

State of Colorado
Office of the State Auditor

Performance Audit of the Department of Corrections'
Inmate Canteen and Banking Programs

June 2018



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June 8, 2018

Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the Inmate Banking and Canteen Programs managed by 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, and Section 2-7-204(5), C.R.S., which requires the State Auditor to annually conduct performance audits of one or more specific programs or services in at least two departments for purposes of the SMART Government Act. The State Auditor contracted with Sjoberg Evashenk Consulting, Inc., to conduct this audit. The report presents our findings, conclusions, and recommendations, and the responses of the Department of Corrections.

Respectfully submitted,

A handwritten signature in blue ink that reads "George J. Skiles".

George J. Skiles
Principal

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REPORT HIGHLIGHTS

Inmate Canteen and Banking Programs

Performance Audit, June 2018

Department of Corrections

CONCERN

The Department lacks adequate controls over price setting and procurement practices for the Canteen and policies to ensure Canteen profits are used in accordance with statute. The lack of controls and policies could lead to the Canteen paying more than necessary for some items, inequitable pricing, reductions in the amounts inmates have for other purposes (such as to pay off debts or save), and the Canteen's revenue not covering costs.

KEY FINDINGS

- The Department's Canteen Account revenues (averaging about \$18 million per year) were sufficient to cover the costs of operating the Canteen (averaging less than about \$15 million per year) for Fiscal Years 2012 through 2017.
- The Department does not have a markup policy for Canteen items, as required by Department regulation. For 6 of the 9 categories of items regularly sold through the Canteen, the average markup ranged from 18 to 43 percent and individual items within categories varied even more widely. For example, in the medical category, items were priced from 49 percent below cost to 72 percent above. Further, the Department does not use complete cost information to set Canteen prices, does not retain cost data for some items, and has not set profitability targets for the Canteen.
- The Department does not have a consistent process to consider price when selecting Canteen vendors, as required by regulation, and had no records to show consideration of product price or other factors required by regulation (product quality, availability, and security issues) when selecting vendors. Further, the Department excludes Canteen purchases from the Colorado Procurement Code but did not substantiate its decision in writing, as required by statute.
- The Department spends Canteen profits for inmate benefit programs, as required by statute, but has decreased the use of profits for this purpose and increased the balance in its Canteen Account. In Fiscal Year 2017 the Department spent \$1.4 million of profits for inmate benefit programs, down from \$2.6 million in Fiscal Year 2015, increased General Fund spending for the programs from \$18.8 million to \$22.6 million over the same period, and grew the balance in the Canteen account to about \$8.4 million as of June 30, 2017, more than twice the balance as of June 30, 2012. The Department reported it does not have a plan for using the balance in the Canteen Account.

BACKGROUND

The Department of Corrections (Department), operates a Canteen for inmates. The mission of the Canteen includes offering high quality, fairly-priced merchandise to inmates.

Under statute, the Canteen must generate sufficient revenue to fund all expenses of the Canteen and produce a reasonable profit, and the profits are to be expended for programs to provide educational, recreational, and social benefits to inmates (inmate benefit programs).

The Department groups Canteen merchandise into 11 categories – greeting cards, faith/hobby, food, beverages, medical, hygiene, female products, miscellaneous, catalog (non-everyday items), special order items (products typically available for a brief period), and necessities. Over Fiscal Years 2015 through 2017, inmates spent \$53 million purchasing over 40 million units of 1,400 unique items from the Canteen.

KEY RECOMMENDATIONS

- Implement written policies to specify profitability targets, standard item markups based on complete and accurate cost information, and requirements to document pricing for all Canteen merchandise.
- Implement written policies to use a consistent, documented process to select Canteen vendors that include considering price, quality, availability, and security concerns. Complete a written determination to substantiate the Department's decision to exclude Canteen purchases from the Colorado Procurement Code.
- Implement written policies that specify when profits should be spent or accumulated and that establish Canteen Account balance targets and purposes.

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Overview

Chapter 1

Colorado Correctional Industries (CCI), which operates as a division within the Department of Corrections (Department), is authorized under statute to establish and operate a Canteen for “the use and benefit of the inmates of state correctional facilities and to operate vending machines for the use of visitors to such facilities” [Section 17-24-106(1)(t), C.R.S.]. The Inmate Canteen Program (Canteen Program or Canteen), developed in 1987, allows eligible inmates to purchase a variety of items and services; some restrictions on Canteen purchases are in place based on inmate custody levels. Canteen items available to eligible inmates include necessities (such as toothbrushes, toothpaste, and other hygiene products), and amenities (such as snacks, hobby supplies, religious-based merchandise, and televisions), as well as phone time and music and video streaming. Through the Department’s Inmate Banking Program, a bank account is established for each offender at the time he or she enters a Department facility, and inmates may use funds in these accounts to make Canteen purchases after the Department has withdrawn any required withholdings, such as for child support or victim’s restitution.

Prior to being offered for sale to inmates, the products made available through the Canteen Program are reviewed by a committee comprised of Canteen and facility staff, and are approved by the CCI Assistant Director. Approved Canteen items are made available to inmates through orders placed over the phone once a week. Items available weekly include food, personal care products, and paper and pens. In addition, a catalog of permanent property items (e.g., coffee makers, electric razors, and lamps), Faith Group items, and cosmetic items (for women only) is available on a once-per-month order basis.

Day-to-day Canteen and vending operations are overseen by Canteen Services within CCI, including managing Canteen inventory and filling inmate orders. Orders are filled from two Canteen locations, the Central Canteen in Cañon City, which serves 16 facilities, and the Northern Canteen in Denver, which serves 10 facilities. Canteen Services staff inspect orders for accuracy, package items into clear tamper proof plastic bags, and deliver orders to each facility. The Canteen processes approximately 69,000 orders monthly. Canteen Services staff manage inventory using the inventory management module within the Department of Corrections Information System (DCIS).

In addition to allowing inmates to purchase items of their choice, the Canteen Program provides an offender work program that employs approximately 115

inmates at the Arrowhead Correctional Center in Cañon City and the Denver Women’s Correctional Facility.

The mission of the Canteen Program is to provide inmates with work and self-improvement opportunities that promote successful community reintegration, and to offer high quality, fairly priced merchandise and services in an efficient and profitable manner. Further, the Canteen Program was established to aid in the maintenance of a secure environment and to reduce reliance on taxpayer-provided funds for inmates. The Department is required to use all revenue generated through Canteen sales for the benefit of inmates [Section 17-24-126(3), C.R.S.].

Audit Scope and Methodology

The Colorado Office of the State Auditor (State Auditor) contracted with Sjoberg Evashenk Consulting, Inc., to conduct this performance audit pursuant to statute [Section 2-3-103, C.R.S.], which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government, and Section 2-7-204(5), C.R.S., the State Measurement for Accountable, Responsive, and Transparent (SMART) Government Act. The audit was conducted in response to a legislative request by the Joint Budget Committee, which expressed concerns regarding the operation and management of the Inmate Canteen and Banking Programs. Audit work was performed from September 2017 through May 2018. We appreciate the cooperation extended by the Department during the course of this audit, and the assistance provided by Department management and staff as we performed these audit procedures.

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

The objectives of this audit were to evaluate the Department’s controls over the revenue generated through Canteen sales and controls over inmate bank accounts. To accomplish the audit objectives, we reviewed relevant statutes and Department Administrative Regulations; interviewed Department management and staff of the Department’s Inmate Canteen and Banking Programs; and reviewed prior State Auditor findings and recommendations related to CCI in general and the Inmate Canteen and Banking Programs in particular.

With respect to the Canteen, we assessed the Department’s controls for ensuring Canteen products are priced in accordance with applicable requirements and

Canteen goals, including covering all operating costs, producing a reasonable profit, and establishing equitable prices across products and Canteen locations. We also evaluated whether the profit from Canteen sales is being used for allowable purposes. To conduct our assessment, we observed Canteen operations at the Department's two locations, Central Canteen in Cañon City and the Northern Canteen in Denver. We requested and reviewed available purchase, resale, and inventory management records related to Canteen operations, including inventory management system records from DCIS for all items sold to inmates between Fiscal Years 2015 and 2017. We also calculated markup rates for all items sold; evaluated Canteen profits over this period; and reviewed fiscal records related to the Canteen Account, including the Trial Balance and the Annual Report prepared by the Department Controller for each Fiscal Year 2015 through 2017. As part of our work to evaluate internal controls related to Canteen operations, we also reviewed purchasing, receiving, and invoice processing practices; inventory recording, monitoring, auditing, and adjusting procedures; pricing practices and price comparability audits; and order fulfillment, packing, and shipping processes.

With respect to inmate bank accounts, we assessed the Department's controls for ensuring that deposits into the accounts are accurate and timely; withdrawals comply with applicable requirements and priorities; inmates are notified of their account balances; and inmates are paid out their account balances on release. To conduct our assessment, we observed Inmate Banking Program staff and management activities, and walked through deposit and debt payment processes including receiving bank deposits, recording the transaction in the bank record, processing bank withdrawals, identifying inmate debts and garnishments, calculating withholdings, issuing and recording debt payments, and reconciling all inmate bank activities. We found that the Department effectively segregated these activities and implemented sound controls to mitigate the risk of loss, fraud, or abuse related to Inmate Bank monies.

We also obtained and reviewed inmate bank and garnishment records for all 28,500 inmates in the custody of the Department between Fiscal Years 2015 and 2017, detailing deposits received and amounts withheld for inmate debts. For the 22,000 inmates with active garnishment orders as of December 20, 2017, we determined the inmates' bank account balances, mandatory savings account balances, and all discretionary expenses paid through the inmate bank accounts (e.g., Canteen purchases, donations, medical co-pays, monies sent to family members). We concluded that the Department had developed procedures to ensure compliance with statutory requirements that the Department withhold a minimum of 20 percent of all deposits into inmate bank accounts for which a garnishment had been applied.

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, as well as specific details about the audit work supporting our

findings, conclusions, and recommendations, are described in the remainder of this report.

A draft of this report was reviewed by the Department. We have incorporated the Department's comments into the report where relevant. The written responses to the recommendations and the related implementation dates are the sole responsibility of the Department.

Inmate Canteen Program

Chapter 2

To operate and manage the Inmate Canteen Program (Canteen Program or Canteen), the Department of Corrections (Department) has established processes for all aspects of obtaining and reselling items to inmates, including establishing item pricing that will generate a profit. Specifically, operating and managing the Canteen includes approving and procuring items brought into facilities for resale to inmates; maintaining the inventory of these items and fulfilling inmate orders; and establishing item pricing. Additionally, the Department must ensure that any profit generated by Canteen sales is expended for the benefit of inmates. This audit reviewed and assessed the Department's key controls for ensuring that Canteen item approval and procurement, inventory and order fulfillment, and item pricing allow the Canteen to, as stated in its mission, provide high quality, fairly-priced merchandise and services in an efficient and profitable manner. Our audit did not identify any findings or recommendations related to the Department's controls over Canteen inventory management or inmate order fulfillment but did identify findings related to the Department's controls over item procurement and pricing. The audit also reviewed the Department's use of Canteen profits and we found that the Department does not have a policy for the use of Canteen profits, resulting in a Canteen Account fund balance that increased to more than \$8 million in Fiscal Year 2017.

Canteen Item Pricing

Between Fiscal Years 2015 and 2017, the Canteen made available over 1,400 unique products for sale and sold more than 40 million units to inmates. These included hygiene and cosmetic items (e.g., soap, deodorant, toothpaste), snack foods, postage stamps, clothing, phone services, and miscellaneous allowable property (e.g., televisions, radios, and hobby supplies). During this period, Canteen Services, within Colorado Correctional Industries (CCI), oversaw all Canteen operations, including establishing resale prices for items offered to inmates, and inmates spent nearly \$53 million purchasing Canteen products.

All revenues generated by the Canteen Program and vending operations are required, under Section 17-24-126(1) and (3), C.R.S, to be deposited into a revolving enterprise account called the "canteen, vending machine, and library account" (Canteen Account).

What audit work was performed and what was the purpose?

We interviewed Department management and staff regarding the Canteen Program, and observed Canteen operations at the Department's two locations, Central Canteen in Cañon City and the Northern Canteen in Denver. We also evaluated purchase, resale, and inventory management records related to Canteen operations. This included obtaining inventory management system records from the Department of Corrections Information System (DCIS) for all items sold to inmates. We compared the purchase and resale prices for all items sold to inmates through the Canteen to identify the Department's markup rates and profits, and evaluated Canteen profits between Fiscal Years 2015 and 2017. We also evaluated internal controls related to Canteen operations, including purchasing, receiving, and invoice processing practices; inventory recording, monitoring, auditing, and adjusting procedures; pricing practices and price comparability audits; and order fulfillment, packing, and shipping processes.

The purpose of the audit work was to determine whether the Department priced items sold to inmates through the Canteen in accordance with statutory and Department policy requirements.

How were the results of the audit work measured?

Statute requires that, "Items in the [C]anteen shall be sold to inmates ... at prices set so that revenues from the sale are sufficient to fund all expenses of the [C]anteen ... and to produce a reasonable profit" [Section 17-24-126(3), C.R.S.]. Canteen Services staff are responsible for establishing resale prices for items sold to inmates. Canteen Services staff are advised by a "Canteen Review Committee" consisting of facility staff and the Canteen manager. The Department's Administrative Regulation (AR) 200-11(IV)(L)(3) requires Canteen Services to price items for resale to inmates using a standard markup policy, which is the percentage above the Department's cost that Canteen items will be priced at in order to produce a profit. The Canteen Review Committee is responsible for recommending the markup policy to Canteen Services.

The Department's regulation requiring a standardized markup policy indicates that Canteen item pricing should be consistent and non-discriminatory (e.g., that sales prices for religious symbols of one faith are not significantly more profitable than those of other faiths, or that grooming products for females are not significantly more profitable than those for males). By adhering to a standard markup policy, Canteen Services can promote profitability while ensuring inmates contribute to the Canteen's profitability regardless of what they purchase. Canteen Services management and Review Committee members stated that although there is no written markup policy, a standard practice has been in place, for as long as staff can remember, to apply the following markups:

- 0 percent to items considered necessities, such as a soap, toothpaste, and sunscreen.
- 21 percent to hygiene and medical items.
- 26 percent to all other items.

What problems did the audit work identify and why did the problems occur?

Our review of the Canteen’s expenses and sales revenue found that Canteen Account revenues (averaging about \$18 million per year) were sufficient to cover the costs of operating the Canteen (averaging less than about \$15 million per year) for Fiscal Years 2012 through 2017. However, we also identified the following three concerns with the Department’s processes for setting Canteen prices.

Canteen Services Did Not Have Sufficient Information on All Canteen Expenses. CCI did not generate a Canteen Program Profit/Loss report for Canteen Services and the Review Committee to use in determining pricing and markups until Fiscal Year 2017, and once this report was generated it did not account for all related Canteen costs. Specifically, the Fiscal Year Profit/Loss report did not include approximately \$330,000 in personnel costs for the Canteen. As such, while Canteen has generated sufficient revenue to cover costs for the years we reviewed, neither the Review Committee nor Canteen Services utilized complete expense information as a basis for item pricing during Fiscal Year 2015 through Fiscal Year 2017. Canteen Services indicated that CCI has been developing the Profit/Loss reports over the last several years—and remain in development—and staff acknowledged some Canteen cost elements were lacking.

Markups Were Not Standardized. We reviewed the Department’s inventory management system records for all items sold to inmates through the Canteen as part of our work to identify the markup rates used during Fiscal Years 2015 through 2017. We confirmed that Canteen Services priced all products designated as “necessities” at cost, as staff had indicated was their practice. However, we found that the average markups for 6 of the 9 product categories the Department uses to classify items the Canteen regularly sells did not align with the standard 21 and 26 percent amounts the Department described. As shown in Table 1, the average markups for these six categories ranged from 18 percent to 43 percent.

Table 1: Canteen Item Markup Rates, Fiscal Years 2015 - 2017

Department Category	Markup Target	Average Markup
Greeting Cards(<i>e.g., Birthday, Anniversary</i>)	26%	43%
Faith/Hobby (<i>e.g., Christian Cross, Star of David, Sage Powder</i>)	26%	29%
Beverages (<i>e.g., Hot Cocoa, Lemonade, Powdered Milk</i>)	26%	26%
Food Items (<i>e.g., Candy Bars, Fruit Snacks, Top Ramen</i>)	26%	26%
Catalog (<i>e.g., Television Sets, Alarm Clock, Wash Cloth</i>)	26%	26%
Misc. (<i>e.g., Writing Tablet, Coffee Filters, Dish Soap</i>)	26%	25%
Female Products (<i>e.g., Make-up</i>)	26%	24%
Medical (<i>e.g., Muscle Rub, Medicine, Vitamins</i>)	21%	20%
Hygiene (<i>e.g., Dental Floss, Lip Balm, Styling Gel</i>)	21%	18%
SOURCE: Auditor analysis of detailed Canteen transaction data from the Department of Corrections Information System (DCIS) for Fiscal Years 2015 through 2017.		

Within these nine categories for non-necessities, Canteen Services sold 1,064 unique types of items during the period we reviewed and of these items, 872 (82 percent) were not sold at the markup targets in at least one of the three fiscal years we reviewed. Because of the large number of items with markups that varied from the targets, the Department did not review each item we identified, but instead reviewed roughly a few dozen items to try to determine the cause of the variations. Based on this review, the Department reported that some of the variations were due to errors while others were the result of intentional decisions by the Department.

With respect to the errors, the Department identified some instances of staff data entry errors in the inventory management system, DCIS, as well as some instances where the cost information used to calculate the markup price was outdated or otherwise incorrect. For example, Canteen makes available a variety of hobby items, such as beads, which cost either \$2.31 or \$2.51 per unit. However, DCIS reflected the unit price for some beads to be \$0.07, well below the actual unit cost. According to Canteen Services, the cost information was incorrectly calculated and entered into DCIS, but this was not identified until December 2017 when the Department was reviewing the results of our analysis.

With respect to the deliberate variations, the Department explained that, in some cases, it has chosen not to apply the 21 or 26 percent markups to avoid making frequent changes to the resale prices charged to inmates and to ensure that prices at each Canteen facility (Central and North), are comparable. For example:

- The Department may purchase a particular item to be sold at both Canteen facilities, such as snacks or hobby supplies, but the per-unit cost of the item may be different due to differences in delivery costs. In a case like this, the Department may mark up the less expensive snacks or hobby supplies slightly more than the more expensive, so that prices at each facility are the same.
- Sometimes vendors offer a discount on an order, such as when a large order is placed. The Department may not apply the standard markups to the discounted per unit price of the items in that order to keep the price consistent over time, rather than adjusting each time the underlying cost varies.

Currently, the Department does not have a process in place to review pricing to identify errors in any of the cost or price data and to ensure that markups are being applied as intended. DCIS can produce a “price markup report” that shows all instances in which an item price is set at a margin that does not align with the markup target. However, Canteen Services has not established a schedule for generating and reviewing this report as a way to monitor Canteen pricing. Rather, evaluations of pricing, when they do occur, are not comprehensive and are performed on an *ad hoc* basis.

Canteen Services Did Not Retain Cost Data for Special Order Items. For “special order” items that the Canteen does not sell on a regular basis, Canteen Services did not retain sufficient data to confirm what markup was used. We found that for about 5 percent of products sold through the Canteen and categorized as “special order,” we could not determine all of the specific products sold, the number of products sold, or confirm the actual markup rates used because Canteen Services did not maintain product-specific records on these items, including cost information. Management stated that special order items are typically only purchased once, and as such, staff do not assign these items unique stock numbers in DCIS to keep a record of the one-time cost information.

Overall, the variations we saw from markup targets and the lack of data on “special order” items occurred because the Department does not have written policies on pricing Canteen items. Specifically, the Department has no written policies that establish:

- What markup will be applied to each category of merchandise and how the markup percentages will be determined. The Department could not provide a rationale for how or why the 21 and 26 percent markup rates were identified as appropriate to meet the statutory requirement to fund Canteen operations and “produce a reasonable profit” [Section 17-25-126(3), C.R.S.]. While the Canteen has generated a profit over the last several years,

the Department has not established any profitability target to inform its pricing policies.

- What factors would affect whether the standardized markup should not apply, such as ensuring resale pricing to inmates does not change frequently.
- What product cost and price information staff should maintain, in DCIS or elsewhere, including items that are special ordered, on a one-time basis.
- A process to routinely review pricing to ensure management expectations for pricing are followed and that the data used to establish prices are complete and accurate.

Why does this problem matter?

We identified the following risks of the Department not ensuring Canteen prices are established using accurate and complete expense information and not having a written pricing policy:

Inequity in pricing. We found instances of individual items within categories having significantly different markups. As shown in Table 2 below, for individual items within all nine item categories, the markups ranged from -225 percent (i.e., in some cases items were priced below cost) up to 140 percent.

Table 2: Canteen Item Range of Markups, Fiscal Years 2015 - 2017

Department Category	Markup Target	Actual Markups	
		Min.	Max.
Greeting Cards(e.g., Birthday, Anniversary)	26%	23%	51%
Faith/Hobby (e.g., Christian Cross, Star of David, Sage Powder)	26%	-62%	100%
Beverages (e.g., Hot Cocoa, Lemonade, Powdered Milk)	26%	-21%	100%
Food Items (e.g., Candy Bars, Fruit Snacks, Top Ramen)	26%	4%	36%
Catalog (e.g., Television Sets, Alarm Clock, Wash Cloth)	26%	-225%	140%
Misc. (e.g., Writing Tablet, Coffee Filters, Dish Soap)	26%	0%	44%
Female Products (e.g., Make-up)	26%	-4%	100%
Medical (e.g., Muscle Rub, Medicine, Vitamins)	21%	-49%	72%
Hygiene (e.g., Dental Floss, Lip Balm, Styling Gel)	21%	-60%	50%
SOURCE: Auditor analysis of detailed Canteen transaction data from the Department of Corrections Information System (DCIS) for Fiscal Years 2015 through 2017.			

For example, while “Faith/Hobby” items have a target markup of 26 percent, Canteen Services set prices for religious texts and symbols at markup rates ranging from just over 3 percent for some items to a markup of nearly 100 percent for other comparable items. Similarly, within the “Hygiene” category, a regular sized bathrobe was marked-up at a rate of 26 percent, while a size 3XL bathrobe was marked-up at a rate of 36 percent. In most cases, markup variances appear random, but they nevertheless result in situations in which some individuals bear a greater burden for the profitability of the Canteen than others.

Limits on Inmate Debt Payment and Savings. Department management identified several functions of the Inmate Banking Program, including facilitating inmates’ payment of court-ordered debt pursuant to statute [Section 16-18.5-101(g) and Section 16-18.5-106, C.R.S.] and allowing inmates to save income for use after their release.

Most inmates have relatively small balances in their Inmate Bank Accounts. In Fiscal Year 2017, the average inmate began the year with a bank balance of \$186 and the bulk of inmate balances are spent on merchandise at the Canteen. For inmates that owe debt, we confirmed the Department withholds from each deposit into the inmates’ accounts the minimum amount required by statute [Section 16-18.5-106(2), C.R.S.] or Administrative Regulation [Administrative Regulation 200-15], typically 20 percent of the amount deposited, and applies this withholding to the inmates’ debt. All remaining balances are made available to the offenders for use at their own discretion, within defined limits based on the inmates’ status. This includes making additional debt payments, increasing bank savings, sending funds to family members, making donations, or making purchases from the Canteen. As such, higher-than-necessary Canteen prices could reduce inmate resources available to make any additional debt payments above the mandatory minimum withholding amounts, or to increase savings.

As shown in Table 3, inmates received \$29.8 million in deposits in Fiscal Year 2017, and spent \$19 million (64 percent) on merchandise sold through the Canteen; \$5.5 million (19 percent) on paying off court-ordered debt, such as victim restitution and child support, and other debts; and \$5 million (17 percent) on other expenditures including medical fees, attorney’s fees, transfers to family, and donations. Total deposits exceeded expenditures during Fiscal Year 2017 by about \$0.3 million, representing an increase in bank account balances of less than 1 percent.

Table 3: Inmate Spending, Fiscal Year 2015 through Fiscal Year 2017 (in millions)

Fiscal Year	Number of Inmates	Total Deposits/ Account Credits	Total Paid on Garnishments	Total Amount Spent at Canteen	Total Other Purchases	Total Increase in Savings
FY 2015	33,679	\$31.2	\$7.3	\$16.7	\$6.8	\$0.4
FY 2016	33,560	\$30.4	\$5.9	\$17.6	\$6.8	\$0.1
FY 2017	32,331	\$29.8	\$5.5	\$19.0	\$5.0	\$0.3
Total		\$91.4	\$18.7	\$53.3	\$18.6	\$0.8

SOURCE: Transaction data extracted from DCIS by the Department for Fiscal Years 2015 through 2017.

Inmates who were incarcerated for the full period between Fiscal Year 2015 through 2017 saw a negligible \$37 increase in their bank account balances. In addition to reducing resources available to paying off debt or increasing bank savings, high Canteen prices also reduce the overall incentive provided to inmates, who have minimal resources, by limiting what the inmates will be able to purchase.

Recommendation No. 1:

The Department of Corrections (Department) should improve its Canteen price-setting practices by:

- a. Ensuring Canteen Services and the Canteen Review Committee have and use complete and accurate information regarding all costs of the Inmate Canteen Program, including all personnel, indirect, transportation and other related costs of the Canteen.
- b. Implementing written policies on pricing Canteen items that specify: (1) an overall profitability target to inform pricing; (2) the standard item markups, including the factors for when standard markups should not apply; (3) what documentation should be maintained for all Canteen merchandise, such as the product cost, markup percentage, and resale price; and (4) a regular review schedule to ensure that pricing consistently adheres to the policies and that the data used to establish prices are complete and accurate.

Department of Corrections Response:

- a. Agree. Implementation Date: July 1, 2018

Canteen Services and the Canteen Review Committee will ensure that they are using complete and accurate information regarding all costs of

the Inmate Canteen Program, including all personnel, indirect, transportation and other related costs of the Canteen.

b. Agree. Implementation Date: January 1, 2019

Written policies regarding the profitability target, record retention, product cost review, resale item price review schedule, standard markups and exclusions of those items offered through Canteen Services will be developed and implemented through the Canteen, Vending Machine and Library Account Fund Committee. The policies and procedures developed and implemented by the DOC Purchasing Office and Canteen Services will also identify the documentation that will be maintained regarding product cost, markup percentages and resale prices, as well as establishing a review schedule to be followed for monitoring the pricing to ensure they are complete and accurate.

Vendor Selection

Canteen Services staff purchase items from vendors to then resell to inmates through the Canteen, including approved food, personal care products, and other items not furnished by the Department. During Fiscal Years 2015 through 2017, the Department purchased over 1,400 unique types of items for resale to inmates through the Canteen from more than 60 vendors (four primary vendors and numerous secondary vendors for specialized items).

The Canteen Review Committee—which includes the Department’s Service Sector Manager and Canteen Manager, as well as representatives of Department facilities, the Private Prison Monitoring Unit, Clinical Services, and Food Services—is responsible for reviewing and recommending products for sale in the Canteen. Canteen Services is responsible for approving the sale of merchandise to offenders and selecting vendors to supply and deliver the products to the Central Canteen and Northern Canteen locations. Canteen Services does not enter into contracts or price agreements with suppliers of Canteen products, but rather uses purchase orders to procure products.

What audit work was performed and what was the purpose?

We interviewed Department management and staff regarding the Canteen Program, and how staff identify and select vendors to use for Canteen items. We reviewed DCIS data for all purchase orders and products received and placed into Canteen

inventory during Fiscal Years 2015 through 2017. We also requested all documentation the Department had related to their vendor selection process.

The purpose of the audit work was to assess whether the Department complies with procurement rules and selects vendors for Canteen items in accordance with its Administrative Regulations.

How were the results of the audit work measured?

We evaluated the Department's compliance with statute and regulations for selecting vendors for Canteen items, as follows:

Procurement Code. The Colorado Procurement Code [Section 24-101-101, *et seq.*, C.R.S.] generally applies to all purchases by executive branch agencies but allows an exception when an agency is purchasing items for resale to the public. Specifically, Section 24-101-105(1)(e), C.R.S., states that "the [Department's] procurement official may, by written determination, provide that this [C]ode shall not apply to items acquired for such resale." The Department told us it does not follow the Procurement Code for the Canteen, due to this statutory authority to determine an exception is warranted. To exercise this exception, procurement rules require the agency's procurement official to prepare a written determination that has "set out sufficient facts, circumstances, and reasoning to substantiate the specific determination" the agency has made [CCR R-24-101-201-02] and file and retain the determination in the solicitation or contract file to which it applies [CCR R-24-101-201-04].

Regulations. The Department's Administrative Regulation 200-11(IV)(L)(3) states that Canteen Services must select vendors for Canteen products based on:

- price,
- product quality,
- security issues, and
- availability.

What problem did the audit work identify?

We found that the Department does not have a written determination related to its decision to not follow the Procurement Code for purchase of Canteen items. The Department said that its practice to exempt Canteen product purchases from the Procurement Code has been long-standing and predates current management and staff, and that it believed this practice remains appropriate because tax dollars are not used in the procurement of Canteen products.

We also found the Department does not have a consistent, documented process to consider price when selecting vendors. The Department stated that for some purchases, Canteen Services contacts a few vendors to gather price information prior to committing to one vendor, but it has broad discretion in whether, and to what extent, it considers price, as well as the other factors, in determining which vendor to use. The Department had no records of these contacts or any other documentation showing it had gathered and considered the factors cited in regulation for any of its vendors used for Canteen items over the three years we reviewed. Canteen Services staff agreed that no uniform process is followed.

The Department was able to provide documentation, such as Canteen Review Committee meeting minutes, that showed consideration of product quality, security issues, availability, and affordability in relation to similar products—such as the relative affordability between two different brands of shoes.

Further, once Canteen Services selects a vendor, it stated that the vendor is used indefinitely. We evaluated the vendors Canteen Services used in Fiscal Years 2015 through 2017 and found that it utilized the same primary vendors throughout this period. Canteen Services was unable to provide documentation showing how long any of its vendors had been providing any single product or that it had ever evaluated whether that vendor continued to provide competitive product quality or pricing. However, our review of “active” stock items revealed that the vendors for more than 280 of the 1,400 items offered were first selected more than 18 years ago, and the Department could not demonstrate it had re-evaluated these vendors at any point to ensure competitive pricing.

Why did this problem occur?

The Department has not established policies or procedures on considering the factors listed in the regulations, including price, as part of the Canteen vendor selection process. For example, there are no written policies or procedures that direct staff in any aspects of the vendor selection process, such as:

- The type and amount of information they should collect regarding product quality, price, availability, or security issues. Written policies and procedures could require staff to obtain information on these factors from a minimum number of vendors for each type or category of merchandise.
- How they should weigh each of the factors of quality, price, security, and availability. This could include guidance on whether one factor is typically more important than others or all should be considered equally.
- Under what circumstances, if any, comparisons of product quality, price, security, and availability across vendors is not expected. This could include

establishing guidance on how long a specific vendor may be used before the factors are reevaluated against other possible vendors.

- What documentation must be maintained to support vendor selection evaluations and decisions.

Although the Department may not be required to follow the Procurement Code for purchasing Canteen merchandise, the Code contains provisions intended to help ensure that state agencies obtain fair prices and promote open competition among possible vendors [Section 24-103-202, C.R.S.]. Adopting some of the requirements of the Code, such as obtaining competitive bids from possible vendors and establishing guidelines to evaluate bidders consistently and equitably could help ensure the Department adhere to the intent of the Administrative Regulation.

Why does this problem matter?

We did not find any evidence that the Canteen experienced problems with product availability or security issues. However, because the Department did not have any documentation of its vendor selection process, we were unable to assess whether the Department may have been able to purchase any of the Canteen merchandise at lower prices or obtain better quality.

The lack of a consistent and documented process to obtain comparative information on price, quality, security issues, or availability of merchandise before selecting a vendor creates a risk of the Department paying more for products than necessary, obtaining poor quality items, or being unable to acquire merchandise in a timely manner. For example:

- If the Department does not consider vendor pricing, it may pay more than necessary for merchandise, which could lead to lower Canteen profits. Conversely, the Department may have to increase resale prices in the Canteen, thus reducing inmates' buying power.
- If the Department does not consider quality, it may obtain low quality items that need to be replenished more frequently, potentially reducing the variety of items for sale, and inmates may have to repurchase the items, affecting their ability to save or pay off debt.
- If the Department does not consider security issues, it may procure products that inmates could use or alter in a manner that could pose risks to the safety of other inmates, facility staff, or visitors.

- If the Department does not consider availability, the Department may have to purchase unavailable items from other vendors with higher prices or inmates may have to go without items that are unavailable.

Finally, the Procurement Code establishes processes for selecting vendors that is intended to provide for increased public confidence in public procurement; ensure the fair and equitable treatment of all persons who deal with the procurement system; maximize to the fullest extent practicable the purchasing value of public funds; foster effective broad-based competition; and provide a procurement system of quality and integrity [Section 24-101-102 (2), C.R.S.]. By choosing to exempt itself from use of the Procurement Code and failing to establish its own policies for vendor selection that reflect the goals of the Code, the Department's processes for purchasing Canteen merchandise may not be supporting any of these intents.

Recommendation No. 2:

The Department of Corrections should improve its procurement practices for the Canteen by:

- a. Preparing a written determination that sets out sufficient facts, circumstances, and reasoning to substantiate its decision to exclude Canteen purchases for resale from the Procurement Code, as required.
- b. Developing and implementing written policies and procedures for selecting vendors for Canteen merchandise. At a minimum, the policies and procedures should provide direction on: (1) the type and amount of information to be collected regarding price, quality, availability, and security issues from all potential vendors; (2) weighing each of the factors, including under what circumstances, if any, one or more of the factors may not need to be considered; (3) how long a vendor can continue to be used without reassessing the factors against other possible vendors; and (4) what documentation must be maintained to support vendor evaluation and selection decisions.

Department of Corrections Response:

- a. Agree. Implementation Date: January 1, 2019

In accordance with C.R.S. 24-101-105-1, a written determination will be provided by the CDOC Purchasing Manager to substantiate the exclusion of Canteen purchases for resale from the Procurement Code. Canteen and Procurement policies will be updated accordingly.

- b. Agree. Implementation Date: January 1, 2019

Canteen Services and the Purchasing Office will implement policies and procedures using the Procurement Code as a guideline to ensure fair and reasonable pricing and equitable vendor selection. Canteen Services will notify existing vendors of upcoming procurement changes to allow ample time to adjust their inventory levels. These policies and procedures will provide direction on the type and amount of information collected including pricing, quality, availability, security issues and any exceptions; identify the maximum term length of vendor agreement(s) utilized by Canteen Services and document retention.

Use of Canteen Profits

According to the Department's Administrative Regulation 200-11(IV)(J), the use of funds in the Canteen, Vending Machine, and Library Account, which holds all revenues from the Canteen and vending machines, is "supervised by [the Canteen Account] Committee." The Canteen Account Committee (Account Committee), consists of the CCI assistant director, the Director of Prisons, the Director of Finance and Administration, the Controller, and the Budget and Business Operations Director. According to the regulation, the Account Committee is also responsible for:

- Developing policies for and recommending use of the Account funds to the Department's executive management during the Department's annual budgeting process.
- Following statutory definitions of how net profits may be spent.

During Fiscal Years 2015 through 2017, inmates spent nearly \$52 million purchasing Canteen products. These purchases generated about \$8.9 million in profits.

What audit work was performed, what was the purpose, and how were the results measured?

We interviewed Department management and staff regarding the Canteen Program, and observed Canteen operations at the Department's two locations, Central Canteen in Cañon City and the Northern Canteen in Denver. We also reviewed fiscal records related to the Canteen Account, including the Trial Balance and the Annual Report prepared by the Department Controller.

The purpose of the audit work was to determine whether the Department used Canteen profits in accordance with statutory requirements. Specifically, according to statute [Section 17-24-126(3), C.R.S.], any profits from the operation of the Canteen and vending machines “shall be expended for the educational, recreational, and social benefit of the inmates and to supplement direct inmate needs.” Throughout the report we refer to spending for this purpose as spending for inmate benefit programs.

What problem did the audit work identify?

We found no expenditures from the Canteen Account during Fiscal Year 2017 that appeared to be inconsistent with the statutory requirement to spend profits for inmate benefit programs. For example, we found Canteen Account profits have been used for a variety of purposes related to inmates programs, such as purchasing recreational and educational equipment as well as beauty and grooming supplies for an inmate training program; providing inmates access to cable television; and purchasing computers for inmate use. However, the Department has decreased both the amount and percentage of Canteen profits it has spent for inmate benefit programs over the last six years. As shown in Table 4, the Department reduced its spending of Canteen profits on inmate benefit programs by nearly half.

Table 4: Revenues and Expenditures of the Canteen Account, Fiscal Year 2012 through Fiscal Year 2017 (in millions)

Canteen Account Activity	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Canteen Revenues	\$16.9	\$16.6	\$17.9	\$19.2	\$18.7	\$19.8
Canteen Expenditures	\$13.4	\$13.3	\$14.2	\$15.6	\$16.3	\$17.0
Net Profit	\$3.4	\$3.3	\$3.7	\$3.6	\$2.4	\$2.9
Expenditures for Inmate Benefit Programs	\$3.1	\$2.9	\$2.9	\$2.6	\$1.4	\$1.4
Percent of Profit Spent on Inmate Benefit Programs	89%	88%	78%	74%	58%	48%
Fund Balance	\$3.8	\$4.2	\$5.0	\$5.9	\$6.9	\$8.4

SOURCE: Canteen, Vending Machine, and Library Account Annual Reports for Fiscal Year 2012 through Fiscal Year 2017.

Why did this problem occur?

The Account Committee has not developed a policy for the use of the Canteen, Vending Machine, and Library Account funds, and has not developed an agreed-upon, written, or authoritative process for developing recommendations for the use

of Canteen Account funds. While there is not a requirement that all Canteen profits be spent within a specified period, the Department has not established policies for spending the profits versus saving them, including setting a target fund balance that should be maintained and the purpose of maintaining the target amount. Further, the Department has not developed a process for conveying a spending plan to executive management for budgeting purposes.

A policy for use of the Canteen Account funds could facilitate decision-making regarding profitability targets and the mark-up policy that is required to be established by the Canteen Review Committee. According to the Department, decisions about spending Canteen Account funds depends on two primary factors: (1) the needs of inmates as presented through budget requests from each Department facility, and (2) the availability of General Fund monies or other revenue streams to fund inmate benefit programs.

Why does this problem matter?

Increasing Use of General Funds. Over Fiscal Years 2012 through 2017, the Department spent about \$129 million to fund inmate benefit programs throughout its facilities. As illustrated in Table 5, below, the General Fund was used to cover more than 92 percent of these costs while the Canteen Account funded only about 8 percent. During this time period, the Department requested an increase to the Fiscal Year 2016 General Fund appropriation to offset projected revenue losses that year as a result of changes to the Colorado Inmate Phone System (CIPS); the request was intended to allow funding for inmate education programs at state and private facilities to continue. However, between Fiscal Year 2016 and 2017, the Canteen Account fund balance increased by approximately \$2.5 million, ending with a balance of \$8.4 million as of June 30, 2017, as shown in Table 4, above.

Table 5: Inmate Benefit Program Expenditures, Fiscal Years 2015 - 2017 (in millions)

	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	Total
Canteen Account	\$3.1	\$2.9	\$2.9	\$2.6	\$1.4	\$1.4	\$14.3
Total General Fund	\$17.5	\$17.0	\$17.0	\$18.8	\$22.1	\$22.6	\$115.0
Percent Funded by Canteen Account	15.0%	14.6%	14.6%	12.3%	5.8%	5.4%	7.8%
Total	\$20.6	\$19.9	\$19.9	\$21.4	\$23.5	\$24.0	\$129.3
SOURCE: Canteen, Vending Machine, and Library Account Annual Reports for Fiscal Year 2015 through Fiscal Year 2017.							

Had the Department maximized the use of Canteen Account funds for inmate benefit programs over these years, the Department could have reduced its need for

General Funds by as much as \$8 million and the General Assembly could have directed these General Fund monies to other priorities.

Further, without a policy, and given the growth in the Canteen Account Balance, it is not clear that the Account Committee is fully carrying out its regulatory charge to following statutory definitions in using Canteen profits.

Recommendation No. 3:

The Department of Corrections (Department) should ensure compliance with the statutory requirement to use Inmate Canteen Program profits for the educational, recreational, and social benefit of the inmates and to supplement direct inmate needs by developing a policy for the use of the Canteen, Vending Machine, and Library Account funds that: (1) establishes a process for developing recommendations for the use of Canteen Account funds that account for the availability of General Fund or other revenue and specify whether Canteen funds should be spent or accumulated to increase the Canteen Account fund balance; (2) defines a target fund balance that should be maintained and the purpose of maintaining the target amount; and (3) conveys a spending plan to executive management for budgeting purposes.

Department of Corrections Response:

Agree. Implementation Date: August 1, 2018

The Department will develop and implement policy and procedures in the Canteen Administrative Regulation for the Canteen, Vending Machine, and Library Account Committee to recommend Canteen Fund usage, in coordination with available General Funds, to executive staff to project and substantiate the Canteen fund balance. The Committee will establish, monitor, and communicate the needs for the target fund balance to those affected by the Canteen fund balance spending plan.