maximize the overall benefit it provides to the State. Further, operating its industries at a profit margin of around one percent, as it did between Fiscal Years 2009 and 2014, increases the risk that CCI may not generate sufficient revenues to cover its expenses in future years.

RECOMMENDATION 1

The Division of Correctional Industries (CCI) should improve its management of the financial performance of its industries operations by:

- A Establishing long-term profitability targets and strategies to meet them, methods for incorporating such targets and strategies into the annual financial plans for each shop, and procedures for regularly evaluating profitability to assess performance and develop strategies to improve.
- B Developing processes and quantifiable metrics for evaluating all benefits that shops provide to the State, including profits, cost savings, and other non-financial benefits; incorporating these processes and metrics into CCI's operational policies that require an annual shop-level financial review; and enforcing the policy requiring unprofitable shops to develop written business plans, including corrective actions, to improve performance.
- C Adjusting accounting practices to independently track the finances of each major business, service, and product line or category within the shops and to allocate overhead costs to each shop in quarterly profit-and-loss statements that management uses to evaluate performance.
- D Based on the processes outlined in PARTS A through C, making changes necessary to ensure that shops operate in a cost effective manner and closing or repurposing shops that do not provide benefits to the State that outweigh their costs.

RESPONSE

DEPARTMENT OF CORRECTIONS

- A AGREE. IMPLEMENTATION DATE: SEPTEMBER 2015.

The CCI Management Team will incorporate long-term profitability goals into the annual business plan process, which occurs in August every year. Long-term profitability goals will also become part of CCI's business plan summary so they can be tracked from year to year. Minutes for quarterly budget reviews will include discussions of individual shops and overall organizational performance, as well as strategies for improving shops that are struggling to meet performance targets.

B AGREE. IMPLEMENTATION DATE: DECEMBER 2015.

Management agrees with quantifying as many of the costs and benefits related to managing CCI's various shops as feasible. However, as part of the Colorado Department of Corrections, CCI provides support to the security and operational protocols of the State's correctional system. Any processes and metrics developed in the coming months will be incorporated into CCI's Operational Memorandums and other departmental process directives for future analysis. CCI's internal policy regarding unprofitable shops will be reviewed and revised where necessary and then applied moving forward during quarterly budget reviews and during CCI's annual business planning cycle. This revised policy will include requiring unprofitable shops to develop written business plans that include corrective processes.

C AGREE. IMPLEMENTATION DATE: DECEMBER 2015.

Overhead allocations will only be applied to profit and loss statements prepared for the CCI Management Team for analysis during quarterly budget reviews. The Department believes it is important to hold the shops accountable only for revenue and expenses that they can control and overhead costs are not part of that accountability. Senior management will document application of CCI's overhead allocations during quarterly budget reviews, as well as any related discussions about controlling overhead expenses. However, since CCI has been unable to generate accurate profit and loss statements through CORE, it is difficult to know when the next formal quarterly budget review might occur.

At the present time, it is not clear the feasibility of implementing enterprise accounting functions within the framework of CORE. Over the course of the next 18 months, management will commit to reporting the revenue and expenses of all business operations within each shop in one manner or another, but the method used will be dependent on determining the full capabilities of CORE. Ideally, enterprise accounting will occur within the State's accounting system, but may have to be maintained 'offline' as an addendum to CCI's monthly profit and loss statements.

D AGREE. IMPLEMENTATION DATE: DECEMBER 2015.

CCI management will utilize the processes discussed in PARTS A, B, AND C of this recommendation to undertake aggressive steps toward improving the financial standing of unprofitable shops where necessary. Any decision to close or repurpose shops in the future based on the processes discussed in PARTS A, B, AND C of this recommendation will be made in conjunction with the DOC Executive Director, senior executive staff, and facility wardens especially as pertains to security concerns and other intangibles related to the best methods of managing correctional facilities.

FINANCIAL INDEPENDENCE

In accordance with the General Assembly's intent that CCI operate on a "thoroughgoing business basis," statute [Sections 17-24-104(1) and 113(4), C.R.S.] provides that CCI must be self-sustaining and pay for its industries operations from the sale of goods and services and surplus property. Thus, CCI is required to be self-funded and not reliant on grants or assistance from the Department or other governmental agencies. Despite this financial independence, CCI and Department operations are highly integrated. For example, statute [Section 17-24-109(4), C.R.S.] makes Department property available for CCI's use, and in practice, CCI and the Department must work closely together to share facility space, coordinate inmate time, and ensure security. In addition, the Department is CCI's largest single customer, providing 14 percent of CCI's revenue in Fiscal Year 2014. Although this close relationship is necessary, it creates a risk that Department resources could be improperly transferred to CCI or used to supplement CCI's operations.

WHAT AUDIT WORK WAS PERFORMED AND WHAT WAS THE PURPOSE?

We examined CCI's revenues, expenses, and capital assets recorded on COFRS, the State's accounting system, to determine whether CCI operates as a self-funded enterprise. Specifically, we reviewed CCI's expenditures during Fiscal Year 2013 to determine whether CCI is paying for all of the utilities it uses in Department facilities and whether depreciation costs for buildings used by CCI are being properly charged to CCI. In addition, we examined CCI's revenue sources, including money it receives through contracts with the Department, to determine whether the revenues were provided in exchange for goods or services. We also reviewed Department and CCI procedures and interviewed management and staff to assess the

controls in place to ensure that CCI is self-supporting and not subsidized through the transfer of general funds.

HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

In Sections 17-24-104(1) and Section 17-24-113(4), C.R.S., the General Assembly established CCI as an enterprise under Article X, Section 20 of the State Constitution and statute requires that, aside from canteen operations, “all acquisitions, purchases, and loan repayments of the division shall be payable out of the revenues derived from the sale of correctional industry goods and services authorized in this article....” In line with this intent, CCI adopted a mission statement that includes the goals of creating “self-supporting and productive industries” and “operat[ing] in a business-like manner so that earnings are realized each year to meet the on-going capital equipment, working inventory, and operating cash needs of the Division and to partially reimburse the General Fund for the cost of incarcerating offenders.” Thus, in accordance with Section 24-17-102 C.R.S., which requires state agencies to establish effective accounting and administrative controls, we expected the Department and CCI to have adequate controls in place to ensure that CCI is fully self-funded from the sale of its goods and services and operates without receiving funding from the Department or other sources outside of its business revenue.

WHAT PROBLEM DID THE AUDIT WORK FIND?

We found that CCI is not entirely self-funded and lacks adequate controls to ensure that its operations are solely funded from the sale of correctional industry goods and services. Rather, as explained below, we found that in Fiscal Years 2009 through 2014 the Department annually transferred funds to CCI with insufficient evidence of goods or services being provided in return, covered some CCI expenses and purchases from its general fund appropriation, and allowed CCI to

retain funds intended to cover inmates' incarceration costs for which CCI may lack proper spending authority.

CCI AND THE DEPARTMENT'S ADMINISTRATION OF TRAINING CONTRACTS LACKED ADEQUATE CONTROLS. From Fiscal Year 2009 through 2014, the Division of Education (DOE) within the Department has paid CCI approximately \$2 million per year to provide training programs, such as vocational courses for community college credits and industry-approved skills certifications, to employed inmates under annual letters of agreement between CCI and DOE. DOE is authorized under Section 17-32-106(1)(b), C.R.S., to enter into contracts with state agencies to provide vocational training opportunities to inmates, and statute [Section 17-24-106(1)(c), C.R.S.] authorizes CCI to create training programs. Thus, under statute it appears proper for DOE to contract with CCI to provide specialized training programs and courses to CCI-employed inmates. However, based on our review of the terms and administration of the agreements for Fiscal Years 2009 through 2014, CCI and DOE lack adequate controls to ensure that no general fund money is being transferred without a commensurate exchange of goods or services.

First, most of the funding under the agreements compensates CCI for unspecified "career and technical education opportunities" that are not clearly distinguished from trainings CCI offers outside of the agreements. Specifically, CCI provides job skills training to fulfill a core objective of its mission, which includes "train[ing] inmates in meaningful skills, work ethics and quality standards which will better enable them to secure long-term employment after release from prison." However, under the letters of agreement, DOE agreed to pay CCI about \$1 million annually from Fiscal Year 2009 through 2011 and about \$1.4 million annually from Fiscal Year 2012 through 2014—or about 59 percent of the total funding under the agreements—for providing training opportunities that, as each agreement states, are "in existing programs" that CCI would offer "without guaranteed funding by [the Division of] Education." Although CCI management reports that it would discontinue such training programs if DOE were to cease funding them altogether, the

letters of agreement do not clearly specify which programs this funding is for. The Fiscal Year 2014 agreement, which is the most recent one we reviewed, does not provide any specific information about the training programs that CCI will offer to receive this funding, such as course titles, topics, certification types, number of courses offered, or number of inmates expected to participate.

Second, we found that the administration of the agreements by DOE and CCI lacks key processes that would be expected under a contract for the provision of services. Specifically we found the following:

- **FUNDED AMOUNTS WERE NOT BASED ON COSTS.** Neither DOE nor CCI were able to explain how they arrived at the dollar amounts in the letters of agreement, and the agreements do not appear to be based on actual costs or the specific services provided by CCI. For example, in Fiscal Year 2013 DOE reduced the number of community college courses that CCI would provide from six programs to three and reduced the number of instructors for these programs from 11 to 6.25, but DOE did not make any adjustment to the Fiscal Year 2013 agreement amount to reflect this reduction.
- **INVOICES WERE NOT BASED ON SERVICES ACTUALLY PERFORMED.** We reviewed monthly invoices related to the letters of agreement that CCI sent to DOE for Fiscal Years 2011 to 2013 and found they are not based on services performed during the period and do not include information on services performed. Instead, they are calculated by allocating the total annual amount that DOE agreed to pay across each month. Further, although the agreements require CCI to submit class rosters, certificates, and enrollment information to receive funding, this information was not submitted with the invoices. In Fiscal Year 2014 CCI began providing DOE with regular enrollment reports for apprenticeship programs. However, these reports were not provided in prior years, and CCI does not currently provide similar information for other training programs funded by the agreements.
- **CCI RECEIVED MONEY FOR PROGRAMS THAT IT DID NOT ACTUALLY OFFER.** DOE agreed to pay CCI \$66,000 in a letter of agreement for

Fiscal Year 2013 to fund a horticulture and landscape technologies community college program for up to 75 inmates. However, DOE staff confirmed that CCI did not provide the course that year. Nevertheless, CCI still received the full \$66,000.

- **CCI RECEIVED MONEY FOR A PROGRAM THAT WAS NOT INCLUDED IN THE AGREEMENT WITH DOE.** Specifically, DOE paid CCI \$50,000 during Fiscal Year 2014 for a training program in print technology that does not fit within the parameters of the letter of agreement for that year. In previous years, CCI had offered a community college-approved course in this field, which was funded through the agreement with DOE, but before the beginning of Fiscal Year 2014, DOE canceled the community college relationship for this course. Nevertheless, CCI continued to offer the print technology course without the community college sponsorship and invoiced DOE for the same amount it had received in prior years even though the letter of agreement for Fiscal Year 2014 states that all programs funded by the agreement “must be approved by the DOE and the Colorado Community College System (CCCS) and/or lead to an industry approved license or certificate, or be actively participating in the DOL [Department of Labor] Apprenticeship Program.” Because the print technology program was offered in-house without approval from the community college system, it was not eligible for funding under the 2014 agreement.

Overall, because of the lack of clear contract deliverables, information on the methodology used to set the contract prices, and invoices documenting the vocational training provided by CCI, we were unable to determine what services DOE received under the agreements and whether CCI provided services commensurate with the \$12 million in revenue it received through agreements with DOE from Fiscal Year 2009 through 2014. Thus, there is a risk that all or part of this revenue was not based on the sale of CCI goods and services as required by statute.

THE DEPARTMENT USED GENERAL FUND MONEY TO PAY FOR SOME OF CCI’S EXPENSES AND PURCHASES. Although the Department and CCI’s

normal practice is for CCI to reimburse the Department for expenses incurred on its behalf, we found several instances where the Department either did not charge CCI for expenses it incurred or used general fund money to pay for CCI expenses:

- **UTILITIES.** The Department pays utility bills for electricity and natural gas usage at all of its facilities, including those used by CCI, and generally bills CCI for its portion of the costs based on usage. The total amount CCI is expected to pay is appropriated each year in the Department's budget request. However, we found that the Department does not charge CCI for utilities at five of the 16 facilities in which CCI conducts operations and does not have a method for determining how much CCI should contribute.

- **WATER RIGHTS AND LAND IMPROVEMENTS.** In July 2013, the Department paid a total of about \$88,000 to meet CCI's growing water needs for crop irrigation and the wild horse program. Specifically, the Department paid \$34,000 for 20 shares of water rights and about \$54,000 on piping and hardware to transport the water into the East Cañon City prison complex for CCI's use. CCI pays annual assessments to the ditch company that manages the rights. However, the initial purchase of the rights and the investment in piping were not paid from the Correctional Industries Account and recorded as a CCI asset in the State's financial system as was the case for other water rights purchases, but rather were paid from the Department's general fund appropriation and recorded as a Department asset.

CCI RETAINED INMATE PAY DEDUCTIONS INTENDED TO OFFSET THE DEPARTMENT'S COST FOR INMATES' ROOM AND BOARD. The Department deducts 20 percent of the pay for inmates who work in a CCI shop that has been certified through the federal Prison Industry Enhancement (PIE) Certification Program. This program, which exempts certified state-run prison industries from federal restrictions on the interstate sale of prisoner-made goods, requires CCI to pay inmates prevailing wages in its PIE program shops, but allows the Department to deduct up to 20 percent for room and board.

According to federal regulators (i.e., the Bureau of Justice Assistance in the Federal Register, Vol. 64, No. 66, April 7, 1999), Congress intends room-and-board deductions be used to “lower incarceration costs otherwise borne by the public.” We found that the Department, which is responsible for authorizing and allocating the deduction under the PIE program, allocated the entire amount, which totaled about \$70,000 in Fiscal Year 2013 and \$90,000 in Fiscal Year 2014, to the Correctional Industries Account, which is used by CCI to fund its operations. Consequently, the Department did not use this money to cover room and board expenses. Further, as a funding source which the Department controls and allocates to CCI without any sale, it is not clear that inmate pay deductions are “derived from the sale of correctional industry goods and services” as required by state statute, and therefore, CCI may not have spending authority for these funds.

WHAT CAUSED THE PROBLEM TO OCCUR?

Overall, these problems occurred because the Department has not implemented clear policies and procedures to ensure that CCI operates as a financially independent enterprise, that revenues CCI receives are tied to goods or services that CCI provides, and that CCI reimburses the Department for all expenses incurred on its behalf. For example, because CCI is viewed by Department staff as an inmate program within the Department, DOE and CCI staff did not observe the same administrative procedures for the annual letters of agreement as would be expected with an outside vendor to ensure that the Department received services commensurate with the funds it provided. CCI management indicated that the education agreement with DOE was established because CCI offers training that is consistent with DOE’s goal of providing offender education programs, but that it would need to significantly reduce its training programs if the Department no longer provided the revenue from the agreements. However, in light of this convergence of goals, management needs to clearly define which training activities are fundamentally part of CCI’s mission, and thus,

should not be reimbursed, versus those that it would not otherwise be expected to perform without payment under a contract for services.

Similarly, for the utilities and water rights, the Department and CCI lacked consistent procedures to determine the amount CCI should reimburse the Department for costs incurred on CCI's behalf. Specifically, the Department reports that it does not charge CCI for utilities at some of its locations because the space that CCI occupies is shared with other programs and the facilities are not equipped with submeters to accurately record CCI's electricity usage. However, for other facilities that lack submeters, the Department has developed models for allocating utilities costs to CCI. Thus, the Department could improve its methods for determining CCI's utilities costs by developing similar models for locations for which CCI is currently not paying.

Further, for the purchase of water rights and piping, CCI and Department management indicated that ultimately the purchase was for the benefit of the Department because the Department wanted to secure water rights for its future needs. Because the Department does not have a present use for the water, it paid for piping and hardware and allows CCI to use the water. However, the Department was not able to provide any planning documents showing when or how it would eventually use the water, and our review of internal Department correspondence indicates that at the time of the purchase, Department staff responsible for processing the transaction were also unclear of how the Department would ultimately use the water and whether Department funds should have been used for the purchase.

According to management, the Department has allocated the PIE program deductions from inmates' pay to be deposited into the correctional industries account because it considers CCI to be a program of the Department and because CCI bears offender-supervision costs that the Department would otherwise bear if CCI were not in existence. Further, management reported that, although it has not sought guidance from the State Attorney General's Office, it believes that this funding is allowable under Section 17-24-113(4),

C.R.S., which requires CCI's operations to be funded by the sale of industry-produced goods and services, because the inmate pay from which the deductions are drawn is funded by CCI's sales. However, given that the revenue CCI receives from the deductions is not directly connected to any specific sales and, unlike other CCI revenue, is contingent on the Department's decision regarding its allocation, it is unclear whether it is allowable as a funding source for CCI. Further, although the federal regulators largely defer to state authorities in determining how the PIE deductions should be spent within corrections departments, Congress intended that the deductions be used to offset the cost of inmates' room and board, which is not paid for by CCI. Thus, if the Department intends to continue allowing CCI to spend the inmate pay deductions, it should seek legal advice from the State Attorney General's Office on whether such use is consistent with state statutes and Congressional intent for the PIE program.

WHY DOES THIS PROBLEM MATTER?

Without adequate controls to ensure that CCI operates as a financially independent entity, there is a risk that Department funds, which largely come from taxpayers through the General Fund, are being used to supplement CCI's revenue. In Fiscal Year 2013, CCI received or retained about \$2.2 million, equivalent to about 3.5 percent of its revenue, from the transactions we identified above related to educational programs, water rights and piping, and inmate pay deductions. In addition, if left unchecked, the financial support CCI receives from the Department could eventually jeopardize its status as an enterprise under Article X, Section 20 of the State Constitution, which prohibits enterprises from receiving more than 10 percent of their annual revenue in the form of grants from state and local governments. Retaining enterprise status is important, because it allows CCI's revenue to be excluded from the determination of whether the State's total revenue is within the limits imposed by the Constitution.

RECOMMENDATION 2

The Department of Corrections (Department) should ensure that the Division of Correctional Industries (CCI) operates as a financially independent entity and that its operational expenses are funded solely by its business activities by:

- A Developing a written policy to clearly define the Department and CCI's financial responsibilities in a manner that ensures that CCI operates as a financially independent entity.
- B Amending the written agreement between CCI and the Division of Education for training programs to ensure that all payments provided under the agreement are for clearly defined training programs that CCI would not otherwise provide.
- C Implementing contract monitoring procedures for the agreement between CCI and the Division of Education to ensure that funding amounts align with actual costs for training programs and that CCI provides agreed-upon, measurable deliverables before receiving payments on invoices.
- D Implementing procedures to ensure that CCI pays or reimburses the Department for all CCI expenses, including for utilities and capital investments, such as water rights acquisitions and improvements to land.
- E Seeking guidance from the State Attorney General's Office on whether the current practice of using room-and-board deductions taken from the wages of inmates working in industries certified by the federal Prison Industries Enhancement Certification Program to fund CCI operations is consistent with state and federal law, notwithstanding the concerns raised in this report, and if necessary, changing its practice to comply with all applicable laws.

RESPONSE

DEPARTMENT OF CORRECTIONS

A AGREE. IMPLEMENTATION DATE: DECEMBER 2015.

The Colorado DOC and CCI will establish an Administrative Regulation as part of either the Administrative or Industries series to define the responsibilities of each party as pertains to budgetary and financial transactions between the two parties. Such a policy would also recognize the unique nature of the relationship that exists between the Colorado DOC and CCI.

B AGREE. IMPLEMENTATION DATE: MARCH 2015.

CCI believes the training and apprenticeship programs covered by the contract with the DOC Division of Education are clearly beyond the statutory mission defined in Title 17, Article 24 of the Colorado Revised Statutes. CCI will include clearly defined terms in the written agreements between CCI and the Division of Education that explain basic training covered by the essential components of CCI's mission, versus those that require monies to provide additional resources to meet the numerous requirements of advanced inmate training and apprenticeship programs.

C AGREE. IMPLEMENTATION DATE: JUNE 2015.

CCI fully agrees with this recommendation and, in conjunction with the DOC Division of Education, has already initiated tracking procedures to ensure that contract funding aligns with the expectations of both parties. The new contract for FY 2014-15 was expanded to include tracking procedures that require measurable deliverables that will be included with monthly and quarterly invoices.

D AGREE. IMPLEMENTATION DATE: JUNE 2015.

The Colorado DOC and CCI believe that historically this recommendation has been fulfilled except in a limited number of

instances. Both parties will review the exceptions noted in the audit narrative and determine how to correct such oversights. The Colorado DOC and CCI will also review the allocation method for the Department's utilities to determine if a more accurate method exists to ensure that CCI reimburses the Department for utilities costs incurred on its behalf.

E AGREE. IMPLEMENTATION DATE: MARCH 2015.

CCI will seek guidance from the State Attorney General's Office on whether the current policy and practice on inmate pay deductions is consistent with State statutes and Congressional intent for the PIE program. The Department will submit a report narrative to the Attorney General's office some time during the first quarter of 2015 but has no control over how quickly an opinion will be forthcoming. The Department will then make changes as necessary based on guidance received from the State Attorney General's Office.

REPORTING TO STAKEHOLDERS

Much like a private corporate entity, CCI is required to report on its performance on a regular basis. Specifically, recognizing the need for transparency and for outside input into CCI's business planning, the General Assembly established several requirements for CCI to report its performance to the Advisory Committee, the Joint Budget Committee (JBC), the Governor, and other policymakers. This reporting includes both financial statements and information on CCI operations, such as the number of inmates employed, proposed business ventures, and the types of products it produces.

WHAT AUDIT WORK WAS PERFORMED AND WHAT WAS THE PURPOSE?

We examined CCI's financial and performance reporting during Fiscal Year 2014 to determine whether CCI provides sufficient information to stakeholders. We reviewed CCI's annual reports for Fiscal Year 2013, the Department's budget request for Fiscal Year 2015, and business proposals it provided to the Advisory Committee between July 2010 and January 2014, as well as Advisory Committee meeting minutes from July 2010 through August 2014. We also examined information that is publicly available on CCI's website, reviewed CCI's policies and procedures regarding reporting financial information, and interviewed staff on reporting practices.

HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

Statute and CCI's policies require that CCI regularly report financial and performance information to policymakers and inform the Advisory Committee of its operations and any new business ventures it is considering. As discussed below, these required communications

take the form of regular financial reports, budget requests, and new business proposals.

REGULAR FINANCIAL REPORTS. Section 17-24-113(6), C.R.S., requires CCI to “make regular reports, including monthly operating statements and annual financial reports, to the governor, the joint budget committee, and the office of state planning and budgeting regarding the financial operation of the Division.”

BUDGET REQUESTS. Section 17-27-113(7), C.R.S., requires CCI to submit an annual budget—which is ultimately incorporated into the budget request that the Department sends to the Governor’s Office of State Planning and Budgeting (OSPB) and the JBC—to the Advisory Committee for review. Statute [Sections 17-24-111(2)(b) and 113(7), C.R.S.] further requires CCI’s budget to contain the following specific information:

- The value of all goods and services sold to each state agency;
- Proposed industry products and services to be produced by CCI during the upcoming fiscal year and their prices;
- Past, current, and expected number of offenders employed in each program and at each institution;
- Past, current, and expected production levels, sales revenues, operating expenses, profits, and reversions to the General Fund;
- Payment rates for financial incentives paid to CCI staff;
- Past, current, and expected staff personnel;
- Capital requirements for equipment and facilities;
- All budgetary schedules, forms, and other information required by the JBC.

BUSINESS PROPOSALS AND CHANGES. In addition to reviewing CCI’s budget, statute (Sections 17-24-104, 121, and 122, C.R.S.) tasks the Advisory Committee with considering the feasibility of new CCI industries, the effect such industries will have on similar businesses already established in the state, and the advisability of entering into venture agreements with private parties for the use of inmate labor. The Advisory Committee then makes recommendations to the CCI

director on whether to move forward with proposed businesses and venture agreements. To support the Advisory Committee's work, CCI's policies require that it provide written business proposals that include the following:

- Anticipated market, volume, and potential impact on private sector competitors.
- Number of staff and inmates to be employed.
- Projected revenue and expenditures over a three-year period.
- Information on the potential for post-release employment for participating offenders.

In addition, CCI's policies require that it inform the Advisory Committee when it decides to close a shop or make significant changes to its operations.

WHAT PROBLEM DID THE AUDIT WORK FIND?

Overall, we found that CCI does not report all of the information to policymakers that is required by statute and its own policies, and reports insufficient information related to its shops' financial performance.

CCI DID NOT REPORT STATUTORILY REQUIRED INFORMATION. We found that CCI does not report everything that statute requires to be included in regular financial statements to the governor, the JBC, and OSPB. Additionally, much of the information that statute requires CCI to include in the Department's budget request was not included in the Fiscal Year 2015 request. When we inquired with staff about the missing items, we were directed to CCI's annual report and its product catalog for some items, both of which are publicly available on CCI's website. However, upon examining these other media along with the Department's budget request, we found the following items were not reported at all:

- **MONTHLY OPERATING STATEMENTS.** CCI only reports *annual* financial statements in its annual reports and has not provided monthly operating statements to the governor, the JBC, and OSPB, as required.
- **EXPECTED NUMBER OF OFFENDERS EMPLOYED IN EACH SHOP.** CCI’s annual reports show employment levels by shop during the preceding year but do not indicate whether the numbers are expected to change in the coming year.
- **PAST, CURRENT, AND EXPECTED PRODUCTION LEVELS.** CCI does not report production levels for any of its industries, such as the number or value of finished goods produced, hours of service provided, or the yield of agricultural operations.
- **EXPECTED SALES REVENUES, OPERATING EXPENSES, AND PROFITS.** CCI’s annual reports include fund-level financial statements for the prior two fiscal years, but do not show expected values for future fiscal years.
- **PAST, CURRENT, AND EXPECTED REVERSIONS TO THE GENERAL FUND.** Staff report that, with the exception of payments to the Department to cover allocated administrative expenses and indirect cost recoveries, CCI has not transferred any money to the General Fund in recent years. However, although CCI’s annual reports show how much was transferred to cover allocated Department expenses, the reports do not clearly indicate that none of the money transferred was in excess of appropriated expenses or came from CCI’s profit. This lack of reporting is not consistent with the General Assembly’s declared intention in statute [Section 17-24-102(1)(a), C.R.S.] that the Division be an entity that “is profit-oriented” and “partly reimburses the General Fund for the expense of correctional services.”

FINANCIAL REPORTS FOR THE CANTEEN FUND LACKED INFORMATION NECESSARY TO DETERMINE PROFITABILITY. We found that CCI’s financial reporting is insufficient for assessing the profitability of its canteen operations. Specifically, CCI’s annual reports include financial statements for the enterprise fund that CCI uses for the canteen.

However, this fund, which is called the “Canteen, Vending Machine, and Library Account,” is also used by a number of educational and recreational inmate benefit programs that are administered by the Division of Education, and the financial statements do not clearly indicate the financial activity that is attributable to these programs. Specifically, some of the programs earn revenue—for example by selling craft supplies to the inmates—that is not reported separately from CCI’s revenue from canteen sales. Further, although the statements show expenses labeled as “offender benefits,” the educational programs have additional expenses that are not included in this line but are rather reported as operating expenses along with CCI’s canteen expenses. The net effect of this activity is that the fund balance was increased by about \$217,000 in Fiscal Year 2013 due to transactions not related to the canteen. Consequently, it is not possible to ascertain the profitability of CCI’s canteen operations from the fund’s financial statements alone.

CCI DID NOT PROVIDE THE ADVISORY COMMITTEE WITH COMPLETE INFORMATION IN BUSINESS PROPOSALS OR NOTICE OF CHANGES TO BUSINESS OPERATIONS. We found that CCI does not include all of the information required by its policies in the business proposals it submits to the Advisory Committee for review. Specifically, we reviewed the 17 business proposals that CCI had retained on file out of the 26 new businesses considered by the Advisory Committee between July 2010 and January 2014 and found that none of the proposals included all of the required information. For example, none of the proposals included statements on the potential impact on private sector competitors, and only one gave information on the potential for post-release employment for participating offenders. Additionally, although nearly all the proposals included projections of revenue and expenditures, only two of the 17 showed projections beyond the first year.

We also found that, contrary to its policy, CCI does not always inform the Advisory Committee when it decides to close a shop or significantly change operations. For example, CCI management did not inform the Advisory Committee when it decided to close the

plastic bag manufacturing shop in June 2013. Also, as of the August 2014 meeting, management did not return to the Advisory Committee to report on the progress of 16 of the 26 venture agreements (62 percent) it approved between July 2010 and January 2014, even though five of them never went into operation and were eventually abandoned.

WHAT CAUSED THE PROBLEM TO OCCUR?

CCI relies on its annual reports and budget requests to supply much of the information that statute requires, and according to management, CCI does not provide all of the required information because it would be cumbersome and because it is not clear that all of the information is needed by the public or policymakers who receive CCI's reports. Although we recognize that it may be cumbersome to include some information—such as CCI's entire product catalog—in its budget request document or annual reports, CCI needs to report everything that statute requires or clarify with policymakers what information is needed and seek statutory change accordingly.

CCI also lacks a process to ensure that the Advisory Committee is informed of the ongoing performance of industries it has approved, including those that were closed or were approved but never became operational. Based on our review of Advisory Committee meeting minutes from Fiscal Years 2011 through 2014, although CCI presents all new business opportunities for approval, it only provides follow-up information on the performance of approved businesses on a sporadic basis and does not provide any information on most of its businesses once they are approved. CCI staff report that they do not provide updates on all approved businesses due to the constraints of time for Advisory Committee meetings, lack of inquiries from Advisory Committee members, and the fact that such updates are not explicitly required by statute. However, CCI's written policy requires that it notify the Advisory Committee of any significant changes to any operation. Moreover, CCI has a responsibility to supply the Advisory

Committee with sufficient information so that the Advisory Committee can perform its statutory duty and make informed judgments about the likelihood of success for proposed businesses and venture agreements and their potential impact on private businesses.

WHY DOES THIS PROBLEM MATTER?

It is important for policymakers to have access to complete information about CCI's fiscal health and performance in order to know whether it is accomplishing its mission, is financially stable, and returns sufficient benefits to the State without negatively affecting other private-sector businesses. Because CCI does not currently report required information, such as production levels; expected sales revenue, expenses and profits; and current and expected reversions of profits to the General Fund, policymakers lack information necessary to fully assess its fiscal health and anticipate changes in its business performance that could result in increased or decreased costs to the State.

The Advisory Committee, in particular, needs complete information on CCI's financial performance and operations in order to make informed recommendations on new proposals. Because CCI does not provide information on the potential effect of new business ventures on existing businesses in the state and on the progress of recently approved venture agreements, the Advisory Committee's ability to assess new proposals is reduced.

RECOMMENDATION 3

The Division of Correctional Industries (CCI) should improve its reporting practices by:

- A Reporting all statutorily required information in its budget requests, annual reports, and financial reports. If CCI management believes that some of the required information is not necessary, it should clarify with policymakers who receive the reports what information is needed and seek legislative changes accordingly.
- B Providing the Correctional Industries Advisory Committee (Advisory Committee) with information required by its policies, including information to evaluate proposed new industries and notice of major changes to existing operations, such as closures. In addition, CCI should provide the Advisory Committee with regular updates on each of its businesses and follow-up reports on approved business proposals and venture agreements.

RESPONSE

DEPARTMENT OF CORRECTIONS

- A AGREE. IMPLEMENTATION DATE: JULY 2016.

After consultation with relevant policymakers including members of the CCI Advisory Board to determine whether all reporting requirements contained in current statute are still necessary, CCI management will seek to address any potential changes through legislation as needed. During the interim, CCI will provide information to the CCI Advisory Board and the DOC as required by current statute. In light of current reporting issues with CORE including the production of any type of profit and loss statements, a new format for CCI's Annual Report may not be feasible until FY 2015-16. However, CCI management supports the recommendation

and will work to rectify any reporting deficiencies by the end of the fiscal year or during the next budget submission cycle.

B AGREE. IMPLEMENTATION DATE: APRIL 2015.

While some of the items mentioned in this recommendation are not required by statute, CCI management agrees that these are best practices in helping the Advisory Board members meet their designated responsibilities and will begin instituting them at the CCI Advisory Board meeting in April 2015.

INMATE PAY

According to statute, CCI has discretion to determine how much it pays inmate workers, and CCI management reports that it is important to set pay rates that incentivize the development of skills and productivity among the inmate work force. Therefore, its approach has been to base a significant proportion of inmates' pay on inmate skill levels and the amount of goods or services produced or performed within each shop. Specifically, CCI's inmate wage policy sets a base rate of \$.66 per day (increased from \$.60 per day in December 2014) and then provides for additional incentive pay as follows:

- **INCENTIVES BASED ON SKILL OR RESPONSIBILITY LEVEL.** Several shops pay tiered rates according to the workers' skill level or job assignment, for example, line worker versus lead worker. In most shops, this incentive pay can range from \$.30 to \$.90 per day added to the base rate.
- **INCENTIVES BASED ON PRODUCTIVITY.** Production incentive plans vary based on the type of industry; however, most shops incentivize production by creating a pooled amount based on monthly production levels achieved by the shop and then dividing the pool among the workers according to the number of days worked.

Once payments for victims' restitution and incarceration costs have been deducted, the inmates' pay is deposited into personal accounts maintained by the Department. Inmates can use these funds to purchase canteen items, such as snacks, toothpaste, hobby supplies, and phone system time. Inmates are also able to save money, which is available to them when they are released. During Fiscal Year 2014, CCI expended about \$1.7 million on inmate pay.

WHAT AUDIT WORK WAS PERFORMED AND WHAT WAS THE PURPOSE?

The purpose of the audit work was to determine whether the methods CCI uses to set inmate wages comply with federal and state standards, as well as Department and CCI policies governing inmate pay. We examined payroll reports for 32 of CCI's 40 industries and canteen shops during May 2014, excluding industries that are certified under the federal PIE program, which requires wages be paid at prevailing rates for similar work in the locality. As part of our analysis we compared the total amounts and rates paid to inmates, inclusive of both base pay and bonuses for skill and production in different shops. We also interviewed staff and reviewed the Department and CCI's inmate wage policies to understand the methods the Department and CCI use to set inmate wages.

HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

According to statute [Section 17-24-114(2), C.R.S], CCI's director is responsible for setting the wage rates for inmates who work within CCI. As required, CCI has established an inmate wage policy "to provide a uniform and equitable process for payment to inmates employed by the Division." The policy states that its goal is to set wages "to promote the peak proficiency of the inmate workforce."

According to CCI policy, shop supervisors annually create incentive pay plans, which must be approved by the CCI director and a committee of CCI managers. The incentive pay plans for each shop detail the tier structure for skill-level pay, how production incentive bonuses will be calculated, how long inmates must be employed to be eligible for incentive pay, and any exclusions or deductions that will be applied in the event of disciplinary actions. In addition, CCI does not have a formal policy on the amount an average inmate should be paid, but CCI managers report they intend annually to adjust wages and bonus pay rates in each shop so that an average inmate who

exhibits an average rate of production efficiency will earn about \$100 per month.

Based on CCI's inmate wage policy, we evaluated wage rates for CCI's inmate workers to determine (a) whether they are based on a uniform and equitable process across CCI's various shops and (b) whether they are designed to effectively achieve CCI management's goal of incentivizing production.

WHAT PROBLEM DID THE AUDIT WORK FIND?

Overall, we found that inmate pay rates vary significantly across shops and may not be optimal for incentivizing productivity. Specifically, based on our analysis of inmate pay data for the month of May 2014, we found that average wages, inclusive of incentive pay, ranged from \$1.09 to \$12.03 per day. Exhibit 2.5 illustrates the variance in wages for the 32 shops we analyzed.

EXHIBIT 2.5. AVERAGE INMATE WAGES BY SHOP MAY 2014	
AVERAGE DAILY WAGE	SHOPS
\$12.03	Modular Office Systems
\$9.37	Seating & Refurbishing
\$7.60	Garment Factory – Limon
\$6.30	Printing Services
\$5 - \$5.99	5 shops, including Fleet Services and Metal Fabrication
\$4 - \$4.99	4 shops, including Furniture and Dairy Processing
\$3 - \$3.99	14 shops, including Greenhouse, Dairy, License Plates, Wildland Firefighting, and Wild Horse Program
\$2 - \$2.99	4 shops, including Northern Canteen and Canine Training Program
\$1.09	Culinary Service – Rifle
SOURCE: Auditor analysis of inmate pay records provided by CCI.	

Based on the rates shown above, in some shops inmates working every day earned as little as \$24, on average, during the month while in other shops inmates earned as much as \$265. Although CCI is not required to pay equal wages to all inmates, this wide variance

indicates they are not based on a uniform and equitable process as intended by CCI's policy. In addition, the average wage paid to inmates across all the shops was \$3.95 per day, which—based on 22 workdays for the month of May—equates to about \$86.90 per month, or 13 percent less than CCI's target rate of about \$100 per month. Further, among the 32 shops we analyzed, 21, or two-thirds, paid wages less than the target rate.

According to management, although daily wages can vary significantly across shops for any given month, its understanding is that productivity pay in each shop tends to fluctuate such that pay rates across shops become more even over the course of the year. For example, inmates in the firefighting shop tend to earn less in May than in the peak summer wildfire season. Thus, the information we present in the table may not be indicative of inmate pay over the course of the entire year. However, as we discuss in the following section, management could not provide information showing whether the shops' wages for inmates tend to become more equal over time or whether they continue to exhibit the level of variance we observed for the month of May.

WHAT CAUSED THE PROBLEM TO OCCUR?

We found that the reports used by CCI management to monitor inmate pay do not provide enough information to determine average daily or hourly wage rates. For example, management's report for the seating and refurbishing shop in May 2014, which is in the same format as reports it generates each month for all shops, provides the following information on inmate wages:

- The highest paid inmate in the shop earned a total of \$225.82 and worked 15.5 days.
- The lowest paid inmate in the shop earned a total of \$11.10 and worked 11 days.

- The average inmate in the shop earned a total of \$144.22, and no information on the average or total number of days worked is provided.

Because the report does not provide more detailed information, such as the average number of days worked, it is not possible to determine the average rate of pay from this report alone. Further, the report does not indicate how many inmates were paid at the highest and lowest rates in each shop or how much of their pay was composed of skill-level bonuses or production incentives, which constitute the bulk of CCI's inmate pay. Thus, there is no way to compare the shops' actual pay incentives or to track changes within a shop over time using these reports. Although we were able to compile averages for the month of May based on hardcopy payroll reports for each inmate, the process was time-consuming and would not be feasible for CCI to conduct on an ongoing basis.

According to management, the monthly wage reports lack information on average daily wages and incentive pay because the Department's information system used to generate monthly pay reports cannot extract this information. Further, CCI management reported that it does not attempt to set even wage rates across shops. Instead, CCI management has delegated authority for managing inmate wages to the individual shop supervisors and relies on the supervisors to use wages to incentivize productivity. In addition, some pay differences may be attributable to custody levels, the difficulty of the job, and seasonal factors that increase the workload in some shops. Although there are likely practical reasons to pay different rates from shop to shop and allow shop supervisors some flexibility to manage wages within their shops, without centralized coordination and monitoring, CCI management has no means of ensuring that the wages it actually pays are consistent with its goal of achieving "peak proficiency" within its inmate labor force and making adjustments to shops pay plans when it does not achieve pay rates that it considers ideal for productivity.

WHY DOES THIS PROBLEM MATTER?

By not monitoring average inmate pay rates, there is a risk that CCI is not efficiently using the \$1.7 million it expended on average annually for Fiscal Years 2012 through 2014 on inmate wages to incentivize production and promote “peak proficiency of the inmate workforce” as intended by its policy. Although management monitors the total monthly pay of inmates, as a measurement, the average daily or hourly wage rate is more precise, especially because the number of days inmates work in a month can vary widely. Ultimately, if some inmates are underpaid relative to others, they may lack sufficient incentives to maximize production or may be receiving more incentive pay than necessary. For example, an inmate who makes \$1.09 per day, which was the average for one shop in our analysis, would receive only \$.49 per day of incentive pay based on productivity and skill in addition to the \$.60 per-day base rate that was in place at the time of our analysis, which might not be enough to encourage high productivity. Conversely, an inmate making \$12.03 per day would receive \$11.43 per day in incentives and would make the equivalent of \$265 per month, which may be more than necessary considering CCI management’s target rate of \$100 per month.

RECOMMENDATION 4

The Division of Correctional Industries should ensure that its inmate pay plan is uniform and equitable by:

- A Working with the Department of Corrections to modify its information system or developing an alternative method to capture average incentive pay and average daily or hourly wages paid to inmates in each shop.
- B Implementing a policy and regular process for monitoring the average wages paid in each shop to ensure that actual wages are cost-effective and provide appropriate incentives to promote efficient production and inmate proficiency and that any variations between the wages paid by the shops are aligned with this goal.

RESPONSE

DEPARTMENT OF CORRECTIONS

- A AGREE. IMPLEMENTATION DATE: APRIL 2015.

It is agreed that a system should be developed and installed to capture average incentive pay and daily or hourly wages paid to offenders in each shop. A method outside of the current offender payroll system will be developed initially until such time as the Department of Correction's information systems can be updated for a more permanent solution.

- B AGREE. IMPLEMENTATION DATE: JULY 2015.

The Division will incorporate information provided by processes developed pursuant to PART A into our quarterly and annual business planning review.

COMPETITION WITH PRIVATE-SECTOR BUSINESSES

Statute (Section 24-113-101 et seq., C.R.S) generally prohibits state agencies from selling goods or services to the public that are also being offered for sale by private businesses. However, Section 24-113-103(3)(b), C.R.S., grants CCI an exception to this prohibition, authorizing it to sell to the public and to compete directly with private enterprises as long as it sells its products at market price. This exception increases the variety of industries CCI can operate and provides greater opportunities for CCI to employ and train inmates and to offset inmates' incarceration costs. Revenues from the private sector and other non-state sources comprised 41 percent of CCI revenue in Fiscal Year 2014 and totaled about \$19.1 million. Exhibit 2.6 shows CCI revenue from all non-state sources during Fiscal Year 2014.

EXHIBIT 2.6. REVENUE FROM NON-STATE SOURCES BY SHOP ¹ FISCAL YEAR 2014 (THOUSANDS)		
SHOP	REVENUE	PERCENT
Dairy ²	\$4,915	27%
Wild Horse Program ³	\$3,789	21%
International Correctional Management Training Center ⁴	\$1,880	10%
Office Furniture, Seating, and Systems	\$883	5%
Metal Fabrication	\$671	4%
Saddles & Leather Products	\$632	4%
Goat Dairy	\$616	3%
Surplus State Property	\$609	3%
Canine Training	\$503	3%
Other Shops and Operations ⁵	\$4,647	20%
TOTAL	\$19,145	100%

SOURCE: Auditor analysis of COFRS data.

¹Includes revenue from federal and local government agencies, non-profits, private venture partners, and the general public.

²Primarily sales to Dairy Farmers of America.

³Primarily contract revenue from U.S. Bureau of Land Management.

⁴Primarily contract revenue from U.S. State Department.

⁵Includes revenue from 24 other shops.

Although a substantial portion of CCI's revenue comes from private sector sales, according to management, several of its shops, such as the water buffalo dairy and the tilapia farm, were established in industry sectors for which there are few private sector competitors in the state. Further, management often works with private-sector businesses to form venture partnership agreements that are mutually beneficial. Under these agreements, CCI generally relies on a private sector partner to provide equipment and materials, and CCI provides inmate labor and workspace for the business in exchange for payments based on inmate work hours or the volume of products produced.

In addition to CCI selling to the private sector, the Department's Division of Education (DOE) administers several career and technical education programs within the prison facilities that produce and sell goods and services to the public on a limited basis. These programs, which are not affiliated with CCI, provide work opportunities for inmates who are enrolled in either apprenticeships or training courses sponsored by the community college system. Since these programs have a business-like aspect similar to CCI and bear similar risks with respect to competition with private enterprises, we included these programs in our evaluation.

WHAT AUDIT WORK WAS PERFORMED AND WHAT WAS THE PURPOSE?

The purpose of our audit work was to determine whether CCI has adequate procedures to ensure that it does not improperly compete with private businesses. To assess the pricing of its products we evaluated whether CCI (a) uses reasonable methods for pricing its goods and establishing reimbursement rates that it charges venture partners for the use of inmate labor and facility space to ensure such prices and rates cover production costs and generate profits and (b) sets prices that fairly reflect the market for similar goods of similar quality.

We selected a judgmental sample of 12 products that CCI offers on its website, sells to non-state customers, or produces for private companies through venture agreements. Specifically, we reviewed pricing information for the following products: custom kitchen cabinets, specialized wood products, goat's milk, cow's milk, waste dumpsters, a large aquaculture tank, granite paving stones, air filters, aprons, dog houses, flags, and file cabinets. For each product in our sample for which there were comparable products being sold by private sector companies or established market prices, we compared CCI's prices with market prices. For products that were customized for a specific customer or venture partner and for which market prices were not available, we reviewed the method CCI used to set the price or reimbursement rate. For two products, the custom kitchen cabinets and specialized wood products, we interviewed CCI's customers and principal competitors. In addition, we reviewed CCI's policies for starting new businesses and setting prices and reviewed Advisory Committee meeting minutes from July 2010 through August 2014 to assess CCI's procedures for seeking the Advisory Committee's recommendations on new businesses that might compete with private-sector businesses. Because CCI was authorized through Section 24-113-103(3)(b), C.R.S., to sell goods and services to the public, we did not evaluate the effect of such sales on private businesses in the state.

We also examined financial data from the state's accounting system to identify products and services that were sold to the public by career and technical education programs not affiliated with CCI. We interviewed Department staff to gain an understanding of the types of products and services that are being sold through these programs and the programs' purposes. We also reviewed state statute and Department regulations to evaluate whether the Department has authority for conducting such sales outside the purview of CCI.

HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

We evaluated CCI's methods for setting prices and reimbursement rates according to three criteria:

- **PRICES SHOULD REFLECT THE MARKET.** Statute requires CCI to set prices for its industry products that are “as near the prevailing market prices for similar goods and services and quality as is practical.” Statute goes on to specify that “such prices, other than prices for agricultural products, shall not exceed the wholesale market prices for like articles and products in the case of sales to the state or its political subdivisions or the *prevailing retail market prices* for like articles and products *in the case of sales to the general public*” [Section 17-24-112(1), C.R.S., emphases added]. Accordingly, Department policy requires CCI's prices for goods and services sold to the general public to “be as close as possible to the prevailing retail market price of similar products and services in the private sector.”
- **PRICES AND REIMBURSEMENTS SHOULD GENERATE PROFITS.** As stated previously, the General Assembly intends for CCI to be “profit-oriented” and to operate its industries “on a thorough-going business basis” [Sections 17-24-102(1) and 113(2), C.R.S.]. Therefore, like a private business, we expect CCI to price its products and services above cost with the goal of generating a profit.
- **THE ADVISORY COMMITTEE MUST MAKE RECOMMENDATIONS ON ALL NEW CCI BUSINESSES.** Statute [Section 17-24-104(3)(a), C.R.S.] requires the Advisory Committee to consider the potential impact of any proposed new CCI industry on existing private businesses in the state and make recommendations to CCI on the feasibility of the business.

In addition, we evaluated whether the Department's policies and practices for vocational programs within DOE comply with statute (Section 24-113-103, C.R.S.) which prohibits state agencies from “engag[ing] in the manufacturing, processing, sale, offering for sale,

rental, leasing, delivery, dispensing, distributing, or advertising of goods or services to the public which are also offered by private enterprise unless specifically authorized by law.” Statute further prohibits agencies from circumventing this restriction by using another state or local agency to offer goods or services to the public.

WHAT PROBLEM DID THE AUDIT WORK FIND AND WHAT CAUSED IT TO OCCUR?

For all 12 of the products and venture agreements we reviewed, we found no evidence that CCI is charging significantly above or below market prices. For example, CCI sells cow’s milk, which is a traded commodity, to the Dairy Farmers of America precisely at prevailing market prices. Additionally, we found that for five of the products, which are shown in the Exhibit 2.7, CCI’s prices were comparable to the range of prices offered by private retailers.

EXHIBIT 2.7. CCI PUBLISHED PRICES COMPARED TO MARKET PRICES DECEMBER 2014		
PRODUCT	CCI PRICE	PRIVATE RETAILER MARKET RANGE
File Cabinets	\$655	\$579 - \$864
Dog Houses	\$209	\$204 - \$290
Flags	\$58	\$56 - 65
High Capacity Pleated Air Filters	\$4.02	\$3.80 - \$8.17
Work Aprons	\$2.10	\$1.98 – \$3.95

SOURCE: Office of the State Auditor review of CCI website and prices available from private sector retailers.

Market prices were not available for the remaining six products we reviewed because the products were customized to meet the needs of a specific customer or were sold under the terms of a venture partnership. For these products, we reviewed CCI’s pricing methods and found that CCI had accounted for both production costs and expected profits for each product.

However, we also found areas for improvement. As discussed in RECOMMENDATION 1, CCI does not fully allocate all of its overhead costs to each shop and has not established any long-term profitability targets. As a result, CCI's calculations of production costs for these types of goods and services may be understated. Therefore, as it implements RECOMMENDATION 1, CCI should adjust the overhead cost rates it uses and account for profitability targets in its pricing formulas to ensure it will earn a profit on the goods and services the shops sell.

In addition to the issues discussed in RECOMMENDATION 1, we identified two other concerns related to sales of goods and services to the private sector.

CCI DID NOT PROVIDE THE ADVISORY COMMITTEE WITH INFORMATION ON THE IMPACT OF NEW CCI BUSINESSES ON THE PRIVATE SECTOR. Although Section 17-24-104(3)(a), C.R.S., requires the Advisory Committee to consider the potential impact of any proposed new CCI industry on existing private businesses in the state, as discussed in RECOMMENDATION 3, we found CCI does not provide the Advisory Committee with information in its business proposals to permit this evaluation. In the 17 business plans we reviewed (all the plans CCI had on file for the 26 new businesses proposed from July 2010 through January 2014), none contained any information on the possible effect of the proposed business on the private sector.

PRISON EDUCATIONAL PROGRAMS SELL GOODS AND SERVICES TO THE PUBLIC IN VIOLATION OF STATUTE. As indicated in Exhibit 2.8, we identified nine educational programs not administered by CCI that earned revenue through sales to the public during Fiscal Year 2014. Although Department policy limits these sales to Department employees, contractors, non-profit entities, and state officials, it lacked specific statutory authorization, as required by Section 24-113-101, et seq., C.R.S., to make the sales.

EXHIBIT 2.8. REVENUE FROM SALES TO THE PUBLIC FOR DOC'S CAREER AND TECHNICAL EDUCATION PROGRAMS FISCAL YEAR 2014		
PROGRAM	LIVE WORK PROJECT EXAMPLES	REVENUE FROM PUBLIC SALES ¹
Culinary Arts	Cafeteria and snack bar, cakes and desserts, meals for off-site functions	\$ 237,975
Auto Body	Damage repair, windshield replacement	\$ 15,027
Welding	Repair and modifications of bed rails, window well covers, flatbed trailers, patio furniture, fire pits	\$ 12,649
Cosmetology	Hair and beauty salon	\$ 7,517
Construction Technology & Carpentry	Cabinets, blanket chests, rocking horses, headboards, toy trains	\$ 5,676
Upholstery	Chairs, recliners, car seats	\$ 1,656
Horticulture	Centerpieces, corsages, plants	\$ 1,447
Machine Shop	Metal work	\$ 1,076
Electronics	Power cords and equipment repair	\$ 139
TOTAL		\$ 283,163

SOURCE: Auditor analysis of financial data from COFRS.
¹ Excludes sales to inmates and state agencies.

As shown, the culinary arts program had the highest volume of sales to the public. This is largely due to the existence of three cafeterias at the Sterling, Arkansas Valley, and Colorado Territorial Correctional Facilities. According to staff, the cafeterias' primary customers are correctional officers and DOC staff members who purchase lunches during the work day. However, the cafeterias also sell food items that can be taken off-site for personal consumption or for catering non-state functions. Other programs offer services such as auto body work, upholstering and welding for customers' personal property.

Recognizing statute's prohibition on state agencies selling goods and services to the general public, the Department established a policy restricting the customers for vocational program sales to Department employees, contractors, non-profit organizations, and state officials. Although the intent of this policy is to avoid sales to the public, the sales we identified were made to individuals in their personal capacity, as members of the public, and not as part of their employment or professional relationship with the Department. Also, authorizing sales to such a broad group may not effectively limit the potential for competition with private sector businesses, which is the intent of Section 24-113-101, et seq., C.R.S.

According to Department staff, its vocational training courses are focused on providing educational opportunities for inmates, as opposed to seeking outside revenue sources, and the Department has received an appropriation for the revenue it receives from its training programs. Further, the ability to sell products to customers enables the programs to provide inmates with training that will assist them in finding employment upon release. For example, operating a cafeteria provides inmates with customer service and food preparation experience that would not be possible outside of a retail environment. Thus, the Department's career and technical education programs operate in a manner similar to some vocational programs offered by community colleges that sell items to the public on a limited basis and are approved under the community college system. However, unlike the Department, community colleges have been specifically authorized by statute (Section 24-113-104, C.R.S.) to sell products and services. For example, statute [Section 24-113-104(1)(a), C.R.S.] allows all institutions of higher education to provide goods and services through competitive bidding to "students, faculty, staff, and invited guests" when such provision "offers a valuable educational or research experience for students as a part of their education or fulfills the public service mission of the institution of higher education." Therefore, in order to continue its vocational programs in their current form, the Department needs statutory authorization similar to that provided to institutions of higher education or will need to transfer the programs to CCI.

WHY DOES THIS PROBLEM MATTER?

With respect to CCI not providing information to the Advisory Committee on the potential effect of new CCI businesses on existing private businesses in the state, the lack of such information limits the Advisory Committee's ability to evaluate and make recommendations on new business proposals, as intended by statute.

With respect to sales to the public by the Department's vocational training programs without legal authorization, such sales may deprive private businesses of opportunities that they might otherwise have, especially since these sales are not subject to the same controls, such as market pricing and approval by the Advisory Committee, that are in place for CCI. The legal restrictions on such sales by state agencies are designed to protect private businesses from competition with the government in the marketplace. Specifically, the Department policy for goods and services sold through its vocational training programs provides that prices should be calculated by adding 120 percent of the cost of any materials and a labor charge of \$0.15 per hour. In contrast, CCI generally must sell its products at market price. Thus, it is possible, especially for labor-intensive work, that the prices established for goods and services sold through the vocational training programs would be lower than those that could be offered by CCI or private businesses in the state. For example, when the upholstery technology program at Sterling Correctional Facility reupholstered armchairs for a DOC employee in July 2014, it charged only \$35.10 for 234 hours of labor, which is clearly lower than a professional would charge, even if the job could be done in less time. Although the problematic sales we identified within the Department's vocational training programs were for relatively small amounts, by seeking statutory approval, as well as guidelines on pricing, for selling goods and services from its vocational training programs on a limited basis—or, alternatively, moving the programs to CCI—the Department can ensure that it is operating in accordance with the General Assembly's intent and is mitigating the risk of unfair competition with businesses in the state.

RECOMMENDATION 5

The Department of Corrections (Department) and the Division of Correctional Industries (CCI) should ensure that they do not improperly compete with the private sector by:

- A Including in all new CCI business plans and venture agreement proposals information analyzing the possible effect of the new business or agreement on private sector businesses in the state and providing such information to the Correctional Industries Advisory Committee to use in evaluating the proposals in accordance with statute.
- B Working with the General Assembly to establish appropriate statutory authority and pricing guidelines for selling inmate-produced goods and services through the Department's vocational and educational training programs not currently administered by CCI or, alternatively, moving these programs into CCI.

RESPONSE

DEPARTMENT OF CORRECTIONS

- A AGREE. IMPLEMENTATION DATE: APRIL 2015.

It is agreed that all new business plans and venture agreement proposals provided to the Correctional Industries Advisory Committee shall include written information regarding the possible effect on private sector business within the state.

- B AGREE. IMPLEMENTATION DATE: MAY 2016.

It is agreed that the Department of Corrections, the DOC Division of Education, and CCI need to establish appropriate statutory authority and pricing guidelines for selling inmate produced goods and services through its vocational and educational programs and will work with

the General Assembly accordingly. The Department will review this recommendation to determine its best course of action. The DOC may enlist the assistance from the Attorney General's Office to explore current statutory language and provide guidance as necessary. Due to its relationship with the Colorado Community College System and its similarity to local community colleges, the Department may very well be seeking the same options to sell goods from its Education division as is afforded those institutions. We will simultaneously review organizational structure to determine our most efficient program delivery method for all operations.



CHAPTER 3

INMATE PROGRAMS AND SERVICES

In addition to running profitable businesses that employ inmates, Colorado Correctional Industries (CCI) has been assigned specific duties that contribute to the overall functionality of the prisons and support their rehabilitative mission. Specifically, statute charges CCI with training inmates in specific job skills that will help them succeed outside prison when they are released. CCI is also responsible for managing the canteen, which is the ordering and distribution system that allows inmates to purchase approved merchandise. This responsibility extends

to the inmate phone system, which operates from the canteen account. Also, statute requires CCI to produce certain goods for the benefit of the state and to manage the inmate labor force that performs certain necessary functions within the prisons, such as the laundry and food service. In this chapter, we evaluate CCI's performance in managing these inmate-focused programs and services.

TRAINING PROGRAMS

According to CCI management, providing inmates with job skills training is a key part of CCI's mission. Inmates working in CCI's shops receive general training, such as following directions, completing work on time, and working on a team, and also learn skills necessary to complete their job duties. Additionally, CCI provides specific skills training through structured programs and classroom settings, which fall into the following categories:

- **INDUSTRY-APPROVED CERTIFICATIONS.** Inmates learn and demonstrate specific job skills, such as forklift safety, fiberglass molding, and construction work, over the course of a few days or weeks.
- **APPRENTICESHIPS.** Inmates learn a trade, such as animal trainer, cabinet maker, computer operator, or fish hatchery worker, during a two to six year period.
- **COLLEGE COURSES.** Inmates earn college credits for courses approved by the Colorado Community College System, such as wildland firefighting and heavy equipment operation.

CCI management reported that the structured training programs can be particularly useful to inmates upon release because they allow them to demonstrate specific skills to potential employers. As previously discussed, the Department of Corrections (Department), through its Division of Education (DOE), is also responsible for providing inmates with vocational skills training and contracts with CCI to make the training programs, including the certification, apprenticeships, and courses described above, available to inmates.

WHAT AUDIT WORK WAS PERFORMED AND WHAT WAS THE PURPOSE?

The purpose of our audit was to determine whether CCI effectively provides training programs to inmates that increase the inmates' likelihood of finding employment after being released. We examined the purposes and expectations established for the training of inmates in statutes, Departmental regulations, and CCI's mission statement. We also collected and analyzed CCI and Department records related to training programs and interviewed CCI management on the procedures it uses to monitor and plan the training it provides to inmates.

HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

Pursuant to Section 17-24-106(1)(c), C.R.S., CCI is given the authority to “develop programs that assume responsibility for training offenders in general work habits, general work skills, and specific training skills which increase the offenders’ employment prospects when released.” Accordingly, part of CCI’s self-identified mission is “to train inmates in meaningful skills, work ethics, and quality standards which will better enable them to secure long-term employment after release from prison.” Management reported that it considers providing work and training programs to inmates to be the primary goal of CCI.

In addition to CCI’s responsibility for training inmates in work skills, statute (Section 17-32-101 et seq., C.R.S.) provides that the Department is responsible for offering educational and vocational training programs to inmates. As part of this responsibility, statute requires that the Department target its training programs, which it operates through DOE, to focus on job skills that are most likely to lead to employment for inmates following release, as indicated in reports by the Colorado Department of Labor and Employment (CDLE) on labor sectors with the highest demand for additional

workers. In addition the Department is required to annually report the number and type of programs offered and the number of inmates participating in and completing the programs. In addition, DOE considers CCI employment to be a key part of its overall plan to provide training courses, contracts with CCI to provide training programs, and includes programs completed by inmates working for CCI in its annual report on inmate education.

Given the importance of inmate training programs to CCI's statutory charge and the Department's broader mission, we would expect CCI to:

- Establish work and training program goals and benchmarks—such as the number of inmates participating in and completing specific training programs and the number of each type of program offered—that define what CCI should accomplish to meet its statutory mission of providing training that is likely to increase the inmates' employment prospects when released.
- Offer training programs that support the Department's overall effort to provide inmates with marketable job skills that are in demand according to reports from the CDLE.
- Define the strategies it intends to use to accomplish its goals.
- Monitor performance over time by tracking key information, such as the number and type of formal training programs offered, the number of inmates participating in each program, and the number of inmates successfully completing programs.

WHAT PROBLEM DID THE AUDIT WORK FIND AND WHAT CAUSED IT TO OCCUR?

Overall, we found that CCI could improve its planning and monitoring of the structured training programs it provides to inmates

to ensure that the programs are effective and targeted on job skills likely to improve inmates' employment opportunities upon release. Although CCI tracks the number of inmates employed in each shop and has set goals related to increasing total inmate employment over time, as discussed below, it (a) has not set strategic goals and performance measures for its training programs and specific job skills, (b) lacks procedures to track the range and scope of trainings offered, and (c) does not centrally monitor inmates' participation in and completion of training programs to track performance.

- **MANAGEMENT HAS NOT SET STRATEGIC GOALS RELATED TO TRAINING.** In the Department's performance plan for Fiscal Year 2015, CCI is tasked with employing offenders and teaching marketable skills through employment. However, the plan does not include any performance measures or strategic objectives related to training, and CCI has not defined specific training goals, developed strategies for increasing the amount of trainings offered, or developed ways to target trainings to specific industries that are in high demand or that have been shown to be successful at reducing recidivism. CCI senior managers reported they do not set training program participation targets for the shops, but rather allow interested inmates and the shop supervisors to decide which inmates will participate.

- **MANAGEMENT LACKS COMPLETE INFORMATION ON THE RANGE OF TRAINING OPPORTUNITIES THAT ARE AVAILABLE IN THE SHOPS.** We found that management does not maintain a complete list of training programs that have been developed or monitor which programs are currently active. Specifically, when we asked what the maximum inmate capacity is for the trainings that are offered, management was not able to provide definitive figures. For example, CCI has a list of apprenticeships that have been approved by the U.S. Department of Labor and could be offered in its shops, but it was unable to tell us which programs are active, the number of supervisors who are approved to be instructors for them, or the total number of inmates that the apprenticeship supervisors could accommodate.

- **MANAGEMENT DOES NOT MONITOR PARTICIPATION OF INMATES IN TRAINING COURSES.** We requested that CCI provide information on how many inmates participated in and completed each of the apprenticeships, community college courses, and industry-approved certificates it offered inmates through its work programs during Fiscal Years 2010 through 2014. However, because it does not centrally monitor the trainings provided within its shops, CCI lacked ready access to key information such as the number and type of completed apprenticeships and community college courses and the number of industry-approved certificates earned by inmates through CCI. Although CCI was eventually able to provide some of this information by contacting each shop supervisor, manually sorting records or referring us to individual Department staff, management lacks procedures to centrally track and regularly monitor the training programs it provides and evaluate its performance over time. Instead, each shop supervisor is responsible for tracking training programs offered in the shop and does not forward this information to CCI management on a regular basis.

WHY DOES THIS PROBLEM MATTER?

According to management, the training and education programs CCI provides inmates through its work programs can reduce recidivism and are one of the key benefits it provides to the State. However, due to a lack of strategic planning and performance monitoring, there is a risk that CCI is not optimizing its efforts to educate and train inmates and improve their ability to find employment upon release. For example, as shown in Exhibit 3.1, the majority of the community college courses, apprenticeships and certificates completed by CCI-employed inmates from Fiscal Year 2010 through 2014 have been concentrated in only three programs: wildland firefighting, animal training, and forklift operation.

EXHIBIT 3.1. COMPLETED TRAINING PROGRAMS FISCAL YEARS 2010 – 2014						
TRAINING PROGRAM CATEGORY	COMMUNITY COLLEGE COURSES ¹ & PERCENT TOTAL		APPRENTICE- SHIPS ² & PERCENT TOTAL		INDUSTRY- APPROVED CERTIFICATION ³ & PERCENT TOTAL	
Animal Training			126	80%		
Cabinet Making			1	1%		
Computer Skills			6	3%		
Construction					89	9%
Dairy Tech			3	2%		
Drafting			4	3%		
Fiberglass Materials					95 ⁴	9%
Flagging (Road construction)					226	22%
Forklift operation/heavy equipment	36	11%			612	60%
Firefighting (Wildland)	274	81%				
Fish Hatchery	8	2%	5	3%		
Industrial Housekeeper			2	1%		
Landscaping and Horticulture			4	3%		
Machinist			1	1%		
Maintenance (Mechanic/Building repair)			2	1%		
Office Skills			3	2%		
Transportation Fleet Service	19	6%				
TOTAL	337	100%	157	100%	1022	100%
SOURCE: Office of the State Auditor's analysis of completion figures provided by CCI and the Department of Corrections Division of Education.						
¹ Number of CCI inmates that completed at least one course in program category						
² Number of apprenticeships completed by CCI inmates						
³ Number of industry-approved certifications awarded to CCI inmates						
⁴ Includes Fiscal Years 2012 through 2014, data was not available for 2010 and 2011.						

CCI management reports that, in addition to the inmates who completed training programs, many more participated in the programs listed in Exhibit 3.1 and that participation in a program can also provide important skills to inmates that improve their ability to find employment upon release. For example, an inmate who is released after completing half the required hours in an apprenticeship program

has more skills than an untrained worker and can complete the remainder of the apprenticeship while working for an employer. CCI could not provide data showing the total number of inmates who participated in, but did not complete, training programs each fiscal year.

Due to the concentration of program completions in relatively few job types and its lack of information on training program participation, CCI may not be focusing its apprenticeship and certificate programs towards industries that offer greater employment opportunities for inmates upon release. For example, according to the CDLE's Labor Market Information Gateway, only about 50 animal trainer jobs are projected to be available each year in Colorado from 2013 to 2015. Therefore, to get jobs in the industry the 25 inmates who on average completed the apprenticeship program each Fiscal Year from 2010 through 2014 would have to be successful in securing half of the projected openings in the state. Similarly, CDLE predicts that there will only be an average of about 190 jobs for firefighters available each year in Colorado between 2013 and 2015. Therefore, the 55 inmates who on average received this certificate each year would also need to secure more than a quarter of the projected openings in the state. In contrast, CCI offers an apprenticeship program for landscape management technicians, for which CDLE predicts there will be approximately 1,400 annual job openings between 2012 and 2022. However, we found that only one inmate completed this apprenticeship in the last five fiscal years. Similarly, CCI offers courses for community college certificates in transportation and fleet services, a job category that CDLE predicts will have about 1,100 annual job openings between 2012 and 2022. However, only 19 inmates completed courses in this program in the last five fiscal years.

Further, without clear goals and monitoring, CCI lacks information on whether its spending on training programs is cost-effective. For example, CCI reports that it has spent \$20 million since 1989 on capital expenses, which helps ensure that inmates have opportunities to be trained on state-of-the-art equipment and gain employable skills. However, because management does not adequately monitor the

performance of the training programs that are actually offered, it cannot demonstrate that a sufficient number of offenders have received training, apprenticeships, certifications, or college credits to justify the expense.

In addition to not providing CCI management with information necessary to oversee its training programs, CCI's lack of a centralized process for tracking its inmate training programs reduces the information available to the Department, which is required to monitor and report on education and vocational training programs available to inmates. We reviewed the Department's education and training reports issued from Fiscal Year 2010 through 2013 and found that they lacked complete and accurate information on the programs offered to inmates working for CCI. Specifically, we found that two programs were inaccurately attributed to CCI in the Fiscal Year 2012 report and that the report lacked any information on four industry-approved certificate programs offered by CCI.

Through the State Measurement for Accountable, Responsive, and Transparent (SMART) Government Act (Section 2-7-201, C.R.S.), the General Assembly expressed its intent that departments develop measurable goals related to their programs and share the performance goals and progress in achieving the goals with a wide audience, including the General Assembly and the general public to promote the accountability, transparency, and efficiency of state programs. Without clear goals, strategies, and performance monitoring of CCI's training programs, it is difficult for the Department, policymakers, or the general public to determine whether the programs are accomplishing their intended purpose.

RECOMMENDATION 6

The Division of Correctional Industries (CCI) should improve its management of the training programs offered to CCI-employed inmates by:

- A Developing and annually updating strategic objectives, goals, and quantifiable performance measures for its training programs that are aligned with CCI's mission of providing inmates with meaningful job skills that will help them find employment upon release.
- B Monitoring training programs offered in CCI shops to assess performance toward the strategies and goals outlined in PART A. This should include centrally tracking information related to each training program, including the scope of training offered and inmate participation and completion data. CCI management should then use the information collected when making strategic decisions regarding its training programs.
- C Reporting strategic objectives, goals, and measures, as well as data showing its progress each year to policymakers, stakeholders, and the general public through the Department of Corrections' strategic plan or CCI's annual reports.

RESPONSE

DEPARTMENT OF CORRECTIONS

- A AGREE. IMPLEMENTATION DATE: JULY 2015.

The Division has diligently worked at expanding work and training opportunities for offenders and we will improve the documentation that reports and measures those efforts. Furthermore, the CCI management team will utilize this information for decision making regarding training programs. As indicated by the implementation date, over the next several months, CCI will develop measurable

performance goals related to its training programs that reasonably align with the typical job skills and educational background of the inmate population.

B AGREE. IMPLEMENTATION DATE: JULY 2016.

Based upon efforts developed in relation to PART A of the recommendation, CCI and the DOC Division of Education will develop a method for centrally tracking training programs and related completion data for inmates. The implementation date indicates that will not be realistically feasible until a full year of data is available to evaluate these efforts.

C AGREE. IMPLEMENTATION DATE: JULY 2015.

Beginning with the Annual Report for the year ending 7/01/2015, CCI will include the pertinent data delineated by the recommendation in that report as well as in the Department's Strategic Planning document.

INMATE PHONE SERVICE PRICING

As part of its canteen operations, CCI manages the Colorado Inmate Phone System (CIPS), which allows inmates to place phone calls to their lawyers, friends, and family. According to studies by the Urban Institute’s Justice Policy Center, allowing inmates access to phone service is an important part of managing the inmate population and helps inmates stay in contact with family and friends which can reduce the risk of recidivism upon release. To provide phone service, CCI contracts with a private phone service provider. Under the terms of the contract as amended, effective February 2014, the phone service provider is responsible for providing, maintaining, and supporting, all hardware and software necessary for the phone system, including the telephones and equipment for call processing, recording, and monitoring. CCI, for its part, manages inmates’ approved phone lists, assigns inmates’ pin numbers used to pay for calls, addresses grievances, and coordinates phone usage within the facilities. Under the terms of the contract, the per-minute rates for inmate calls are negotiated between CCI and the provider, with the provider keeping 51 percent of the revenue and remitting the remainder to CCI.

Exhibit 3.2 provides CIPS connection fees and phone rates effective as of February 2014. As shown, phone rates vary depending on the payment method and whether the call is in-state or interstate. Thus, a 15-minute call can cost \$2.75 to \$3.75.

EXHIBIT 3.2. COLORADO INMATE PHONE SYSTEM RATES EFFECTIVE FEBRUARY 2014						
PAYMENT METHOD	IN-STATE			INTERSTATE		
	CONNECT FEE	PER-MINUTE CHARGE	RATE & TOTAL FOR 15-MINUTE CALL	CONNECT FEE	PER-MINUTE CHARGE	RATE & TOTAL FOR 15-MINUTE CALL
Debit from Inmate Bank Account	\$1.25	10¢	18¢/min. \$2.75 total	\$1.50	10¢	20¢/min. \$3.00 total
Prepaid Collect Charge to Called Party	\$1.25	11¢	19¢/min. \$2.90 total	\$1.50	11¢	21¢/min. \$3.15 total
Collect Charge to Called Party (not Prepaid)	\$1.50	15¢	25¢/min. \$3.75 total	\$1.50	15¢	25¢/min. \$3.75 total

SOURCE: Contract between Department of Corrections and Value Added Communications, Inc., a subsidiary of Global Tel-Link.

WHAT AUDIT WORK WAS PERFORMED AND WHAT WAS THE PURPOSE?

We reviewed inmate phone rates to determine whether they are reasonably priced and comply with state and federal laws and regulations. Specifically, we compared Colorado's rates to those charged in other states, as well as to rate caps set by the Federal Communications Commission (FCC). In addition, we examined the terms of the contract between the Department and the inmate phone service provider, analyzed a summarized report of call records for all the facilities during the month of March 2014, and reviewed revenues and expenses for the phone system recorded in the State's accounting system, COFRS. We also interviewed CCI management regarding its process for setting inmate phone rates and reviewed the Department's policies regarding phone system pricing and use.

HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

Although CCI is generally charged to be “profit-oriented,” statute and Departmental regulations require that inmate phone services be reasonably priced on the basis of cost. Specifically, Section 17-24-126(3), C.R.S., limits the amount of profit CCI can earn from canteen sales, which includes inmate phone services, stating that “items in the canteen shall be sold to inmates...at prices so that revenues from the sale *are sufficient to fund all expenses* of the canteen..., including the cost of services of employees of the canteen...and to produce a *reasonable profit*” (emphases added). The Department’s Administrative Regulation 850-12 further restricts phone service prices, stating that “DOC shall ensure that offenders have access to *reasonably priced* telephone services” and that phone service “contracts are based on rates and surcharges that are commensurate with those charged to the general public for like services. Any deviation from the ordinary consumer rates reflects *actual costs* associated with the provision of services in a correctional setting” (emphases added).

In addition to state statutes and Department regulations, federal law [Title 47, Section 201(b), U.S.C.] requires that interstate phone rates be “just and reasonable” and gives the Federal Communications Commission (FCC) authority to set rules necessary to enforce this requirement. Accordingly, in September 2013, the FCC promulgated rules aimed at reforming the rates and practices used for interstate inmate calling services. According to the FCC rules (47 C.F.R. Section 64.6010), the rates charged for inmate interstate phone usage must be based on costs that are directly related to providing the phone services. Further, in evaluating whether rates are in compliance with this requirement, the rules (47 C.F.R. Sections 64.6020 and 64.6030) provide “safe harbor” rates, under which phone service providers will be presumed to be in compliance, and “hard caps” on rates for interstate inmate calls, beyond which a provider’s rates will be considered unlawful. Rates between the safe harbor and hard caps

could be deemed unlawful based on a review by the Wireline Competition Bureau, if they are found to provide revenues above the cost of providing phone service. Under these rules, rates are evaluated by the FCC on the basis of total cost for a 15-minute call, inclusive of per-call or per-connection charges. The rates established by the FCC in the September 2013 rules are provided in Exhibit 3.3.

EXHIBIT 3.3. FCC PER-MINUTE RATE CAPS FOR INTERSTATE INMATE PHONE SERVICES ¹		
PAYMENT METHOD	SAFE HARBOR	HARD CAP
Prepaid by Inmate, Debit from Inmate Bank Account or Prepaid Collect Charge	12¢	21¢
Collect Charge to Called Party (not Prepaid)	14¢	25¢

SOURCE: 47 C.F.R. Sections 64.6020 and 64.6030.
¹ The hard caps became effective in February 2014; however, the safe-harbor rates are currently stayed pending judicial review.

The FCC's hard caps for inmate phone service rates took effect in February 2014, but the requirement that rates be based on costs and the safe-harbor rates were suspended in January 2014, pending judicial review. Despite the suspension of the safe-harbor portion of the FCC rules and the fact that they apply only to interstate calls, the FCC rules remain relevant for judging whether a provider's rates are reasonable and, depending on the outcome of the pending judicial review, could become an important threshold for CCI and its service provider to avoid possible legal challenges. In addition, the FCC has begun the process of considering new rules that, if codified, would apply similar standards to in-state inmate calling.

WHAT PROBLEM DID THE AUDIT WORK FIND?

Overall, we found Colorado's inmate phone system rates generate revenues that are much higher than the actual cost of providing the service and, therefore, produce profits in excess of statutory intent and Department regulations. Specifically, during Fiscal Year 2014, CCI received \$2.62 million in revenues from the inmate phone system, but only spent about \$680,000 on activities directly related to

administering the system, plus about another \$411,000 in canteen operations costs that CCI estimates was spent processing sales of debit phone time, for a total of \$1.09 million. CCI's net profit for the phone system in Fiscal Year 2014 after accounting for all costs, therefore, was about \$1.53 million, for a profit margin of 58 percent. In comparison, CCI's profit margin for the rest of its canteen sales was 13 percent. In addition, although CCI's contracted phone service provider lowered the rates for collect calling in February 2014, we found that since the new rates went into effect, CCI's profit margin increased slightly. Thus, CCI and the phone service provider could charge substantially lower rates for the inmate phone system and still cover CCI's costs for providing the service.

In addition, Colorado's inmate phone rates are at or near the highest level permitted by the FCC for interstate calling and are much higher than the FCC's pending safe-harbor rates. Specifically, interstate calls range from 20¢ to 25¢ per minute, the latter of which is 79 percent higher than the FCC's safe-harbor rate of 14¢ per minute for interstate collect calls. Although these safe harbor rates are currently suspended pending judicial review, if they are upheld, CCI would be required to lower its rates substantially.

WHAT CAUSED THE PROBLEM TO OCCUR?

We found that the Department's contract with the phone service provider provides payments to CCI that far exceed CCI's costs associated with administering the inmate phone system. Specifically, based on our review of call activity for the month of March 2014, in which about 83 percent of calls were in-state, we estimated that if CCI only received what it needed to cover its costs for administering phone access, the rates for all call types could be reduced to about 15¢ per minute, assuming the service provider keeps the same total amount that it currently keeps. Further, based on our review of inmate phone system rates in other states, the current rates may also be providing the phone service provider with more revenues than necessary. For

example, in Colorado, a 15-minute, prepaid collect call to an in-state number costs the call recipient \$2.90, about \$1.48 of which goes to the service provider under the contract terms. In contrast, in New York and Rhode Island—which use the same provider as Colorado—inmates can place a 15-minute, prepaid collect call to an in-state number for 72¢ or less. Unlike in Colorado, in these states the provider does not remit a commission based on a flat percentage of revenue to the state. Thus, the provider is receiving at least 76¢ (51 percent) less per call in these states than in Colorado. CCI management reports that at least some of this difference may be attributed to higher costs for supplying security features in Colorado, such as call monitoring and analysis, that are not provided in these other states. Nevertheless, these differences indicate that CCI may be able to negotiate with the service provider to lower rates by reducing the amounts retained in surplus of costs by both CCI and the service provider.

According to CCI management, the primary reason it collects revenues in excess of its costs for providing inmates phone services is to provide funding for inmate benefit programs. As mentioned previously, profits earned by the canteen, including through the inmate phone system, are statutorily earmarked for various recreational and educational programs for inmates. These programs use canteen fund proceeds to fund the following types of expenses:

- Cable TV fees and equipment maintenance
- Volunteer services
- Recreational equipment and supplies
- Educational services and supplies
- Library equipment
- Computers and computer supplies
- Improvements to areas designated for recreation, vocational education, and libraries
- Books and subscriptions
- Beauty, barber, and grooming supplies for cosmetology instruction

In Fiscal Year 2014, the inmate benefit programs spent about \$2.7 million from profits earned by the canteen and the phone system. Of this amount, about \$760,000 (28 percent) was funded solely by the phone system, after subtracting total profits earned by the rest of the canteen. According to management, if CCI and the contracted provider were to significantly decrease rates for inmate calling, the Department may have difficulty funding these programs and would either need to seek alternative funding sources or discontinue some programs. However, both statute and Department policy disallow charging phone service far in excess of costs, and affordable phone service is an important benefit provided to inmates and their families that should be balanced with the need for other inmate programs.

WHY DOES THIS PROBLEM MATTER?

Bringing calling rates into compliance with statute and Department policy would provide several benefits. First, lowering inmate calling rates would benefit the families and friends of inmates who ultimately pay most of the costs of phone service, regardless of the type of payment used. Specifically, we found that about 38 percent of calls placed in March 2014 were either collect or pre-paid collect calls in which the called party is responsible for the charges, and 62 percent of the calls were paid from the inmates' debit accounts. However, because according to Department staff 84 percent of the money in inmates' debit accounts comes from contributions from family members and friends, many of whom are Colorado residents, these individuals likely bear most of the cost for debit calls as well. To put this in perspective, an inmate who makes ten 15-minute phone calls home each month to an in-state number using a debit account would be charged \$27.50 a month. If the calls were collect, the call recipients would be charged \$37.50. In total, based on Fiscal Year 2014 revenues and expenses, if CCI reduced phone rates to levels necessary to cover its actual costs, it would save inmate phone system users \$1.53 million each year.

Second, keeping phone rates affordable helps inmates keep in contact with family and friends, which can have important benefits to the

State. Studies sponsored by the Urban Institute's Justice Policy Center have demonstrated that the amount of contact offenders maintain with their families during incarceration is an important factor in reducing recidivism. Also, children who maintain regular contact with incarcerated parents tend to fare better emotionally and perform better in school. These outcomes benefit the State by reducing future incarceration costs and the need for social services and behavioral interventions.

Third, although CCI and the contracted provider are currently in compliance with FCC rules, if the pending rules are upheld or if new rules the FCC is considering are implemented, they will need to lower the rates substantially to avoid potential legal challenges.

As previously mentioned, profits from the phone system currently provide a substantial proportion of funding for some inmate programs. Thus, by developing a plan now to bring phone rates down to the level necessary to cover the costs of providing phone services, CCI and the Department will help ensure continued compliance with federal rules and may have more time to explore other funding options for programs that are currently funded through phone system profits.

RECOMMENDATION 7

The Department of Corrections and the Division of Correctional Industries (CCI) should ensure that the rates charged for inmate phone services are reasonable and based on costs by:

- A Renegotiating the contract with the inmate phone service provider to lower the calling rates so that they are based only on CCI and the phone service provider's costs for providing phone service, and not on the need to fund unrelated expenses, such as inmate benefit programs.
- B Implementing a regular process for reviewing the contract with the inmate phone service provider to ensure that the calling rates continue to be reasonable, based on costs, and in compliance with state and federal laws.

RESPONSE

DEPARTMENT OF CORRECTIONS

- A PARTIALLY AGREE. IMPLEMENTATION DATE: FEBRUARY 2016.

The Department is awaiting a ruling by the FCC that will guide the rate structure and determine allowable cost recovery items that will be included in the offender calling cost. This business model is rapidly changing due to FCC rulings and the Department anticipates that a ruling by the FCC will clarify what costs may or may not be recoverable. The Department believes that the General Assembly's direction to fund benefit programs from the Canteen is a direct cost of the operation and not an unrelated expense. The Department believes that this segment of the Canteen should continue to contribute to those program costs. The implementation date above is the date the current agreement with the phone service provider expires but it is anticipated that FCC action will be implemented prior to that date.

B PARTIALLY AGREE. IMPLEMENTATION DATE: FEBRUARY 2015.

The State's contract monitoring process already includes a process for annual monitoring of the performance of the contractor and the Division will ensure that such review will include a review of compliance with State and Federal law. While CCI believes current calling costs are competitive, CCI awaits a final FCC determination as to what is includable in a cost recovery rate before we can agree to reviewing what is reasonable or could be included in the cost.

AUDITOR'S ADDENDUM

RECOMMENDATION 7 is based on state statute and the Department's Administrative Regulations, not on federal allowable cost recoveries. Specifically, Section 17-24-126(3), C.R.S., requires CCI to set prices for all items sold through its canteen to cover its costs and generate a "reasonable" profit and the Department's Administrative Regulation 850-12 requires that "any deviation from the ordinary consumer rates reflect actual costs associated with the provision of services in a correctional setting" (emphasis added). The audit found that the Department does not base its phone service pricing on its costs to provide the service. Further, the Department's assertion that costs for inmate benefit programs should be considered costs of its canteen operation when pricing phone services is inconsistent with Section 17-24-126(3), C.R.S. This statute makes a clear distinction between expenses and profits and states that "profits arising from the operation of the canteen ...shall be expended for the educational, recreational, and social benefits of the inmates... ." Thus, inmate benefits funding should not be considered an expense of the canteen itself.

MAINTENANCE, LAUNDRY, AND FOOD SERVICES

When it created CCI through the Correctional Industries Act (Section 17-24-101 et seq., C.R.S.), the General Assembly gave CCI responsibility for operating several specific programs that provide employment to inmates and stated its intention in Sections 17-24-102(1)(d) and 102(2), C.R.S., that CCI consolidate all “correctional industries” programs operating in the state. Under the Act, CCI is required to provide prison facilities with maintenance, laundry, and food services, and CCI is authorized to charge the Department for these services.

WHAT AUDIT WORK WAS PERFORMED AND WHAT WAS THE PURPOSE?

We compared CCI’s operations to the responsibilities assigned to it in statute to determine whether CCI is providing the State with the services it is required to perform. We also interviewed CCI and Department staff to understand the history of CCI’s relationship to the Department and how Departmental functions are organized.

HOW WERE THE RESULTS OF THE AUDIT WORK MEASURED?

In addition to developing profitable industries that support inmate employment, statute requires CCI to provide certain enterprises and services. Specifically, CCI’s enabling statutes [Sections 17-24-106.6(2), 109(1), 111(1), and 126(1), C.R.S.] charge CCI with operating or managing the following:

- Sales and disposal of surplus state property

- License plate production
- Highway sign production
- Printing services for state agencies
- Canteen (i.e., the selling of goods to inmates)
- Vending machines for visitors to correctional facilities

Additionally, statute [Sections 17-24-109(1) and 17-24-110(3), C.R.S.] requires CCI to provide the following services within the correctional facilities:

- Physical plant and facility maintenance
- Vehicle maintenance
- Food services
- Laundry services
- Vocational training programs

In addition, according to statute it was the General Assembly's intent that all work programs performed by inmates within the State's correctional facilities be administered by CCI.

WHAT PROBLEM DID THE AUDIT WORK FIND?

Although CCI performs many of the functions assigned to it in statute, we found that since Fiscal Year 1982, CCI has not provided physical plant and facility maintenance, food and laundry services, or all the vehicle maintenance within the correctional facilities. Rather, these services are provided by several subprograms within the Department which are managed by Department staff using inmate labor. Specifically, the Department reports that the laundry and food services subprogram employs about 2,550 inmates, and the facilities maintenance subprogram employs about another 640 inmates. Combined, the Department expended about \$70 million on these programs in Fiscal Year 2014. Considering that CCI reports that it employs about 1,600 inmates, it is only managing about one-third of the 4,790 inmate jobs intended by statute and is forgoing the potential

revenues that would be available if it contracted with the Department to provide these services.

WHAT CAUSED THE PROBLEM TO OCCUR?

According to Department staff, the Department assumed responsibilities for physical plant and facility maintenance, some vehicle maintenance, and food and laundry services, because CCI had struggled financially during the late 1970s and early '80s and was unable to effectively perform these functions. This transfer of authority was reflected in the Fiscal Year 1982 budget that was approved by the General Assembly, which transferred CCI's appropriation related to these services to the Department. However, the Department did not seek a corresponding legislative change to transfer these responsibilities away from CCI. CCI managers reported that CCI is now in a financially better position than it was 30 years ago and could viably reassume responsibility for these services. However, neither CCI nor the Department has conducted an analysis of the potential benefits and costs of CCI reassuming some or all of these duties.

WHY DOES THIS PROBLEM MATTER?

Currently the Department and CCI operate two separate management structures to oversee inmates' jobs at correctional facilities, which may increase administrative costs and inhibit potential growth opportunities for CCI. For example, for Fiscal Year 2015, the Department was appropriated 632 full-time-equivalent (FTE) positions for facilities maintenance, food services, and laundry services. Some of these positions, especially those in administration, may be able to be consolidated with positions that are occupied by CCI staff, if the functions were carried out by CCI. Further, CCI managers report that there is the potential for turning the services into profitable enterprises. For example, the laundry facilities could be used to provide laundry services under contract to outside institutions, such as hospitals, and according to CCI staff, correctional industries in

other states earn significant profits from their laundry services. However, because the Department's subprograms that currently administer these services lack CCI's authority to offer services to the private sector, the Department would not be able to take advantage of this type of opportunity. As an additional benefit, by making these services profitable, CCI could potentially expand the number of inmates employed in these jobs. However, there are also potential costs to transferring the services to CCI. For example, under CCI's pay structure inmates are generally paid more than inmates who work for the programs currently administered by the Department. Thus, inmate wage costs could increase. Further, if CCI were not able to operate these programs more efficiently than the Department and had to charge the Department more than its current costs, overall costs to the State would increase.

RECOMMENDATION 8

The Department of Corrections (Department) should ensure that physical plant and facility maintenance, vehicle maintenance, and food and laundry services are operated in a cost-effective manner and in accordance with statute by:

- A Evaluating the cost-effectiveness of the current structure for administering these services as opposed to reassigning these services to the Division of Correctional Industries (CCI).
- B Depending on the results of its cost effectiveness study, either transferring responsibility for these services to CCI or seeking legislative change to allow for the division of responsibilities that the Department determines would be most beneficial to the State.

RESPONSE

DEPARTMENT OF CORRECTIONS

- A AGREE. IMPLEMENTATION DATE: JULY 2016.

The Department will either perform a feasibility analysis using current staff resources or explore hiring a third party to determine the cost effectiveness of the present structure regarding physical plant and facility maintenance, vehicle maintenance, food services, laundry services, and the delivery of vocational training programs. This will be a lengthy undertaking and the implementation date provided assumes the analysis is performed in-house.

- B AGREE. IMPLEMENTATION DATE: DECEMBER 2016.

The Colorado DOC and CCI will review the feasibility analysis from PART A of the recommendation to determine whether the current structure is the most cost effective option or whether a prospective transfer of these functions to CCI is more sensible. This may also

entail delaying any potential changes to statute to monitor and assess how successful either of these alternatives proves to be.



APPENDIX A



CORRECTIONAL INDUSTRIES ACTIVITIES BY SHOP FISCAL YEAR 2014 (DOLLARS IN THOUSANDS)

SHOP	FACILITIES	PRODUCTS/SERVICES	INMATES EMPLOYED ON JUNE 30, 2014	REVENUE	PROFIT/ (Loss)
CANTEEN OPERATIONS					
CIPS Inmate Phone System	Colorado Territorial CF	Inmate phone systems	0	\$2,624	\$1,533
Central Canteen	Arrowhead CC	Canteen warehouse & order fulfillment	60	\$10,034	\$1,382
Northern Canteen	Denver Women's CF	Canteen warehouse & order fulfillment	25	\$4,383	\$546
INDUSTRY SHOPS					
CAD & GIS Services	Arkansas Valley CF	Computer-aided design, map digitization, electronic catalog & web design, customer service information, DMV public information call center	30	\$896	\$570
Canine Training Program	Arrowhead CC, Buena Vista Correctional Complex, Colorado Territorial CF, Denver Women's CF, Four Mile CC, Skyline CC, Sterling CF, Trinidad CF	Dog training and adoption	127	\$802	\$111

SHOP	FACILITIES	PRODUCTS/SERVICES	INMATES EMPLOYED ON JUNE 30, 2014	REVENUE	PROFIT/ (LOSS)
CCI Production Admin. Support ¹	La Vista CF	CCI production administration & office assistance, information technology services & call center for DOC	10	Allocated as overhead in other shops	
Culinary Service	Rifle CC	Culinary arts	36	\$159	\$0
Dairy	Four Mile CC, Skyline CC, Buena Vista Correctional Complex	Dairy, cattle ranching, bighorn sheep & bucking bull housing, pheasant farming, white bison breeding, farming, composting, labor crews, scale house	142	\$5,888	\$538
Dairy Processing	Four Mile CC	Processed milk	7	\$1,302	(\$221)
Delta Farm Program	Delta CC	Farming and related services, maintenance projects for the U.S. Forest Service	0	\$11	(\$9)
Federal Surplus Property	Colorado Correctional Center (Denver)	Federal surplus property disposal and sales	0	\$17	\$7
Fiberglass Products	Fremont CF	Fiberglass tanks & products, redwood canoes	27	\$174	(\$135)
Firefighting Training - Buena Vista	Buena Vista Correctional Complex	Wildland firefighting, mountain trail building	38	\$640	(\$32)
Firefighting Training - Rifle	Rifle CC	Wildland firefighting, mountain trail building	22	\$430	(\$98)
Firefighting Training - Skyline	Skyline CC	Wildland firefighting, mountain trail building	19	\$280	\$7
Fish Processing	Arrowhead CC, Buena Vista Correctional Complex	Tilapia and shrimp farming, fish processing	48	\$580	(\$118)

SHOP	FACILITIES	PRODUCTS/SERVICES	INMATES EMPLOYED ON JUNE 30, 2014	REVENUE	PROFIT/ (LOSS)
Fleet Services	Arrowhead CC, Colorado Correctional Center (Camp George West)	Fleet management, service station, auto body repair & painting	34	\$1,968	(\$72)
Furniture Factory	Fremont CF	Office & dormitory furniture, sewing shop (stuffed animals, garments)	114	\$1,851	(\$817)
Garment Factory - Limon	Limon CF	Garments, uniforms, flags, stuffed animals, banners, embroidery, screen printing	95	\$1,223	(\$223)
Garment Factory - Specialized	Denver Women's CF	Power sewing (garments)	14	\$573	\$194
General Services - Golden	Colorado Correctional Center (Camp George West)	Carpentry, construction, highway beautification & barrier fencing, moving services, office systems & furniture installation, services at Colorado State Patrol Training Academy (garage, kitchen, maintenance)	52	\$749	(\$135)
General Services - Pueblo	La Vista CF	Construction, farming, firewood, moving services, painting	61	\$293	(\$126)
Goat Dairy	Skyline CC	Goat milk for artisanal cheese	32	\$717	(\$2)
Greenhouse	Arrowhead CC, Skyline CC, Youthful Offender System	Cut flowers, lobster farming, fish hatchery, fly rods, musical instruments, tractor refurbishing, honey, apple orchard, apple processing, vineyard	100	\$806	(\$196)

SHOP	FACILITIES	PRODUCTS/SERVICES	INMATES EMPLOYED ON JUNE 30, 2014	REVENUE	PROFIT/ (LOSS)
Heavy Equipment	Buena Vista Correctional Complex, Four Mile CC, La Vista CF, Skyline CC, Sterling CF, Fremont CF	Heavy equipment maneuvering, building deconstruction, solar panels	45	\$1,643	\$214
HVAC Filter Mfg.	Trinidad CF	HVAC filters	5	\$84	(\$59)
International Correctional Management Training Center	Four Mile CC (Operations at the former Colorado Women's CF)	Staff provide training to international correctional officers. Inmates fill jobs in guest services, housekeeping, culinary arts, and landscaping.	33	\$1,885	(\$168)
License Plate & Tab Mfg. ²	Colorado Territorial CF	a) License plates, custom motorcycles, signage; b) License plate tabs, banners, recycled printer cartridges, vehicle graphic wraps	127	\$5,416	\$970
Metal Fabrication	Fremont CF	Metal products, bear-proof & roll-off dumpsters, security cells & detention furniture	60	\$1,027	(\$8)
Modular Office Systems	Arkansas Valley CF	Office panel systems, order fulfillment	37	\$7,912	(\$56)
Pizza Mfg. ³	Four Mile CC (Operations at the former Colorado Women's CF)	Pizzas	12	\$266	(\$139)
Plastic Bag Mfg. ⁴	Arkansas Valley CF	Plastic bags	0	\$0	(\$33)
Printing Services	Denver Women's CF	Printing, television mfg.	22	\$935	\$81
Recycling Operation	Skyline CC	Recycling	11	\$242	(\$171)

SHOP	FACILITIES	PRODUCTS/SERVICES	INMATES EMPLOYED ON JUNE 30, 2014	REVENUE	PROFIT/ (LOSS)
Saddles & Leather Products	Buena Vista Correctional Complex	Leather products, saddles & strap goods	35	\$759	\$3
Sales & Customer Service Support ¹	Colorado Correctional Center (Denver)	Office assistance for CCI furniture sales and customer service staff	11	Allocated as overhead in other shops	
Seating & Refurbishing	Sterling CF	Mattresses, seating, reupholstery	44	\$4,717	\$188
State Forms	Colorado Correctional Center (Denver)	Forms & publications, fingerprinting, office assistance	1	\$246	\$21
State Surplus Property	Colorado Correctional Center (Denver)	State surplus property disposal and sales, fleet sales (eBay), general maintenance, mowing services, janitorial services	7	\$716	\$271
Transport. ¹	Arrowhead CC, Skyline CC	Transportation, warehousing, customer service south, delivery and installation, moving services	18	Allocated as overhead in other shops	
Warehouse - Denver	Colorado Correctional Center (Denver)	Warehousing and delivery preparation of furniture manufactured by CCI and by third parties	2	\$1,110	(\$279)
Water Buffalo Dairy	Four Mile CC	Water buffalo milk for mozzarella cheese	3	\$101	(\$49)

SHOP	FACILITIES	PRODUCTS/SERVICES	INMATES EMPLOYED ON JUNE 30, 2014	REVENUE	PROFIT/ (LOSS)
Wild Horse Inmate Program	Four Mile CC	Wild horse ranch	51	\$3,889	(\$15)

NOTE: CC=Correctional Center, CF=Correctional Facility

SOURCE: Office of the State Auditor analysis of COFRS financial data and information provided by CCI.

¹Although the CCI production administration, sales & customer service, and transportation operations employ inmates, they primarily serve other shops within CCI. Thus, we allocated their revenue and expenses to other shops as overhead.

²CCI tracked the finances for License Plates and Tabs as two distinct shops in COFRS; however, CCI combines the two shops for planning purposes and for tracking inmate employment.

³Pizza Manufacturing is a new shop that CCI began tracking in COFRS during Fiscal Year 2014.

⁴CCI was in the process of phasing out the plastic bag shop during Fiscal Year 2014.

APPENDIX B



CCI SHOPS BY CORRECTIONAL FACILITY

ARKANSAS VALLEY CF

*CAD & GIS Services
Modular Office Systems
Plastic Bag Manufacturing*

ARROWHEAD CC

*Canine Training Program
Central Canteen
Fish Processing
Fleet Services
Greenhouse
Transportation*

BUENA VISTA CORRECTIONAL COMPLEX

*Canine Training Program
Dairy
Firefighting Training - Buena Vista
Fish Processing
Heavy Equipment
Saddles & Leather Products*

COLORADO CORRECTIONAL CENTER (CAMP GEORGE WEST)

*Fleet Services
General Services - Golden*

COLORADO CORRECTIONAL CENTER (OPERATIONS IN NORTH DENVER)

*Federal Surplus Property
Sales & Customer Service Support
State Forms
State Surplus Property
Warehouse - Denver*

COLORADO TERRITORIAL CF

*Canine Training Program
Inmate Phone System (CIPS)
License Plate & Tab Manufacturing*

DELTA CC

Delta Farm Program

DENVER WOMEN'S CF

*Canine Training Program
Garment Factory - Specialized
Northern Canteen
Printing Services*

FOUR MILE CC

*Canine Training Program
Dairy
Dairy Processing*

*Heavy Equipment
Water Buffalo Dairy
Wild Horse Inmate Program*

FOUR MILE CC (OPERATIONS AT THE FORMER COLORADO WOMEN'S CF)

*International Correctional Management
Training Center
Pizza Manufacturing*

FREMONT CF

*Fiberglass Products
Furniture Factory
Heavy Equipment
Metal Fabrication*

LA VISTA CF

*CCI Production Admin. Support
General Services - Pueblo
Heavy Equipment*

LIMON CF

Garment Factory

RIFLE CC

*Culinary Service
Firefighting Training - Rifle*

SKYLINE CC

*Canine Training Program
Dairy
Firefighting Training - Skyline
Goat Dairy
Greenhouse
Heavy Equipment
Recycling Operation
Transportation*

STERLING CF

*Canine Training Program
Heavy Equipment
Seating & Refurbishing*

TRINIDAD CF

*Canine Training Program
HVAC Filter Manufacturing*

YOUTHFUL OFFENDER SYSTEM

Greenhouse



APPENDIX C



OFFICE OF THE STATE AUDITOR
SUMMARY OF FINDINGS RELATED TO THE SMART
GOVERNMENT ACT
COLORADO CORRECTIONAL INDUSTRIES
DEPARTMENT OF CORRECTIONS
DECEMBER 2014

The SMART Government Act [Section 2-7-204(5), C.R.S.] requires the State Auditor to annually conduct performance audits of one or more specific programs or services in at least two departments. These audits may include, but are not limited to, the review of:

- The integrity of the department's performance measures audited.
- The accuracy and validity of the department's reported results.
- The overall cost and effectiveness of the audited programs or services in achieving legislative intent and the department's goals.

The performance audit relating to Colorado Correctional Industries (CCI), within the Department of Corrections, was selected for focused audit work related to the SMART Government Act. This document outlines our findings related to the integrity and reliability of performance measurement for CCI. We have presented our findings as responses to six key questions that can assist legislators and the general public in assessing the value received for the public funds spent by CCI.

What is the purpose of this program/service?

According to Statute (17-24-101 et seq. C.R.S), the General Assembly created CCI to accomplish several purposes, which include the following:

- Employ all able-bodied offenders to the extent possible
- Provide inmates with training and general work skills that will assist them in finding employment upon release
- Be profit-oriented, earning sufficient revenue to pay for its expenses and reimburse the General Fund for the cost of inmates' incarceration

- Operate a canteen to sell goods and phone service to inmates and generate a reasonable profit to fund inmate benefits programs

What are the costs to the taxpayer for this program/service?

CCI is required to be funded entirely through its revenues from the sale of goods, services, and surplus property. During Fiscal Year 2014, CCI industries revenues and expenditures both totaled \$47.1 million; its canteen had revenues of \$17.4 million and expenditures of \$13.9 million for a profit of \$3.5 million.

How does the Department measure the performance of this program/service?

In its performance plan for Fiscal Year 2015 the Department established the following output measures related to CCI:

- Increase industries sales revenue to \$47.5 million by Fiscal Year 2016.
- Increase canteen sales revenue to about \$17 million by Fiscal Year 2016.
- Employ 1,325 offenders in industries shops by the beginning of Fiscal Year 2017.
- Employ 85 offenders in the canteen by the beginning of Fiscal Year 2017.

In addition, CCI management monitors the performance of each of its businesses using internal operating statements.

Is the Department's approach to performance measurement for this program/service meaningful?

The SMART Government Act [Section 2-7-202(18), C.R.S.] includes several requirements to ensure that departments' performance measures are meaningful. Specifically, performance measures included in departments' performance plans are required to:

- Be quantitative indicators used to assess the operational performance of a department.
- Apply to activities directly under the influence of a Department.
- Demonstrate the department's efficiency and effectiveness in delivering goods or services to customers and taxpayers.
- Be reasonably understandable to the general public.

Although the performance measures for CCI included in the Department's performance plan comply with these requirements, we found that CCI lacks measures to fully demonstrate its effectiveness at earning a profit and providing training to inmates, which are key program goals outlined in statute. Specifically, as discussed in Recommendation No. 1, CCI has not established any long-term measures related to its profitability. In addition, as discussed in Recommendation No. 6, we found that CCI does not adequately monitor its programs that provide inmates with apprenticeships, industry-approved skills certifications, and community college credits.

Are the data used to measure performance for this program/service reliable?

We found that CCI's data are reliable for measuring its overall financial performance and the number of inmates it employs in each shop. However, as discussed in Recommendation No.1, we found that CCI could improve the information it uses to monitor the financial performance of its businesses by including overhead costs in its assessment of each shops' profitability and improving its accounting practices to allow management to evaluate the performance of distinct business activities within each shop. Also, in Recommendation No. 6 we found that CCI needs to collect information to allow management to monitor its training programs and report information to the Department on inmates' participation in and completion of training programs.

Is this program/service effective in achieving legislative intent and the Department's goals?

We found that CCI has provided employment opportunities to inmates and operated its canteen at a profit as intended by statute. As discussed in Chapter 2, the Department estimates that CCI's current employment of about 1,600 inmates saves the Department an estimated \$6 million annually by reducing staffing costs that would have otherwise been paid through the Department's general fund appropriation. In addition, CCI's canteen earned about \$3.5 million in profit during Fiscal Year 2014, which was available to fund inmate benefit programs.

However, we found that CCI could make several improvements to better achieve its purpose as outlined in statute. Specifically, in Recommendation No. 1 we found that CCI's industries have not been sufficiently "profit-oriented" as intended by statute, earning little or no profits from Fiscal Year 2009 through 2014. Further, in Recommendation No. 6 we found that CCI could improve its monitoring of the training it provides inmates to ensure that its training programs provide inmates with skills that will be marketable upon release.

