

H. CARL McCALL
STATE COMPTROLLER



A.E. SMITH STATE OFFICE BUILDING
ALBANY, NEW YORK 12236

STATE OF NEW YORK
OFFICE OF THE STATE
COMPTROLLER

May 4, 1999

Mr. Glenn S. Goord
Commissioner
Department of Correctional Services
The Harriman Campus
1220 Washington Avenue
Albany, New York 12226-2050

Re: Report 98-F-46

Dear Mr. Goord:

Pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution and Article II, Section 8 of the State Finance Law, we have reviewed the actions taken by officials of the Department of Correctional Services' as of April 19, 1999, to implement the recommendations contained in our audit report, *Department of Correctional Services Industries Program* (Report 96-S-24). Our report, which was issued on July 24, 1997, reviewed the efficiency and effectiveness of management in employing inmates in real work situations, providing quality products to its customers in a timely manner, and attaining self-sufficiency. In addition, the report identified potential directions management could take to better fulfill its mission in the future.

Background

The Department of Correctional Services (Department) operates a prison industries program (Corcraft). Corcraft's primary mission is to use inmates to:

- produce quality goods and services that are delivered on time; and
- operate at no cost to taxpayers.

For the year ended March 31, 1998, Corcraft reported revenues of \$60.6 million and expenses of \$64.7 million, for a net loss of \$4.1 million. During that year, Corcraft employed an average of 2,393 inmates at 16 of the Department's 70 facilities statewide. This represents about 10.5 percent of the inmate population at those 16 facilities, and 3.4 percent of the State's total inmate population (69,554). The Department has assigned 530 staff to Corcraft operations,

comprising 397 civilians, 125 correction officers and 8 vocational staff.

Corcraft manufactures products in 11 product lines, including cleaning products, chairs and wood furniture, metal furniture, apparel and license plates. By law, Corcraft can sell goods to New York State agencies, local governments, public authorities, the Federal government, and other state governments. Corcraft's largest customers are the Department itself (26 percent of sales) and the Department of Motor Vehicles (17 percent of sales). Other State agencies account for 23 percent of Corcraft's sales, New York City accounts for 10 percent of sales, and other customers account for the remaining 24 percent.

In the past, if a State agency wanted to purchase a product and that product was produced by Corcraft, the agency was required to purchase the product from Corcraft (or obtain Corcraft approval to purchase the product elsewhere). However, the Procurement and Stewardship Act of June 1995 allows State agencies to purchase similar items from outside vendors without Corcraft's approval.

Summary Conclusions

In our prior audit, we identified several deficiencies in Corcraft's operating practices. We found that Corcraft management had not fully accomplished its mission, and stated our belief that management would be more likely to do so if certain internal control weaknesses were corrected. We highlighted internal control weaknesses related to long-range planning, staff qualifications, and information system development.

In our follow-up review, we found that Department and Corcraft officials have taken steps to implement the recommendations contained in our prior audit report. Department officials have taken steps to improve quality control and customer satisfaction, and to evaluate product viability as it relates to cost recovery. Further, improvements in inventory controls led to annual savings of \$280,000 as a result of canceling leases for warehouse space. However, Department officials have not implemented recommendations pertaining to Corcraft's long-range planning, the appropriateness of Department personal service costs being charged to Corcraft appropriations, risk assessments and verification of product component costs.

Summary of Status of Prior Audit Recommendations

Of the 16 prior audit recommendations, Department and Corcraft officials have implemented five recommendations, partially implemented seven recommendations, and did not implement four recommendations.

Follow-up Observations

Recommendation 1

Work with State policy makers to clarify the role of the correctional industries program.

Status - Not Implemented

Agency Action - Department officials continue to disagree with this recommendation. They maintain that the mission of correctional industries and the role it plays in the Department is clear, and as such no additional information is required. As indicated in the original report, we recognize that Corcraft's mission statement is clear. However, we concluded that Department officials and State policy makers need to assess Corcraft's overall future role in light of developments in other states.

Recommendation 2

Determine the reasons for the decline in the number of inmates participating in the program.

Status - Implemented

Agency Action - Department officials stated that the reasons for the decline in the number of inmates participating in the program are known, and they are taking actions to increase inmate employment. Department officials indicated that the decline is due to an overall increase in the productive hours worked by inmates along with the purchase of new equipment. These improvements increased productivity and permitted Corcraft to manufacture products with fewer inmates.

Department officials also stated that the reason for the decline in inmate workers at places like Attica, Auburn and Clinton is that the overall pool of inmates has shrunk somewhat because of the profile of the inmate population at those facilities. Department officials indicated that this trend has changed significantly with the building of new 200 bed special housing units (S-Units), which freed up general population cells at these facilities. This trend is expected to continue with other new facilities coming on line. Officials stated that they expect a modest increase in employment levels in 1999 due to expansion in some areas and increases in production in others. They also indicated that at facilities where they have had difficulty maintaining employment numbers, they now have situations where inmates are idle. Department officials stated their belief that some of these inmates will be assigned to the Corcraft work force.

Recommendation 3

Establish a long-range strategic plan which incorporates Corcraft's vision, mission, guiding principles and goals to better enable Corcraft management to accomplish Corcraft's mission. The strategic plan should address the major activities, the laws affecting Corcraft, and the business environment. Each goal should be supported by relevant objectives, strategies, activities and performance measures.

Status - Partially Implemented

Agency Action - The Department procured the services of a consultant for the purpose of conducting an economic impact study of Corcraft's operations on the State's economy. The consultant concluded that displacing Corcraft operations and its products with public sector procurement of similar products from the open market would have a negative effect on New York State's economy. The consultant also indicated that if Corcraft is to be competitive in a changing market environment, it should more closely replicate private sector business practices and strategies. In addition, other consultants were utilized to review and analyze the markets for specific products produced at Attica, Albion and Elmira correctional facilities. Department officials stated that the conclusions and recommendations of the consultants will be factored into Corcraft's long-range planning.

Although Department officials have taken steps to develop a strategic plan, it has not yet been formalized. Department officials stated that they have a request pending with the Division of the Budget (DOB) to hire a Project Director who will coordinate the development of Corcraft's strategic plan.

Recommendation 4

Continue to improve quality control and customer satisfaction.

Status - Implemented

Agency Action - The Department utilized the services of consultants to analyze several aspects of Corcraft operations. One consultant's review included a survey of customer satisfaction with Corcraft products and services. Although our review of the survey results indicates that there are still areas where product quality can improve, customers did respond that they have seen noticeable improvements in Corcraft's performance in recent years.

Recommendation 5

Work with Division of the Budget officials to evaluate the appropriateness of Department personal service costs charged to Corcraft and whether alternative approaches can or should be used.

Status - Not Implemented

Agency Action - The Department continues to charge Corcraft for the personal service costs of corrections officers whose posts are within Corcraft areas. Department officials stated that they have had discussions with DOB officials concerning the appropriateness of this practice. According to Department officials, DOB agreed that this practice is appropriate. However, the Department did not have any documentation to support DOB's agreement. In addition, prior to fiscal year 1985-86, the Department incurred the personal service costs of the corrections officers whose posts were within Corcraft areas. As was pointed out in the original audit, if the cost of these officers was not charged to Corcraft

operations, Corcraft would have reported an operating profit. Department officials stated that preliminary figures for fiscal year 1998-99 indicate that Corcraft recorded a profit of approximately \$600,000. However, no documentation was provided to support these figures.

Recommendation 6

Develop formal long-range plans relating to product development, pricing and marketing.

Status - Partially Implemented

Agency Action - As discussed in the Agency Action section for recommendation 3, the Department procured the services of a consultant for the purpose of conducting an economic impact study of Corcraft's operations on the State's economy. Department officials stated that the results of this study will be factored into the long-range plans related to product development, pricing and marketing. However, as previously indicated, Corcraft's strategic plan is still in the process of being formalized. Department officials also provided evidence which demonstrates that they review product contribution margins as part of their review of profitability.

Recommendation 7

Formally evaluate the viability of any product that is being sold for less than its standard cost.

Status - Implemented

Agency Action - Department officials stated that they review product viability by reviewing contribution margins. This review seeks to ensure that each product recovers more than its variable cost (selling price less material, labor and other direct costs). We reviewed evidence which supports that these reviews are conducted on a periodic basis. We also reviewed evidence which indicates that the results of these reviews led to price increases for selected products.

Recommendation 8

Enhance staff's capability in sales and marketing skills through recruitment and/or training activities in an effort to boost their effectiveness.

Status - Partially Implemented

Agency Action - Department officials documented that sales and marketing staff receive on-going training. With respect to recruitment, prospective candidates for these positions should be recruited based on established relevant qualifications and skills. Currently, such

minimum qualifications do not exist, allowing anyone to be appointed to these positions. Department officials stated that they have worked with appropriate authorities to ensure that individuals being appointed to marketing and sales positions are qualified even though their positions are, for the most part, in the exempt class.

Recommendation 9

Do periodic assessments of the risks to Corcraft's operations.

Status - Not Implemented

Agency Action - The Department still continues the practice of having Internal Audit staff perform audits that include risk assessments for Corcraft operations. We maintain that Department management, and not the internal auditor, needs to identify and analyze the internal and external risks relevant to the achievement of Corcrafts' stated mission and Corcrafts' continued existence. Periodic risk assessments performed by the internal auditor should be the basis for developing an organization's annual audit plan.

Recommendation 10

Develop information systems to capture accurate and reliable data, and use existing data to evaluate and improve operations.

Status - Partially Implemented

Agency Action - Department management stated that they upgraded their system with a new Manufacturing Accounting and Production Information Control System (MAPICS) computer module. Department management provided evidence which indicates that they are utilizing this system to analyze and improve Corcraft operations. However, Department management also informed us that the level of MAPICS utilization varies among facilities.

Recommendation 11

Train managers and staff in the use of the production and cost accounting system, as well as any other information systems that are developed.

Status - Partially Implemented

Agency Action - Department officials provided evidence which shows that training was provided to all staff involved in MAPICS implementation at the time of installation. As reported in the initial audit, we did not dispute that training had been provided. Rather, we noted that the system has monitoring capabilities, but Corcraft management had not instructed facility managers on how to use the system to monitor operations.

As indicated in the Agency Action section for recommendation 10, management is using MAPICS to analyze and improve Corcraft operations. However, management informed us that the level of MAPCIS utilization varies among facilities. Consequently, some of the deficiencies we identified in program monitoring during the original audit may still exist.

Recommendation 12

Ensure that all changes to systems data and computer programs are authorized by management.

Status - Partially Implemented

Agency Action - Department officials stated that they have taken steps to ensure that all changes to the system are authorized by management, at either the facility or central office level. Management also indicated that any changes previously made to the system without management review or approval are being addressed. Department officials also stated that all system changes are coordinated, approved and implemented by the Assistant Director of Administration and the Supervisor of Data Processing. Further, access to system file maintenance is limited to authorized individuals and is periodically audited by Internal Audit. However, the Department has not finalized the policy directive which would outline the steps required for a system change.

Recommendation 13

Periodically verify that product components and labor costs recorded on the production and cost accounting system are accurate.

Status - Not Implemented

Agency Action - Department officials stated that their overall approach to financial management is to reduce material costs. They maintain that material cost, not direct labor, is a more significant area to address and they do this by reviewing product structure. Department officials noted that this has been done for years through the use of weekly Material Requirements Planning (MRP) runs which test the validity of product components in the production and cost accounting system. However, as we reported in the initial audit, the MRP is a test for the number of component parts in production and inventory. MRP does not test the accuracy of direct labor and materials to produce these parts.

Recommendation 14

Separably account for obsolete and damaged raw materials and finished goods, and dispose of these items either through sales or surplus to other governmental agencies.

Status - Implemented

Agency Action - Department officials revised their policy directive concerning obsolete stock, which identifies the procedures needed for a systematic review and disposition of discontinued or obsolete stock. Department officials also provided evidence which indicates that improved management and disposition of obsolete materials and finished goods has led to the Department terminating two leases for warehouse space resulting in savings of over \$280,000 annually.

Recommendation 15

Ensure that raw materials are not overstocked by considering sales forecasts and current inventory levels when re-ordering the materials.

Status - Implemented

Agency Action - Department management provided evidence which indicates that they have taken steps to improve inventory levels and reduce instances of overstocking. Department records show that between April 1, 1998 and October 31, 1998, inventory was reduced from \$18.1 million to \$15.3 million. This reduction occurred during a period when Corcraft sales increased. Officials indicated that this inventory reduction was a major contributing factor that led to the Department vacating the leases cited in the Agency Action section for recommendation 14.

Recommendation 16

Establish an effective internal audit function which operates in compliance with professional auditing standards. At a minimum, activities should include:

- *ceasing auditor involvement in non-audit activities,*
- *using a risk-based methodology to identify significant audit issues,*
- *following up on all significant external auditors' recommendations,*
- *ensuring that internal audit reports identify the causes of reported problems, and*
- *ensuring that the internal auditor does not give advance notice of audits to the units being audited.*

Status - Partially Implemented

Agency Action - Department officials provided evidence which indicates that improvements have been made in their internal audit function. Some non-audit activities are no longer performed by the internal auditor and the internal auditor is now responsible for following up on external audit recommendations. In addition, internal audit reports identify the cause of reported problems and advance notice is no longer given for any audit activity. However, as indicated in the Agency Action section for recommendation 9, the internal auditor is still actively involved in assessing organizational risks for management via the audit process.

Major contributors to this report were Ed Durocher and Marianne Boyer.

We would appreciate your written response to this report within 30 days, indicating any additional actions planned or taken to address any unresolved matters discussed in this report. We also thank the management and staff of the Department of Correctional Services for the courtesies and cooperation extended to our auditors during this review.

Very truly yours,

Kevin M. McClune
Audit Director

cc: Mr. Charles Conaway