

Audit Report

**Department of Public Safety and Correctional Services
Maryland Correctional Enterprises**

July 2015



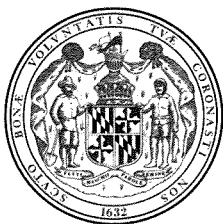
OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Karl S. Aro
Executive Director

July 24, 2015

Thomas J. Barnickel III, CPA
Legislative Auditor

Senator Guy J. Guzzone, Co-Chair, Joint Audit Committee
Delegate Craig J. Zucker, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the Maryland Correctional Enterprises (MCE) for the period beginning August 1, 2011 and ending February 19, 2015. MCE, which is a unit within the Department of Public Safety and Correctional Services (DPSCS), provides work and job training for inmates of the Maryland correctional system.

Our audit disclosed that MCE had not established proper internal controls over collections received through the mail. Our audit also disclosed that MCE lacked controls to ensure the propriety of non-cash credit adjustments posted to customer accounts receivable records, and there was no documentation that adjustments to its materials and supplies inventory records were reviewed and approved.

The response from DPSCS, on behalf of MCE, to this audit is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during the course of this audit by MCE.

Respectfully submitted,

Thomas J. Barnickel III, CPA
Legislative Auditor

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Background Information

Agency Responsibilities and Organizational Change

The Maryland Correctional Enterprises (MCE) is organized under the State of Maryland's Department of Public Safety and Correctional Services (DPSCS) and was formerly a unit within the Department's Division of Correction. Effective July 1, 2012, DPSCS completed a departmental reorganization which eliminated the Division of Correction as a separate budgetary unit and established three regions within the State to provide inmate-related functions. These regions and MCE are separate budgetary units organized under DPSCS's Deputy Secretary of Operations.

MCE operates under the provisions of the Correctional Services Article of the Annotated Code of Maryland. The Code provides, in part, that MCE develop programs that provide work experience or rehabilitation for eligible inmates. The Code also provides that MCE be financially self-supporting. The goods produced (for example, furniture, metal products, mattresses, and printing) and services offered (for example, data entry) by MCE are available to State and federal agencies, political subdivisions, and any charitable, civic, educational, fraternal, or religious agency, association, or institution (for their own use and not for resale to others), or as otherwise indicated in the law.

According to MCE's audited financial statements, MCE's fiscal year 2014 operating revenue and operating expenses were approximately \$51.8 million and \$50.8 million, respectively, and its net operating income for fiscal year 2014 totaled \$1 million. As of June 30, 2014, MCE's net position totaled \$32.5 million.

Financial Statement Audits

For fiscal years 2012, 2013, and 2014, MCE engaged an independent accounting firm to perform the audit of MCE's financial statements. In the related audit reports, the firm stated that MCE's financial statements presented fairly, in all material respects, the respective financial position of MCE and the respective changes in its financial position and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Status of Finding From Preceding Audit Report

Our audit included a review to determine the status of the finding contained in our preceding audit report dated January 24, 2012. We determined that MCE satisfactorily addressed this finding.

Findings and Recommendations

Cash Receipts

Finding 1

Proper controls had not been established over mail receipts.

Analysis

MCE had not established adequate accountability and control over its mail receipts. In February 2013, MCE began processing these receipts using remote deposit, which scans the images of checks and electronically transmits the images to the State's bank for deposit. Our review disclosed that MCE did not restrictively endorse checks "for deposit only" and did not verify that checks scanned through the remote deposit system were properly marked as scanned, as required. As of April 8, 2015, MCE had 110 checks on hand totaling \$215,290 that were processed using remote deposit between March 3, 2015 and March 31, 2015 that had not been restrictively endorsed and marked as scanned. Additionally, our review disclosed that MCE did not independently reconcile scanned checks that were subsequently destroyed with its records of checks initially received and deposited, as required. According to MCE records, mail receipts totaled approximately \$4.7 million during fiscal year 2014.

As a result of these conditions, receipts could be lost or misappropriated without timely detection. The Office of the State Treasurer's *Policy on the Use of Remote Deposit Services by Maryland State Agencies* requires checks to be restrictively endorsed immediately upon receipt and requires agencies to verify that each scanned check was properly marked as scanned. The *Policy* further requires that the agency destroy scanned checks within thirty days of deposit and independently reconcile both the checks deposited at the bank and the checks destroyed to the incoming check receipt log.

Recommendation 1

We recommend that MCE

- a. restrictively endorse checks immediately upon receipt,**
- b. ensure that checks scanned through the remote deposit system were properly marked as scanned, and**
- c. independently reconcile the checks deposited at the bank and checks subsequently destroyed with the initial receipt log.**

Accounts Receivable

Finding 2

MCE lacked adequate controls to ensure that non-cash credit adjustments to customer accounts were authorized and proper.

Analysis

MCE lacked adequate controls to ensure that non-cash credit adjustments to customer accounts were authorized and proper. Our review disclosed that, although non-cash credit adjustment requests were approved by MCE management prior to the adjustment being posted, there was no independent supervisory review and approval of adjustments actually posted in MCE's automated accounts receivable system to ensure that only authorized adjustments were recorded. Our judgmental selection and test of 10 non-cash adjustments totaling \$2.8 million which were processed between June 2013 and January 2015 disclosed that, even though the adjustments were proper, there was no evidence of an independent supervisory review and approval after the adjustments had been posted. As a result, unauthorized or inaccurate non-cash credit adjustments could be made without detection.

The Comptroller of Maryland's *Accounting Procedures Manual* requires that adjustments to accounts receivable records be reviewed and approved by an employee in a supervisory capacity. According to MCE's records, during fiscal year 2014, MCE processed 210 non-cash credit adjustments totaling approximately \$3.1 million.

Recommendation 2

We recommend that MCE ensure that non-cash credit adjustments posted to the accounts receivable records are reviewed and approved by supervisory personnel and that this review is documented.

Materials and Supplies

Finding 3

MCE lacked documentation that adjustments to its materials and supplies inventory records were reviewed and approved.

Analysis

MCE lacked documentation that adjustments to its inventory records were reviewed and approved. Our review disclosed that for fiscal year 2014 MCE performed an annual reconciliation of its materials and supplies inventory records

to amounts on hand and investigated any differences; however, there was no documented supervisory review and approval of the investigations and the related adjustments to the inventory records. MCE advised us that the required reviews were conducted, but not documented.

The Department of General Services' (DGS) Inventory Control Manual requires that all adjustments to the inventory records be approved by someone in authority not below the level of Chief Administrative Officer. According to its records, MCE made 39 adjustments totaling approximately \$400,000, each in excess of \$4,000, after completing the fiscal year 2014 reconciliation. The materials and supplies inventory balance reported to DGS as of June 30, 2014 totaled approximately \$10.3 million.

Recommendation 3

We recommend that MCE ensure that investigations of inventory variances and the related inventory record adjustments are reviewed and approved, in writing, by appropriate supervisory personnel.

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the Maryland Correctional Enterprises (MCE), a unit within the Department of Public Safety and Correctional Services (DPSCS), for the period beginning August 1, 2011 and ending February 19, 2015. The audit was conducted 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.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine MCE's financial transactions, records, and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of significance and risk. The areas addressed by the audit included purchases and disbursements, cash receipts, accounts receivable, payroll, materials and supplies, and equipment. We also determined the status of the finding included in our preceding audit report.

MCE engaged an independent accounting firm to perform audits of its financial statements for the fiscal years ended June 30, 2012, 2013, and 2014. In the related audit reports, the firm stated that MCE's financial statements presented fairly, in all material respects, the respective financial position of MCE and the respective changes in its financial position and cash flows for the years ended in accordance with accounting principles generally accepted in the United States of America. We have relied on the work of the independent accounting firm to provide audit coverage pertaining to MCE's equipment purchases and disposals and materials and supplies recordkeeping. Our audit procedures in these areas were generally limited, therefore, to obtaining a sufficient basis for that reliance.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of MCE's operations, and tests of transactions. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk. Unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, the results of the tests cannot be used to project those results to the entire population from which the test items were selected. We also performed various data extracts of pertinent

information from the State's Financial Management Information System (such as revenue and expenditure data) and the State's Central Payroll Bureau (payroll data). The extracts are performed as part of ongoing internal processes established by the Office of Legislative Audits and were subject to various tests to determine data reliability. We determined that the data extracted from these various sources were sufficiently reliable for the purposes the data were used during this audit. Finally, we performed other auditing procedures that we considered necessary to achieve our objectives. The reliability of data used in this report for background or informational purposes was not assessed.

MCE's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes findings related to conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect MCE's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes findings regarding significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to MCE that did not warrant inclusion in this report.

DPSCS' response, on behalf of MCE, to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise DPSCS regarding the results of our review of its response.



APPENDIX

Department of Public Safety and Correctional Services

Office of the Secretary

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July 15, 2015

Mr. Thomas J. Barnickel III, CPA
Legislative Auditor
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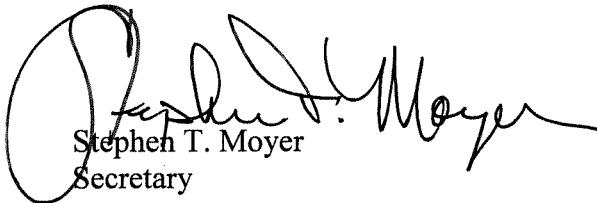
Dear Mr. Barnickel:

We have reviewed the July 9, 2015 Draft Legislative Audit Report for the Department of Public Safety and Correctional Services' (DPSCS) Maryland Correctional Enterprises (MCE) and are pleased that the one finding from the last audit has been satisfactorily addressed. DPSCS appreciates the constructive recommendations that were made as the result of this audit.

Attached is MCE Chief Executive Officer Stephen M. Shiloh's response to the Draft Audit Report. Mr. Shiloh will continue to implement corrective action to resolve the three audit findings and will closely monitor the status in order to prevent any repeat audit findings going forward.

Please let me know if you have any questions or need additional information.

Sincerely,



Stephen T. Moyer
Secretary

Copy: Col. Thomas E. Hutchins, Director, Governor's Office of Homeland Security



Department of Public Safety and Correctional Services

Maryland Correctional Enterprises

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STEPHEN M. SHILOH, CCE
CHIEF EXECUTIVE OFFICER

July 15, 2015

The Honorable Stephen T. Moyer, Secretary
Department of Public Safety and Correctional Services
300 East Joppa Road, Suite 1000
Towson, Maryland 21286-3020

Via

Mr. Wendell M. France, Deputy Secretary Operations
Department of Public Safety and Correctional Services
300 East Joppa Road, Suite 1000
Towson, Maryland 21286-3020

Dear Secretary Moyer:

Attached is the Maryland Correctional Enterprises (MCE) response to the draft Legislative Audit report dated July 9, 2015, covering the examination of MCE's financial transactions, records and internal controls, and the evaluation of compliance with applicable State laws, rules, and regulations for the period beginning August 1, 2011 and ending February 19, 2015. Corrective action has been implemented for the three findings mentioned in the report.

Finding 1 – Proper controls had not been established over mail receipts.

Recommendation 1:

We recommend that MCE

- a. restrictively endorse checks immediately upon receipt,**
- b. ensure that checks scanned through the remote deposit system were properly marked as scanned, and**
- c. independently reconcile the checks deposited at the bank and checks subsequently destroyed with the initial receipt log.**

MCE Response

We Agree. Beginning in the fourth quarter of fiscal year 2015, MCE

- a. reinstated the policy of restrictively endorsing checks immediately upon receipt;
- b. instituted a policy to ensure that checks scanned through the remote deposit system were properly marked as scanned (i.e., have “spray lines” printed on them); and

- c. implemented a policy to independently reconcile the checks deposited at the bank and the checks subsequently destroyed with the initial cash receipt log.

Finding 2 - MCE lacked adequate controls to ensure that non-cash credit adjustments to customer accounts were authorized and proper.

Recommendation 2:

We recommend that MCE ensure that non-cash credit adjustments posted to the accounts receivable records are reviewed and approved by supervisory personnel and that this review is documented.

MCE's Response

We Agree. Beginning in the fourth quarter of fiscal year 2015, MCE implemented a policy to ensure that non-cash credit adjustments posted to the accounts receivable records were reviewed and approved by the Accounts Receivable Manager and that such review is documented. It should be noted that of the \$2.8 million in non-cash credits selected for testing during the audit, \$2.75 million resulted from the correction of data entry errors discovered during the verification of invoices prior to customer invoicing.

Finding 3 - MCE lacked documentation that adjustments to its materials and supplies inventory records were reviewed and approved.

Recommendation 3:

We recommend that MCE ensure that investigations of inventory variances and the related inventory record adjustments are reviewed and approved, in writing, by appropriate supervisory personnel.

MCE's Response

We Agree. Effective with the 2015 fiscal year-end physical inventory and reconciliation, MCE instituted a policy to ensure that the investigation of inventory variances and the related inventory adjustments were reviewed and approved, in writing, by appropriate supervisory personnel. Specifically, MCE will ensure that the annual adjustment to the MAPICS material and supplies record is reviewed and approved by the Chief Administrative Officer, the Chief Operating Officer, or the Chief Executive Officer.

Stephen T. Moyer, Secretary
July 15, 2015
Page 3

MCE would like to acknowledge the cooperation and professionalism demonstrated by the Office of Legislative Audits during the course of this audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Shiloh", with a stylized, cursive script.

Stephen M. Shiloh, CCE
Chief Executive Officer

Cc: William G. Stewart, Deputy Secretary for Administration, DPSCS
Joseph M. Perry, Inspector General, DPSCS
Mark K. Rowley, Chief Administrative Officer, MCE
Verona M. Williams, Chief Financial Officer, MCE

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