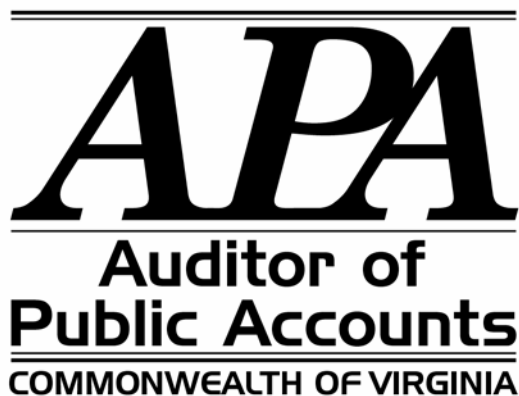


**VIRGINIA CORRECTIONAL ENTERPRISES  
DEPARTMENT OF CORRECTIONS**

**REPORT ON AUDIT  
FOR THE YEAR ENDED  
JUNE 30, 2005**



## **AUDIT SUMMARY**

Our audit of Virginia Correctional Enterprises, a division of the Department of Corrections, for the year ended June 30, 2005, found:

- Proper recording and reporting of transactions, in all material respects, in the Commonwealth Accounting and Reporting System and VCE's accounting records; and
- One matter involving internal control and its operations necessary to bring to management's attention; and
- No instances of noncompliance or other matters with applicable laws and regulations

- TABLE OF CONTENTS -

AUDIT SUMMARY

AGENCY OVERVIEW AND FINANCIAL HIGHLIGHTS

Financial Summary	1- 2
Sales and Profit Information by Industry	2- 4
Inventory Information by Industry	4
Prison Industries Enhancement Certification Program	5
Joint Ventures	5
Future Industry Expansion	5

INTERNAL CONTROL FINDING AND RECOMMENDATION	6
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INDEPENDENT AUDITOR'S REPORT	7- 8
------------------------------	------

AGENCY RESPONSE	9-10
-----------------	------

AGENCY OFFICIALS	11
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## AGENCY OVERVIEW AND FINANCIAL INFORMATION

The Virginia Department of Corrections has operated Virginia Correctional Enterprises (VCE) since 1934 as one of its many work programs for inmates. VCE is the only work program that is entirely self-sufficient, using sales revenue to pay for operations. The Code of Virginia requires VCE to provide job skill training and wage earning opportunities for Corrections' inmates. At June 30, 2005, VCE employed 1,638 (five percent) of the 31,045 inmates housed in state correctional facilities. These inmates work in 16 different industries located in 16 state prisons and 3 off-site locations throughout the state. VCE also employs 167 civilian staff who work in the central office and warehouse in Richmond or in the various correctional facilities throughout the state.

Section 53.1-47 of the Code of Virginia requires all Commonwealth departments, institutions, and agencies, supported in whole or in part with funds from the state treasury, to purchase goods manufactured by VCE. Agencies must obtain a waiver in order to purchase the same goods VCE manufactures from another vendor. Currently, state agencies account for approximately 60 percent of sales, and colleges and universities account for approximately 33 percent. The Code of Virginia also allows counties, districts, cities, towns, non-profit organizations, volunteer lifesavings first aide crews, rescue squads, fire departments, sheltered workshops, and community service organizations to purchase from VCE. During fiscal year 2005, these types of customers accounted for approximately seven percent of sales.

VCE is a self-sufficient operation, paying for all expenses from monies collected for sales of its goods and services. VCE receives no General Fund appropriations, relying totally on monies collected from sales. The following table summarizes the VCE's financial results for fiscal year 2004 and 2005.

### Financial Summary

	<u>Year Ended June 30, 2005</u>	<u>Year Ended June 30, 2004</u>
Charges for sales and services	<u>\$48,406,964</u>	<u>\$41,889,791</u>
Cost of goods sold:		
Raw materials	22,635,179	17,973,688
Inmate labor	<u>1,890,225</u>	<u>1,836,823</u>
Total cost of goods sold	24,525,404	19,810,511
Manufacturing overhead	10,667,145	10,986,643
Administrative and warehouse expenses	<u>9,873,274</u>	<u>7,896,139</u>
Total cost of goods, overhead, and operating expenses	<u>45,065,823</u>	<u>38,693,293</u>
Operating income	3,341,141	3,196,498
Non-operating revenues/(expenses)	125,369	(90,340)
Transfer to General Fund	(1,068,658)	(1,115,020)
Other transfers out	<u>(49,039)</u>	<u>(125,125)</u>
Net income/(loss)	<u>\$ 2,348,813</u>	<u>\$ 1,866,013</u>

Source: VCE financial statements

VCE sales have increased over \$6.5 million the last year. The increase is largely due to increases in revenues in the office systems, wood, and metal industries. VCE received a one-time order from the Department of General Services to furnish the Patrick Henry Building (Old State Library), which accounted for \$2.5 million in sales. VCE has generated operating income of over \$3 million for each of the past two years. VCE also made transfers to the General Fund of the Commonwealth totaling a little more than \$1 million in 2004 and 2005. The next section has further details on sales and profit for each industry.

#### Sales and Profit Information by Industry

VCE manages 16 different manufacturing and service industries in various correctional facilities throughout the state. They are listed below:

Clothing Plants - Halifax, Haynesville, Augusta, Fluvanna

Copy Shop - Atmore, State Corporation Commission, South Park Warehouse

Dental Plant - Southampton

Laundry Plants - Virginia Correctional Center for Women (VCCW), Greenville

License Tag Plant - Powhatan

Metal Plants - Dillwyn, Buckingham

Microfilm Plant - VCCW

Office Systems - Brunswick

Optical Plant - Fluvanna

Plastic Bag - Indian Creek

Printing - Powhatan

Shoe Plant - Augusta

Vinyl binders/silkscreen - Powhatan

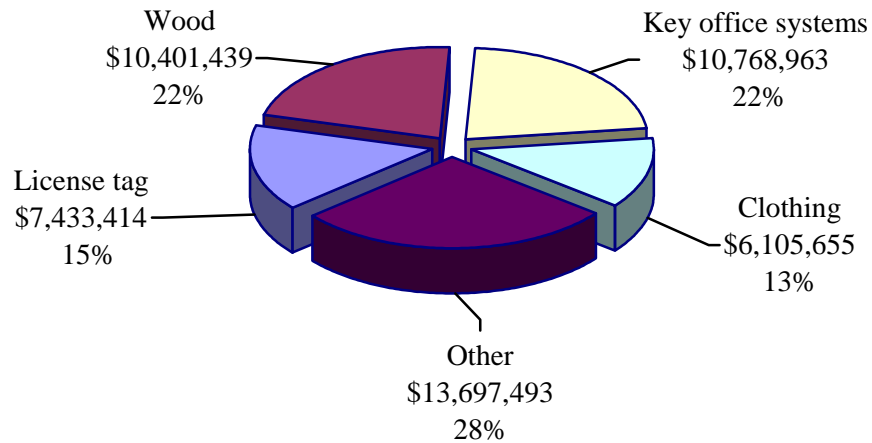
Wood Plants - Greenville, Lunenburg, Nottoway

Joint Venture (Automotive services) - Coffeewood, Sussex II

Prison Industry Enhancement (Wood pallets) – Haynesville, Caroline Field Unit 2

Of these industries, the key office systems industry is the largest in sales volume, accounting for over 22 percent of all sales. The key office systems plant, located at the Brunswick Correctional Center, manufactures office furniture for multiple state agencies. Overall, there are four industries (license tag, wood, key office systems, and clothing) which account for over 72 percent of all sales revenue as shown in the following graph.

### Sales Revenue by Industry for 2005



Source: VCE Financial Statements

Overall, VCE industries have earned a gross profit of between \$10-12 million for each of the past two years. Of the various industries, some have consistently earned a profit while others have had mixed results. Customer demand is the primary factor in determining which industries VCE will support. The following table shows sales as well as gross profits by industry for the last two years.

### Sales and Gross Profit by Industry for 2004 and 2005

	2004			2005		
	Sales Revenue	Gross Profit	Gross Profit as a percent of Sales	Sales Revenue	Gross Profit	Gross Profit as a percent of Sales
License tag	\$ 8,032,316	\$ 3,878,405	48%	\$ 7,433,414	\$ 3,553,581	48%
Wood	7,753,802	(337,302)	(4%)	10,401,439	1,338,166	13%
Key office systems	7,286,823	2,317,076	32%	10,768,963	3,685,030	34%
Clothing	6,704,105	2,130,356	32%	6,105,655	1,955,743	32%
Laundry	3,366,687	1,053,731	31%	3,515,765	670,603	19%
Metal	3,098,505	900,132	29%	4,274,345	1,307,971	31%
Print shops	2,281,970	49,578	2%	2,862,014	(284,707)	(10%)
Automotive services	1,420,552	262,192	18%	1,421,451	253,176	18%
Shoe	1,082,440	355,745	33%	750,608	253,520	34%
Vinyl/silkscreen	455,878	138,903	30%	457,976	114,163	25%
Microfilm	191,828	78,801	41%	221,297	124,354	56%
Dental	109,317	(15,864)	(15%)	109,662	(4,701)	(4%)
Optical	105,568	23,630	22%	84,375	19,194	23%
Total	<u>\$41,889,791</u>	<u>\$10,835,383</u>		<u>\$48,406,964</u>	<u>\$12,986,093</u>	

Source: VCE Financial Statements

The license tag industry had consistently been the largest revenue producer with the highest gross profits for VCE prior to 2005. However due to high demands for furniture, the key office systems industry surpassed the license tag industry in revenue and gross profit in 2005. The wood industry also generated the second highest sales revenue, but lower gross profit due to a high cost of goods sold. Other industries generating significant profits were clothing and metal.

#### Inventory Information by Industry

VCE has 27 decentralized plant sites that produce finished goods for the 16 industries. In addition, VCE has a central warehouse that maintains some finished goods for shipment to its customers. The print shop, license tag, dental, and optical plants ship their finished goods directly from the manufacturing plant to the customer. VCE's inventory at the end of fiscal year 2005 was valued at over \$12 million. The following table shows the inventory balance by industry.

#### Inventory by Industry (June 30, 2005)

<u>Industry</u>	<u>Inventory Amount</u>	<u>Percentage</u>
Wood	\$ 4,560,126	36.0%
Clothing	2,229,424	17.6%
License tag	1,972,635	15.6%
Metal	1,786,158	14.1%
Key office systems	1,409,966	11.1%
Other	<u>713,299</u>	5.6%
Total	<u>\$12,671,608</u>	

Source: Syteline System

The inventory balance consists of raw material, work-in-progress, and finished goods for all industries. Of the total inventory on hand at year-end, four industries own 83 percent of the inventory. The wood industry has the highest amount of inventory on hand at year-end due to the number of furniture orders they receive from agencies and universities towards year-end.

VCE maintains a perpetual inventory system. The plant staff performs a complete inventory count each February, instead of fiscal year end, due to increased orders and high production towards the end of the fiscal year. During the last quarter of the fiscal year, VCE increases the number of test counts at each plant to ensure that the plants are correctly reporting inventory balance at fiscal year end.

VCE values inventory at standard cost for financial reporting purposes on a monthly basis and uses the standard cost to help determine product pricing. For year-end financial reporting purposes, VCE sets inventory value to the lower of cost or market. VCE develops standard cost for material, labor, and manufacturing overhead. To ensure the accuracy of these standard costs, VCE requires each plant to sample a set amount of jobs and document actual cost. Based on these samples, VCE adjusts the system for variances between the sample and what the system estimates.

### Prison Industries Enhancement Certification Program

VCE received federal certification under the Prison Industries Enhancement (PIE) program on March 2, 1995. PIE is a federal Bureau of Justice Assistance certification program where prison industries goods are exempt from federal interstate commerce regulations. All state and local government correctional agencies authorized to administer prison industry programs are eligible to apply for project certification and project partnerships. Certified programs must provide certain safeguards to private sector labor and industry and to prisoner-workers.

Since October 2001, VCE has entered into a PIE contract with Potomac Supply Corporation to repair broken wooden pallets at Haynesville Correctional Center and Caroline Field Unit #2. In April 2005, the PIE contract with Potomac Supply Corporation ended. In March 2003, VCE also had a short term PIE contract with Richmond Commercial Services to manufacture and assemble 100 wooden storage cabinets, which expired after completion of the contract.

### Joint Ventures

In November 2000, VCE entered into a joint venture agreement with World Wide Automotive to disassemble, clean, repair, test, and re-assemble used automotive parts at Coffeewood Correctional Center. In fiscal year 2005, VCE received \$1,421,451 in revenue, earning a gross profit of \$253,176 from this contract. VCE entered into another joint venture agreement in October 2003 with Trex to sort through used plastic bags, recycle them, and produce composite boards from the good plastic and sawdust at Sussex II State Prison. Joint ventures differ from PIE programs because they are an agreement for services performed, for a private industry, instead of the actual production of a good or product. Also, VCE is not required to meet federal regulations established for PIE programs, including the requirement that they pay inmates the prevailing wage rate.

### Future Industry Expansion

VCE is anticipating growth in the wooden furniture market. VCE expects sales to grow by at least four percent annually for the next two years, if the industry continues to meet high standards of quality, on time construction and delivery. VCE expects document services to grow more than ten to 12 percent annually if VCE invests in new facilities, specifically by providing central locations for distribution and service.

Virginia college enrollment is expected to steadily increase through the rest of the decade, creating a need for additional dormitory furniture, office systems and executive and business furniture; however, the restructuring efforts for state colleges and universities may impact VCE sales. Under the restructuring agreement, colleges and universities will have increased operational autonomy and may not have to purchase goods from VCE. It is possible this change could significantly impact VCE sales given that colleges and universities are one of their largest customers.



## INTERNAL CONTROL FINDING AND RECOMMENDATION

### Strengthen SyteLine User Access Procedures

VCE does not have adequate procedures for deleting access to their internal general ledger system, SyteLine. We reviewed a sample of 12 SyteLine user accounts, and found three of the active user accounts still assigned to former employees, and one employee left in 2003.

VCE does not have documented procedures for deleting SyteLine access. The informal procedure requires supervisors to notify information systems staff on or before the individual's last day of employment to delete the SyteLine user account. These informal processes include having the information systems staff periodically reviewing all employees' access to SyteLine to ensure user accounts are current.

Since we found 25 percent of the SyteLine user accounts reviewed remained active for former employees, VCE needs to adopt written procedures for deleting access to SyteLine. The procedures should require supervisors to submit a deletion request to information systems within a given timeframe. The agency should also consider periodically requiring supervisors to certify a listing of SyteLine users. Failure to control SyteLine access could lead to individuals gaining improper entry into the system.



# Commonwealth of Virginia

Walter J. Kucharski, Auditor

Auditor of Public Accounts  
P.O. Box 1295  
Richmond, Virginia 23218

April 17, 2006

The Honorable Tim Kaine  
Governor of Virginia  
State Capital  
Richmond, Virginia

The Honorable Lacey E. Putney  
Vice Chairman, Joint Legislative Audit  
and Review Commission  
General Assembly Building  
Richmond, Virginia

We have audited the financial records and operations of the **Virginia Correctional Enterprises**, a division of the **Department of Corrections**, for the year ended June 30, 2005. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

## Audit Objectives

Our audit's primary objectives were to evaluate the accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System and VCE's SyteLine system, review the adequacy of VCE's internal control, and test compliance with applicable laws and regulations. We also reviewed VCE's corrective actions of the audit finding from the prior year report.

## Audit Scope and Methodology

VCE's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

We gained an understanding of the overall internal controls, automated and manual, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following cycles, classes of transactions, and account balances.

Revenues and Cash Receipts  
Expenditures, including Costs of Goods Sold  
Inventory

We performed audit tests to determine whether VCE's controls were adequate, had been placed in operation, and were being following. Our audit also included tests of compliance with provisions of applicable laws and regulations. Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of VCE's operations. We also tested transactions and performed analytical procedures, including budgetary and trend analysis.

#### Audit Conclusions

We found that VCE properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System and SyteLine. VCE records its financial transactions in its accounting records on the accrual basis of accounting. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System as well as VCE's accounting records and financial reports.

We noted a certain matter involving internal control and its operation that require management's attention and corrective action. This matter is described in the section entitled "Internal Control Finding and Recommendation." The results of our tests of compliance with applicable laws and regulations disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

VCE has taken adequate corrective action with respect to the specific issues in our previously reported finding entitled "Strengthen Internal Controls Over SyteLine Access;" however, we continued to find additional issues related to SyteLine Access. These issues are included in the reported finding "Strengthen SyteLine User Access Procedures."

#### EXIT CONFERENCE

We discussed this report with management on May 9, 2006. Management's response has been included at the end of this report.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

LCR:sks  
sks:30



# COMMONWEALTH of VIRGINIA

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ADMINISTRATION: 804-743-4103  
CUSTOMER SERVICE: 804-743-4100  
TOLL FREE: 800-823-2823

*Department of Corrections*  
*Virginia Correctional Enterprises*

MAILING ADDRESS  
8030 WHITE BARK TERRACE  
RICHMOND, VA 23237  
or  
P. O. BOX 13799  
RICHMOND, VIRGINIA 23225-3799

May 8, 2006

Auditor of Public Accounts  
Mr. Walter J. Kucharski  
PO Box 1295  
Richmond, VA 23218-1295

RE: Response to APA Audit Report on Virginia Correctional Enterprises for the Year  
June 30, 2005

Dear Mr. Kucharski,

In accordance with Section No. 10205 of the Commonwealth's Accounting Policies and Procedures Manual, enclosed is our response to APA's report on the audit of VCE for the year ended June 30, 2005.

Please let me know if you have any questions regarding this report.

Sincerely,

D. R. Guillory  
CEO, VCE

Enclosure



## **APA FINDING AND RECOMMENDATION:**

### **Strengthen SyteLine User Access Procedures**

VCE does not have adequate procedures for deleting access to their internal general ledger system, SyteLine. We reviewed a sample of 12 SyteLine user accounts, and found three of the active user accounts still assigned to former employees, and one employee left in 2003.

VCE does not have documented procedures for deleting SyteLine access. The informal procedure requires supervisors to notify information systems staff on or before the individual's last day of employment to delete the SyteLine user account. These informal processes include having the information systems staff periodically reviewing all employees' access to SyteLine to ensure user accounts are current.

Since we found 25 percent of the SyteLine user accounts reviewed remained active for former employees, VCE needs to adopt written procedures for deleting access to SyteLine. The procedures should require supervisors to submit a deletion request to information systems within a given timeframe. The agency should also consider periodically requiring supervisors to certify a listing of SyteLine users. Failure to control SyteLine access could lead to individuals gaining improper entry into the system.

**VCE RESPONSE:** Management agrees that formal written procedures must be issued to ensure that access to VCE's accounting and manufacturing system is properly controlled and limited to current users.

**ACTION:** Issue written procedures for deleting access to SyteLine.

**RESPONSIBILITY:** Business Manager

**DUE DATE:** 1<sup>st</sup> Quarter, FY2007

DEPARTMENT OF CORRECTIONS

VIRGINIA CORRECTIONAL ENTERPRISES  
As of June 30, 2005

Gene M. Johnson, DOC Director

N. H. “Cookie” Scott, Deputy Director of Administration

Don Guillory, VCE Chief Executive Officer

Jim Sacher, VCE Business Manager