



**REPORT OF  
THE  
STATE AUDITOR**

**Correctional Industries:  
Surplus Property and Furniture Production**

**Performance Audit  
June 2003**

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**STATE OF COLORADO**

Joanne Hill, CPA  
State Auditor

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**OFFICE OF THE STATE AUDITOR**

(303) 869-2800  
FAX (303) 869-3060

Legislative Services Building  
200 East 14th Avenue  
Denver, Colorado 80203-2211

June 11, 2003

Members of the Legislative Audit Committee:

This report contains the results of the performance audit of Correctional Industries' surplus property and furniture production programs. The audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government. The report presents our findings, conclusions, and recommendations, and the responses of the Department of Corrections, the Department of Personnel & Administration, the Colorado Department of Public Health and Environment, and the Governor's Office of Innovation and Technology.

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JOANNE HILL, CPA  
State Auditor

**Correctional Industries:  
Surplus Property and Furniture Production  
Performance Audit  
June 2003**

**Authority, Purpose, and Scope**

This performance audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the Office of the State Auditor to conduct performance audits of all departments, institutions, and agencies of state government. The audit focused on the operations of the Colorado Surplus Property Agency (Surplus Property or Agency) and the furniture production program within the Division of Correctional Industries at the Department of Corrections. The audit work, performed from August 2002 through April 2003, was conducted in accordance with generally accepted governmental auditing standards.

We gratefully acknowledge the assistance and cooperation extended by management and staff at the Department of Corrections, the Department of Personnel & Administration, the Colorado Department of Public Health and Environment, and the Governor's Office of Innovation and Technology as well as surplus property and purchasing representatives from individual state agencies.

**Findings and Recommendations**

Our audit identified the following significant areas for improvement:

- **Sale and Purchase of Used Cars.** Surplus Property is buying and selling used cars for the State's fleet, as well as buying used cars for sale to other state agencies, local governments, and the general public. Surplus Property has sold more than 60 vehicles, most of which were sold at prices that exceeded Surplus Property's costs. The fees Surplus Property charges for its services are not based on reasonable administrative costs, as required by statute. It is also unknown if the pricing methods used to sell the cars meet statutory requirements that place limits on how much Correctional Industries may charge for its goods and services. In addition, statutes require that entities selling used cars for profit be licensed, but it is unclear whether the statutes anticipate licensing of government agencies such as Correctional Industries. Correctional Industries needs to get statutory authority to operate a used-car business and determine if a used-car business operated by a governmental entity needs to be licensed by the Motor Vehicle Dealer Board.

*For further information on this report, contact the Office of the State Auditor at (303) 869-2800.*

## SUMMARY

- **Confidential Information on Surplus State Computers.** Surplus Property and other state agencies are not taking appropriate steps in all cases to purge confidential information from computers that are sold or discarded as unusable. When we examined a sample of used computers obtained by Surplus Property, we found that the methods used by state agencies do not always prevent unauthorized access to personal, nonpublic information. The Governor's Office of Innovation and Technology and the Department of Personnel & Administration need to establish appropriate statewide guidelines for agencies to follow regarding the proper methods of purging confidential information from surplus computer equipment.
- **Hazardous Materials in Surplus State Computers.** Certain parts of a computer's hardware contain hazardous waste, the disposal of which is strictly regulated by state laws implementing federal requirements. We determined that surplus computer equipment handled through individual state agencies and Surplus Property may not always be protected from improper disposal. Surplus Property should send surplus computers to Correctional Industries' Computer Services Manufacturing, Refurbishing, and Recycling Facility (Computer Services). Computer Services uses inmate labor to refurbish usable computers and to properly dispose of nonworking computers by selling the parts to appropriate waste management facilities. In addition, the Colorado Department of Public Health and Environment should publish guidance to all state agencies on the proper methods and documentation for disposal of computer equipment, including methods for identifying legitimate recyclers.
- **Controls Over Surplus Property.** We found a fundamental lack of internal controls at the Colorado Surplus Property Agency regarding inventory records. As a result, there is an inability to reconcile incoming and outgoing property. Surplus Property needs to establish sound inventory controls, including central intake and recording of property received; separation of duties regarding the movement of property; and a year-end physical reconciliation of inventory.
- **Surplus Property Funding.** Statutes provide Correctional Industries with the authority "to assess fees from the recipient of any surplus state property, which fees shall be limited to reasonable administrative costs." We found that rather than charging the recipient of surplus property, the donor is being charged. In addition, Surplus Property lacks documentation to ensure that its fees are based on reasonable administrative costs.
- **Furniture Production.** Furniture production is one of Correctional Industries' largest manufacturing operations, in terms of both dollars generated and inmates employed. The Department maintains that furniture manufacturing provides valuable job skills to inmates, but the program has experienced substantial operating losses in both Fiscal Years 2001 and 2002. This trend is expected to continue in Fiscal Year 2003. We found that state purchasing agents are dissatisfied with the furniture products and office systems manufactured by Correctional Industries,

and that the operation may be needlessly losing potential business. We identified steps that Correctional Industries can take in order to improve its revenues and decrease operating losses, including better tracking of agency furniture purchases to identify lost business opportunities and improving its marketing efforts to both state agencies and non-state buyers.

Our recommendations and the affected departments' responses can be found in the Recommendation Locator on pages 5 and 6 of this report.

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## RECOMMENDATION LOCATOR

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Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
1	14	Through regulation require all state agencies to create and maintain an electronic inventory of all state surplus property, and require surplus property to be made available to state agencies for a reasonable period of time prior to sale to the general public.	Department of Corrections	Agree	December 31, 2003
2	17	Develop an interagency agreement covering the sale of state fleet vehicles and the purchase of federal fleet vehicles or seek a written waiver.	Department of Personnel & Administration	Agree	August 31, 2003
			Department of Corrections	Agree	August 31, 2003
3	17	Establish and document a cost basis for fees for the sale of vehicles on behalf of State Fleet Management. Ensure that sales of cars to State Fleet Management meet statutory requirements.	Department of Corrections	Agree	August 31, 2003
4	20	Seek specific approval from the Correctional Industries Advisory Committee and statutory authority to operate a used-car business. Legislative consideration should include whether or not a used-car business operated by a governmental entity needs to be licensed or is exempt from licensing requirements.	Department of Corrections	Agree	August 31, 2003

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## RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
5	23	Work with state agencies to develop a statewide policy detailing acceptable methods for purging confidential information from surplus computer equipment.	Governor's Office of Innovation and Technology	Agree	December 31, 2003
			Department of Personnel & Administration	Agree	August 1, 2003
6	25	Establish a policy to send surplus computer equipment to Computer Services Manufacturing, Refurbishing, and Recycling facility. Sell refurbished computers through Computer Services and Surplus Property.	Department of Corrections	Agree	July 1, 2003
7	26	Assist state agencies in finding legitimate recyclers and establish guidelines for the proper disposal of computer equipment.	Colorado Department of Public Health and Environment	a. Agree b. Agree	a. Implemented and ongoing b. December 31, 2003
8	28	Evaluate the cost-effectiveness of daily warehouse sales, and if determined viable, seek statutory authority for this option.	Department of Corrections	Agree	Review by December 31, 2003
9	29	Evaluate the costs and benefits of allowing state employees to purchase surplus property, and if deemed appropriate, seek statutory authority.	Department of Corrections	Agree	September 30, 2003
10	31	Ensure adequate controls over the collection, sale, and disposal of surplus property.	Department of Corrections	Agree	September 30, 2003

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**RECOMMENDATION LOCATOR**

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<b>Rec. No.</b>	<b>Page No.</b>	<b>Recommendation Summary</b>	<b>Agency Addressed</b>	<b>Agency Response</b>	<b>Implementation Date</b>
11	33	Seek statutory authority to assess fees against the seller or disposer of surplus property.	Department of Corrections	Agree	November 1, 2003
12	33	Establish procedures to ensure that fees are based on documented, reasonable administrative costs.	Department of Corrections	Agree	August 1, 2003
13	37	Track statewide office furniture and office system purchases, and analyze the resulting data to better meet the needs of the State and its agencies and to ensure compliance with statutory purchasing requirements.	Department of Personnel & Administration	Agree	August 1, 2003
			Department of Corrections	Agree	August 1, 2003
14	40	Develop a written delegation agreement and specific guidelines for the waiver process.	Department of Personnel & Administration	Agree	August 1, 2003
			Department of Corrections	Agree	August 1, 2003
15	43	Improve marketing practices and increase marketing to non-state agencies.	Department of Corrections	Agree	July 1, 2003

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# Correctional Industries

## Background

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The Division of Correctional Industries (Correctional Industries), located within the Department of Corrections (Corrections), is a government-owned business enterprise consisting of 43 distinct business activities producing goods and services. Correctional Industries employs about 1,200 inmates. The balance of more than 15,000 inmates housed by Corrections but not working in Correctional Industries programs are employed in traditional prison activities, such as laundry, food, or custodial services. Correctional Industries operates under the trade name Juniper Valley Products.

Section 17-24-106, C.R.S., empowers Correctional Industries to "develop programs that are profit-oriented and to the extent possible, provide 40 hours of work activity per week." "Profit-oriented" means that Correctional Industries must recover its reasonable costs and partially reimburse the General Fund for the expense of adult correctional services. By statute, costs include both operational costs and capital investment expenditures. Individual industry shops include those that assemble office furniture, produce license plates, manufacture clothing, build industrial dumpsters, recycle and refurbish computers, and grow and distribute agricultural-related products. These programs help reduce idleness while providing inmates with meaningful job skills that better enable them to secure long-term employment after release from prison. Correctional Industries programs also pay higher wages than traditional prison jobs, allowing inmates to potentially pay greater amounts toward court-ordered restitution and child support, as well as purchase goods from the Canteen such as hygiene items, food, religious items, televisions, radios, postage, and photocopies.

Correctional Industries programs produce items that can be sold to state and local governments, nonprofit organizations and the general public. Section 17-24-112(1), C.R.S., places limits on Correctional Industries' pricing. Sales of goods and services to state and local government agencies can not exceed wholesale market prices for similar items. When selling to the general public, Correctional Industries' prices can not exceed the prevailing retail market prices for similar goods and services.

In Fiscal Year 2002, Correctional Industries generated gross revenues of approximately \$35 million. Of this amount, about \$32 million covered Correctional Industries' operational costs. Another approximately \$2.99 million reimbursed the General Fund for direct and

indirect overhead costs of services purchased by Correctional Industries from the Department of Corrections. These services included budgeting, payment processing, utilities, and some personnel benefits expenses for Corrections FTE assigned to Correctional Industries' programs. Correctional Industries retained a little over \$60,000 for future capital investment. Correctional Industries employed 183 FTE in Fiscal Year 2002 to supervise inmates and to market and deliver their products.

## **Audit Scope**

We examined the methods used by the Colorado Surplus Property Agency to operate the State's surplus property program, including the procedures for reselling surplus property. Our review included an examination of Surplus Property's pricing methods for compliance with statutory requirements. We also reviewed its activities with respect to buying and selling used motor vehicles as part of its surplus property program, and whether or not these activities comply with applicable laws. In addition, our audit included an examination of the methods used by both Surplus Property and other state agencies to resell or dispose of surplus computer equipment. The resale and disposal of computers must comply with federal and state guidelines for privacy of personal information that may remain on the computer as well as guidelines for the disposal of hazardous material. We also evaluated the statutory requirements for state agencies to purchase office furniture from Correctional Industries. We examined the need to improve the State's ability to track furniture purchases made by state agencies. We also explored whether changes to the statutory waiver process and improvements in Correctional Industries' marketing techniques could increase its furniture production revenues.

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# Surplus Property

## Chapter 1

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### Introduction

The Colorado Surplus Property Agency (Surplus Property or Agency) utilizes inmate labor to collect, sell, and distribute surplus property. The goal of the program is to maximize the State's investment in assets either by selling used items or by finding uses for them at other state agencies, and to coordinate the proper disposal of items that cannot be sold. In Fiscal Year 2002, Surplus Property generated just over \$1.2 million in revenue and earned \$46,000 in excess of its costs. All of the revenue from this program is credited to the Correctional Industries Account.

Section 17-24-106.6, C.R.S., defines state "surplus property" as equipment and supplies no longer having any use to the State or any state agency. State agencies surplus various types of items including office furniture and equipment, desktop and laptop computers, radios, heavy equipment, and vehicles. Surplus Property maintains these items in a 17,600-square-foot warehouse in Denver. Once state agencies determine that they have items that are in poor condition or are no longer needed, they can contact Surplus Property to pick up the items or deliver the items themselves to the Denver warehouse. Surplus Property is also authorized by Section 24-82-403, C.R.S., to collect and distribute donated federal surplus property. However, Surplus Property representatives informed us that Colorado does not currently seek out federal surplus items other than some motor vehicles because of a perceived lack of quality and availability.

Surplus Property consists of three dedicated state FTE and approximately seven inmate workers. One of the functions of Surplus Property is to utilize inmate labor to pick up and deliver state surplus property to the central warehouse. As with other Correctional Industries' programs, Surplus Property seeks to recover more than its costs. Surplus Property's goal is to sell rather than dispose of all surplus property in its custody by using a variety of methods such as auctions and daily warehouse sales. For those items that Surplus Property staff believe are in better condition or in greater demand, Surplus Property uses a daily retail sales program at its warehouse. State agencies, local governments, nonprofit agencies, and the general public may purchase selected items off the shelf at the Denver warehouse. For items that are less popular or in imperfect condition, Surplus Property conducts monthly auctions at its warehouse and daily Internet

auctions. Internet auction sites, however, are generally used to sell motor vehicles on behalf of State Fleet Management in the Department of Personnel & Administration. Surplus Property staff also purchase used vehicles from federal fleet auctions, which they then often resell on Internet auction sites for a profit.

Surplus property activities of state agencies are governed by Section 17-24-106.6, C.R.S., which states that "the director shall promulgate rules to be utilized by the division in governing the sale or disposal of surplus state property by public auction or competitive sealed bidding." Surplus property is defined as "equipment and supplies no longer having any use to the State or any state agency." Statutes state that all state agencies with the exception of the Department of Transportation must use Surplus Property to handle unneeded items unless a waiver is granted by Surplus Property. Contrary to this statutory requirement, we found a state system in which some agencies use Surplus Property to handle their surplus property, while others do not. We identified several agencies, specifically higher education institutions, that have chosen not to use Surplus Property. In most, but not all, cases, we found that state agencies had obtained a waiver if they chose not to use Surplus Property. In Fiscal Year 2001 and 2002, Surplus Property granted state agencies a total of 19 waivers that allowed these agencies to publically auction their own surplus property. Surplus Property also granted waivers for agencies seeking to donate their property to a specific entity or to simply dispose of the items in a solid-waste landfill.

We contacted seven states to determine how they manage their state surplus property. We found that all but one of these states have a centralized surplus property function. However, in practice the majority of these states exempt certain agencies from using the centralized system. For Colorado, we believe that a decentralized system that allows agencies to make cost-effective decisions when selling or disposing of their surplus property is the best option. Surplus Property should continue to serve as the State's main surplus property agency offering its assistance to all state agencies. At the same time, both Surplus Property and agencies may find it more cost-effective for an agency to sell or dispose of its own property. For example, it would be expensive for both an agency and Surplus Property to travel to the Western Slope to pickup a minimal amount of surplus property. Regardless of whether agencies handle their own surplus property or use the Surplus Property Agency for that purpose, all surplus property activities should incorporate sound internal controls and maximize the value of used state property. As we discuss throughout this chapter, Surplus Property needs to establish statewide standards for handling surplus property and improve its own internal controls and procedures.

## Reuse of State Surplus Property

Section 17-24-106.6(3)(a), C.R.S., supports state agency reuse of surplus property by requiring Correctional Industries to prepare a perpetual inventory. The statute further requires Surplus Property to develop a procedure to inform all state agencies of the availability of such items. According to its Administrative Regulations, Correctional Industries encourages the reuse of surplus property by state agencies to minimize tax dollars spent on new assets, resources consumed, and landfill areas used. The Administrative Regulations give state agencies priority for purchasing surplus items before they are released for sale to the general public. Priority preferences include allowing an agency to place a specific item on hold for five days and to purchase surplus property at a reduced price. Agencies can also identify needed items and request that Surplus Property contact them if qualifying items are surplus. We found that Surplus Property has not fully met these statutory and regulatory objectives.

Surplus Property does not have an accurate perpetual inventory of available surplus property for state agencies to utilize. The intent of a statewide inventory is to encourage state agencies to purchase surplus property by making it easier to locate available items potentially meeting their needs. We spoke with several other states regarding their inventory processes. Five of the seven other states that we contacted have established computerized inventory systems that track individual property.

We also found that available surplus property is not actively being marketed to state agencies. We surveyed representatives from nine state agencies. Four of the agency representatives commented that they were unaware of the types of property maintained by Correctional Industries. Only three representatives stated that they had made purchases from Surplus Property.

Despite its Administrative Regulations, we found that Surplus Property, as well as other agencies that sell surplus, immediately offer the property for sale to the general public. Six of the seven other states we contacted have policies that provide state agencies first choice of surplus property. In those six states, surplus property may be sold to the general public only after it has been offered to state agencies first. Many of these states have waiting periods ranging from 30 to 60 days before surplus property can be made available to the general public. A similar requirement for the State's surplus property would facilitate efforts for reuse of this property by other state agencies.

Surplus Property should create an electronic inventory of available items and place this information on its Web site. Each state agency handling surplus property should do the

same on its own Web site. Surplus Property's Web site should also contain links to other state agency surplus property Web sites so that agencies looking for surplus property may easily shop statewide for available items meeting their needs. All inventories need to be updated periodically as items are sold or disposed of in order to maintain a current, perpetual inventory as required by statute. In addition, under the current dual surplus property system, any state entity that sells surplus property, including Surplus Property, should be required to comply with a reasonable waiting period established in regulations before selling the property to the general public.

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### **Recommendation No. 1:**

In order to encourage reuse of surplus state property and comply with statutes requiring a perpetual inventory of all available items, the Department of Corrections through its Administrative Regulations should:

- a. Require all state agencies to create and maintain an electronic inventory of all surplus state property than can be accessed through state agency Web sites.
- b. Require that all surplus property be made available to state agencies and other approved organizations for a reasonable set period of time prior to being offered for sale to the general public.

### **Department of Corrections Response:**

Agree. Implementation date: December 31, 2003. Colorado Surplus Property Agency (CSPA) will develop a database for use in documenting the intake and disposal of items with a potential resale value greater than \$25.00. Data fields will include acquisition date, release date for sale to the general public, final recipient, and date of sale. All listed items will be available to any government agency for thirty days prior to release date. CSPA will post the skeleton of this database, along with basic instructions for disposing of surplus property by other agencies, on our Web site for downloading and use. Additionally, use of the CSPA Web site will provide easy identification of available items.

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## Used Car Sales for State Fleet Management

As an extension of its state surplus property duties, Surplus Property serves as a sales broker for State Fleet Management within the Department of Personnel & Administration (DPA). According to Section 24-30-1104(2)(f), C.R.S., State Fleet Management has the authority to dispose of and replace state owned motor vehicles. Due to time and staffing constraints, State Fleet Management contracts with Surplus Property to sell those fleet vehicles no longer needed by the State.

We reviewed the contract between State Fleet Management and Surplus Property for the sale of used fleet vehicles. The contract is an unsigned, half-page document permitting Surplus Property to sell fleet vehicles through an Internet auction site. The current contract does not meet the State Controller's Fiscal Rule requirements governing contracting between state agencies. Fiscal Rule 2-2 provides that interagency disbursements in excess of \$5,000 that are not for routine internal services, such as printing, Capitol Complex lease payments, and legal services, must be documented in an interagency agreement. In Fiscal Year 2002, Surplus Property transferred approximately \$1.2 million to State Fleet Management from the sale of used fleet vehicles. The minimum required elements for interagency agreements are specified in Fiscal Rule 3-1, and include identification of parties, appropriation authority, a scope of work, and signatures by the parties. The document used by State Fleet Management and Surplus Property does not describe the appropriations or specific funds supporting the transfers of money and is not signed by the parties.

We also found that the sale of vehicles by one agency for another does not meet the Fiscal Rule exception to interagency contract requirements. Although both State Fleet Management and Surplus Property have statutory authority to engage in their respective roles in these transactions, the type of transaction involved does not appear to be within the meaning of "routine internal services" as defined by the examples given in Fiscal Rule 2-2. In addition, as a business enterprise under the Taxpayers' Bill of Rights (TABOR), Correctional Industries is not permitted to receive more than 10 percent of its annual revenue in the form of grants from the State. In the absence of a specific statute authorizing the buying and selling of motor vehicles on behalf of the State, Correctional Industries should have written contracts in place with State Fleet Management in order to formally document the required fee-for-service independence from the State as a TABOR district. Finally, Surplus Property receives a set 6.5 percent per vehicle fee to cover its administrative costs including staff time, vehicle detailing and preparation, and Internet

listing fees. Surplus Property lacks documentation to support the 6.5 percent fee. Therefore, it needs to establish a cost basis to support this fee.

## **Used Car Purchases for State Fleet Management**

In an effort to generate additional revenue, Surplus Property purchases used federal fleet vehicles and then resells them for a profit. State Fleet Management, which has statutory authority to acquire motor vehicles on behalf of state agencies, has delegated authority to Surplus Property to purchase used motor vehicles on its behalf from the public federal fleet vehicle auctions. Through these auctions, the federal government sells property no longer needed to the general public. At the request of State Fleet Management, Surplus Property purchases vehicles to replace state vehicles that have been damaged or destroyed. In Fiscal Year 2002 the Department of Personnel & Administration paid \$69,800 to Surplus Property for vehicle purchases.

In Fiscal Year 2002, State Fleet Management purchased seven federal fleet auction cars from Surplus Property. Rather than reselling the vehicles at the auction price plus a fee to cover its reasonable administrative costs, Surplus Property is charging State Fleet Management market prices based on what Fleet is willing to pay. In total, Surplus Property charged State Fleet Management \$14,700 more than it paid for the vehicles resulting in an average markup of 27 percent. The per vehicle markup was as much as 50 percent in one case. We found that State Fleet Management was unaware that Surplus Property was charging more than its reasonable costs incurred in supplying these vehicles.

As a business enterprise, Surplus Property should be tracking all direct and indirect costs of engaging in used motor vehicle transactions, determining whether or not costs are reasonable, and fairly allocating those reasonable costs among the vehicles sold. According to Surplus Property staff, one FTE makes approximately nine annual trips to the federal fleet vehicle auctions to purchase vehicles. Expenses of approximately \$410 per trip include hotel, car rental, and meals. In addition, Surplus Property contracts with a third-party carrier to transport the vehicles back to the Denver warehouse, the cost of which averages \$275 per vehicle. Surplus Property staff told us that for each vehicle they apply a minimum \$1,000 discount to the suggested retail price published by the National Association of Automobile Dealers (NADA) in its annual Official Used Car Guide. However, we found no documentation describing the methodology for determining the actual discount.

Statutes at Section 17-24-106.6(2)(a), C.R.S., note that Surplus Property can only sell surplus property through public auction or competitive sealed bidding. Neither of these methods is used when State Fleet Management purchases used federal vehicles from Surplus Property. Instead Surplus Property sets the price and requires State Fleet Management to pay that amount. We believe that Corrections needs to seek statutory authority to acquire non-state surplus property, such as used cars, from external sources for sale to state agencies at a predetermined price. In addition, Section 17-24-112(1), C.R.S., states that prices for Correctional Industries' goods and services sold to the State or its political subdivisions can not exceed the wholesale market price for like articles or services. Surplus Property lacks documentation to ensure that the prices it charges State Fleet Management meet this requirement.

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## **Recommendation No. 2:**

The Department of Personnel & Administration and the Department of Corrections should jointly develop an interagency agreement covering both the sale of state fleet vehicles and the acquisition of federal fleet vehicles, or seek a written waiver from the State Controller.

### **Department of Personnel & Administration Response:**

Agree. Implementation date: August 31, 2003. The Department of Personnel & Administration, Division of Central Services, Fleet Management will work with the Department of Corrections to develop an interagency agreement covering the sale of fleet vehicles by August 31, 2003.

### **Department of Corrections Response:**

Agree. Implementation date: August 31, 2003. The Department of Corrections, Division of Correctional Industries (CI) shall draft a service agreement for use in documenting the authority delegated to it by State Fleet Management to sell State Fleet Vehicles and to acquire and inventory vehicles for sale to other governmental and nonprofit agencies. Additionally, the service agreement will be the vehicle used to document our pricing agreement for acquisition and sale of vehicles.

## **Recommendation No. 3:**

The Department of Corrections should establish and document a cost basis for fees charged to State Fleet Management for the sale of state fleet vehicles via an Internet

auction site. Additionally, the Department should ensure that its sales of used vehicles to State Fleet Management meet statutory requirements regarding selling methods and pricing.

### **Department of Corrections Response:**

Agree. Implementation date: August 31, 2003. The Department of Corrections will establish and document a cost basis for the fees charged to State Fleet Management in our Service Agreement. We shall also ensure that statutory requirements are met when selling purchased vehicles to State Fleet Management, by the establishment of a Correctional Industries Auto Sales unit designated to buy and sell on behalf of governmental agencies. This unit shall abide by the Correctional Industries Statutes when developing our pricing structure.

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## **Used Car Sales To Public and Private Buyers**

In addition to vehicle acquisitions on behalf of State Fleet Management, Surplus Property purchases vehicles at the federal fleet auctions and sells them to other state agencies, approved non-state entities, and the general public. Surplus Property conducts this business under the trade name Colorado Auto Sales.

State statutes allow Surplus Property to acquire donated federal surplus property, including motor vehicles, for any state department, agency, school district, city, local government entity, or political subdivision. Section 24-82-403, C.R.S., authorizes Correctional Industries to participate in the federal government's program to distribute unneeded property to the states under subsection 203(j) of the *Federal Property and Administrative Services Act of 1949*. However, according to a federal surplus property representative, few good-quality vehicles are available through the donation program. Instead, the federal government sells most of its surplus vehicles through the federal fleet auctions in hopes of generating a higher price. These auctions are authorized by other parts of the *Federal Act*, not the donation program under subsection 203(j). Therefore, in order to obtain operative vehicles for state agencies, Surplus Property makes its vehicle purchases through the federal fleet auctions. No Colorado statute specifically authorizes Surplus Property to engage in the business of buying used motor vehicles and reselling them to public and private entities. Such activities do not involve the sale or disposal of surplus state property and they are not covered under the federal donation program.

Surplus Property sells vehicles to state agencies, qualified buyers, and the general public. Surplus Property's qualified buyers include local governments and private nonprofit entities,

such as medical facilities. Staff explained that many vehicles are purchased based on estimating future sales opportunities and are not based on a specific agency request. For Fiscal Year 2002 we found 55 transactions involving sales of motor vehicles to entities other than State Fleet Management. Of this number, 27 were sold to state agencies and local governments, and 28 were sold to the general public. In other words, Surplus Property has established a used-car business and is competing with the private sector.

We found that Surplus Property is disproportionately making profits from state agencies as compared to non-state buyers. In Fiscal Year 2002, sales from all used vehicles sold by Surplus Property, including those to State Fleet Management, generated \$68,300 in profit. Of this amount, \$10,400, or roughly 15 percent, came from vehicles sold to non-state entities including the general public. Correspondingly, Surplus Property earned the remaining 85 percent of its profit, or \$57,900, from sales to state agencies. In one case, Surplus Property charged a state agency 126 percent of the federal fleet auction price. In another case, Surplus Property took a loss of 54 percent on a vehicle. We calculated that the average percentage markup for sales to state agencies, including State Fleet Management, was 22 percent per vehicle as opposed to 5 percent to non-state entities and individuals. Section 17-24-112(1), C.R.S., limits the price charged to the State and its political subdivisions for Correctional Industries' goods and services to the wholesale market price. Surplus Property lacks the documentation needed to ensure compliance with this requirement.

According to Section 12-6-102 (17), C.R.S., the sale of three or more motor vehicles in one year with the intent to make a monetary profit creates the presumption that the seller is engaged in the business of selling used vehicles. Section 12-6-102(20), C.R.S., requires that persons operating a used-car business be licensed. Although it sells upwards of 60 vehicles per year to approved agencies and the general public, Surplus Property is not licensed as a used car dealer. The dealer licensing statutes contain an exception for public officials engaged in their official duties. It appears that express statutory authority to sell motor vehicles is required in order to qualify for this exception because statutes, Section 24-30-1104(f), C.R.S., already designate State Fleet Management within the Department of Personnel & Administration as the State's official buyer and seller of cars. It is unclear whether the statutes governing used-car dealer licensing anticipate the licensing of a business operated by a state agency, such as Correctional Industries.

While the practice of buying and selling used-motor vehicles is not expressly authorized as a surplus property activity, Correctional Industries has general authority to undertake new business activities if approved by the Correctional Industries Advisory Committee. Given the regulatory requirements and the inherent risk of losing money selling used-motor vehicles, we question whether this business makes sense from either a financial or a business perspective. Statutes governing Correctional Industries, 17-24-104(3)(a), C.R.S., require that "before any industry is established to utilize the services of prisoners,

the advisory committee shall consider the feasibility of establishing such industry and the effect of such establishment on similar industries already established in the state." The profits reported by Surplus Property for prior years may actually prove to be a loss in future years because it is unknown if the pricing methods used by Surplus Property meet statutory requirements.

Correctional Industries should reevaluate Surplus Property's used-car sales program. Correctional Industries needs to consider the program's "effect on similar industries," whether the program results in providing learning opportunities for inmates, and whether it is financially viable. Correctional Industries should obtain approval from its Correctional Industries Advisory Committee to continue to buy and sell used cars. Since the operation of a used-car business involves statutory licensing requirements, we believe that Corrections should seek specific authority from the General Assembly to operate a used-car business. As part of this legislative approval Corrections needs to determine whether the Motor Vehicle Dealer Board has the authority to license a used-car business operated by a state agency or if it qualifies for an exemption. If Correctional Industries receives legislative approval to operate a used-car business, then it must ensure compliance with statutory requirements regarding sales methods and pricing guidelines.

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#### **Recommendation No. 4:**

The Department of Corrections should seek specific approval from its Correctional Industries Advisory Committee as well as specific statutory authority to operate a used-car business. Legislative consideration should include whether or not a used-car business operated by a governmental entity needs to be licensed by the Motor Vehicle Dealer Board or is exempt from licensing requirements.

#### **Department of Corrections Response:**

Agree. Implementation date: August 31, 2003. Correctional Industries will again discuss the car sales activities with the Advisory Board, as you request. We will pursue, through communication with the Motor Vehicle Dealer Board and the Attorney General's Office, a legal opinion and recommended steps to meet the State's licensing requirements for continuation of purchase and sale of used vehicles on behalf of governmental and nonprofit entities within Colorado, including subsequent sale of unclaimed vehicles through the eBay auction process. If deemed necessary, we would seek specific statutory authority to continue to operate as such.

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## Sales and Disposal of Computer Hardware

Each year, state agencies surplus computer hardware. We examined the current methods used by the State and its individual agencies to resell or dispose of their surplus computer equipment. When getting rid of surplus computer equipment, agencies, including Surplus Property, must comply with certain federal and state regulations regarding the privacy of personal information and the proper disposal of hazardous materials including some types of computer equipment. Release of confidential information or improper disposal of hazardous materials can expose the State to financial liability for violations of applicable law.

## Purging Confidential Computer Information

We found that state agencies do not always purge confidential information from their surplus computers. State agencies use a variety of personal, nonpublic information when assisting citizens and implementing programs. Examples of this type of information include social security numbers, medical records, mental health records, and personal financial information. Both federal and state laws expressly protect the confidentiality of personal, nonpublic information. For example, the Gramm-Leach-Bliley Act (Public Law 106-102) requires financial institutions to protect against the unauthorized use of confidential customer information. The Health Insurance Portability and Accountability Act of 1996 (Public Law 104-191) obligates health plans and health care providers to prevent the unauthorized disclosure of health care service and payment information. There are also several state laws that protect nonpublic information. These include Sections 24-72-204 and 24-72-502, C.R.S., which require state agencies to develop privacy policies regarding personally identifiable information and detail specific grounds to deny access to such information. Sections 6-18-103, and 25-1-1201, C.R.S., also protect the privacy of identifiable health information and medical records.

We examined a sample of state computers waiting to be auctioned by Surplus Property. We identified four computers that still contained password protected operating systems. We also found two computers that contained personal files including one with files entitled “midterm grades.” These files may have been considered confidential under Section 24-72-204(3)(a)(I), C.R.S., which prohibits the release of scholastic achievement information to anyone but the person who earned the grades. Corrections’ Administrative Regulations require state agencies to take appropriate action to ensure that personal information has been removed from surplus computer equipment prior to giving it to Surplus Property. However, Surplus Property does not check surplus computer equipment to verify that the surplus agency purged all confidential information. Moreover, Surplus Property

does not take any action itself to clean the surplus computer equipment it receives before it sells the systems to secondary users.

Even when state agencies attempt to remove confidential information from surplus computers, we found that the methods used may not effectively prevent unauthorized access. We surveyed representatives of nine state agencies to obtain information on the actions that they take to purge confidential information from computers. The majority of the agency representatives we spoke with stated that their agency simply reformats the hard drive before transferring the computer. One representative from an agency handling particularly sensitive information stated that his agency runs a disk operating system (DOS) command to delete existing partitions on its surplus computers. Our research indicates that these are the least effective methods for protecting against unauthorized access to computer information. Reformatting or using the DOS command to delete partitions does not actually purge information from the hard drive. It simply creates new file allocation tables or eliminates existing partitions on the hard drive. Computer experts we spoke with stated that while such practices may make access to data more difficult, it is still possible to retrieve information from the hard drive.

The U.S. Department of Defense's Clearing and Sanitization Matrix (DoD 5220.22M) details compliant erasure procedures. According to the Matrix, a one-time overwrite of the hard drive makes any information not easily retrievable while a three-time overwrite makes the information almost impossible to retrieve. We found this DoD standard cited by numerous companies that offer software packages to purge confidential information. A DoD representative recommended that computers containing highly sensitive or secret information be destroyed to provide a 100 percent guarantee that the information will be protected from unauthorized access.

State agency representatives expressed frustration over a lack of guidance for properly cleaning information from surplus computers. Although we identified several companies that offer reasonably priced software packages that meet the Department of Defense standard for preventing the retrieval of confidential information, we believe that a full understanding of effective data erasure requirements demands detailed technical knowledge of this issue. Individuals working for the Governor's Office of Innovation and Technology and the Division of Information Technologies within the Department of Personnel & Administration have this type of expertise. These two agencies should continue their work on developing a statewide policy for purging confidential information from computer equipment.

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## **Recommendation No. 5:**

The Governor's Office of Innovation and Technology and the Department of Personnel & Administration should work with state agencies to develop a statewide policy detailing the acceptable methods for purging confidential information from surplus computer equipment.

### **Governor's Office of Innovation and Technology Response:**

Agree. Implementation date: December 31, 2003.

### **Department of Personnel & Administration Response:**

Agree. Implementation date: August 1, 2003. The Department of Personnel & Administration, Division of Information Technologies will work with the Governor's Office of Innovation and Technology to develop policies for purging confidential information from surplus equipment. In addition, the Department will coordinate with Correctional Industries in the development of a service for purging information as appropriate.

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## **Computer Recycling and Refurbishing**

State agencies surplus or dispose of obsolete or nonworking computer equipment. Certain parts of a computer's hardware contain hazardous waste, the disposal of which is strictly regulated by state laws. For example, color computer monitors contain a significant amount of lead while circuit boards and complex computer circuitry can contain lead, chromium, and silver. Since computer equipment contains hazardous waste, U.S. Environmental Protection Agency guidelines require agencies to use due diligence to ensure that their surplus equipment is sold only to legitimate recyclers or reusers. The Colorado Department of Public Health and Environment (CDPHE), which enforces state laws that implement federal requirements regarding hazardous waste disposal, recommends that agencies request documentation from reusers or recyclers regarding what will be done with the surplus computer equipment. For example, CDPHE representatives stated that legitimate recyclers will be able to provide documentation on how they manage the computers, how they are processed, and where various components are sent for disposal or materials recovery. Penalties for improper disposal of hazardous waste can be up to \$15,000 per day per violation in administrative penalties or \$25,000 per day per violation

in civil penalties. Generators of the waste may also be liable for cleanup costs. Since state agencies purchase much of their computer equipment rather than lease it, the State is legally the "generator" of computer-related hazardous waste and therefore has the responsibility for ensuring that surplus computer equipment is disposed of properly.

We found that several higher education institutions surplus their own computer equipment, but a majority of state agencies send their surplus computer equipment to Surplus Property. We determined that surplus computer equipment handled through individual state agencies and Surplus Property may not always be protected from improper disposal, thereby exposing the State to potential liability. For example, Surplus Property sells most of the computer equipment it receives either individually or in large lots through monthly public auctions. Surplus Property may mix working and nonworking computer equipment in one auction lot in an attempt to get rid of the equipment. We found that other agencies also use public auctions to dispose of surplus computer equipment. Our discussions with staff at both CDPHE and Corrections indicate concern that the practice of auctioning large lots of obsolete and unusable computer equipment may actually encourage illegal dumping of that computer equipment. If illegal dumping occurs, the State may be responsible for future cleanup costs.

Correctional Industries has a good alternative to the current system of disposing of computers through Surplus Property. Correctional Industries could move the equipment through its Computer Services Manufacturing, Refurbishing, and Recycling facility (Computer Services). Staffed by inmates, Computer Services refurbishes surplus computer equipment and sells it to nonprofit organizations and the general public. In addition, Computer Services recycles obsolete and nonworking computers and sells the individual parts to established waste management facilities or recyclers. The refurbishing and recycling of used state computers maximizes their useful life and also decreases the likelihood that equipment will be improperly disposed of in landfills. Giving surplus computer equipment to Computer Services also would ensure compliance with the State's policy of encouraging the reuse or recycling of state assets.

We found that Computer Services generally sells its refurbished computer equipment at a higher price than does Surplus Property. In the first quarter of Fiscal Year 2003, Computer Services earned approximately \$5,000 selling 115 refurbished computers and monitors. In addition, the average price of computers and monitors sold by Computer Services' refurbishing program was \$44.00, or about \$27.00 more than the average price received by Surplus Property through its auctions. The difference in price stems in part from the fact that Computer Services only sells working computer systems. For those computers that do not work or cannot be effectively refurbished, Computer Services breaks them into component parts and recycles them. From the computer equipment received in the first quarter of Fiscal Year 2003, Computer Services sold almost 45,000 pounds of component parts for about \$900. Computer Services transfers unusable parts

to legitimate waste management facilities or recyclers. Computer Services staff maintain detailed records documenting from whom each piece of computer equipment was received and to whom each piece was transferred.

We believe that using Computer Services to refurbish and resell surplus computers offers an opportunity to further maximize the State's investment in this equipment. As we have already noted, refurbished computers tend to, on average, generate more revenue than those computers sold by Surplus Property through public auctions. To expand the market for these refurbished computers, Computer Services could work with Surplus Property to sell these computers at the Denver warehouse. Currently, the refurbished computers are only available at Computer Services' Canon City location. We believe this joint effort would increase the sales of refurbished computers and would also allow Surplus Property to replace some of the revenue it will lose by no longer selling surplus computer equipment through public auctions.

Agencies that choose to continue to sell or dispose of their surplus computer equipment, rather than giving it to Computer Services, must ensure that it goes to only legitimate reusers or recyclers. As we have already noted, this includes asking questions of recipients to determine how the computer equipment will be reused or disposed of. Since CDPHE maintains the responsibility for enforcing state laws that implement federal requirements regarding the disposal of hazardous waste including computer equipment, it needs to more actively educate state agencies regarding specific disposal requirements. CDPHE should also help state agencies identify legitimate reusers and recyclers of computer equipment. In addition, CDPHE needs to develop documentation guidelines that state agencies can follow when disposing of computer equipment. These steps will help protect the State from potential liability for the improper disposal of computer equipment.

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## **Recommendation No. 6:**

The Department of Corrections should establish a policy that all surplus computer equipment received by the Colorado Surplus Property Agency be given to the Division of Correctional Industries' Computer Services Manufacturing, Refurbishing, and Recycling facility to refurbish or recycle. Refurbished computers should be available for sale through either Computer Services or the Colorado Surplus Property Agency.

## **Department of Corrections Response:**

Agree. Implementation date: July 1, 2003. The Correctional Industries Computer Services Unit is currently well equipped to test, refurbish and/or recycle all computer components, as well as to dispose of hazardous waste materials as necessary. This Unit has already established needed procedures for these tasks

and has available capacity to expand this area immediately. Additionally, Correctional Industries' Computer Services Unit would be willing to perform the desired purging service for state agencies with minimal charge, which would eliminate the need to replicate the purchase of specialized software throughout the state. Correctional Industries encourages the Colorado Department of Public Health and Environment to consider directing all state agencies to use the Correctional Industries' Computer Services Unit to provide this service.

### **Recommendation No. 7:**

The Colorado Department of Public Health and Environment should establish guidelines for the proper disposal of computer equipment including:

- a. Assisting state agencies in finding legitimate reusers and recyclers of surplus computer equipment.
- b. Providing state agencies with documentation guidelines for showing that they exercised due diligence when selling or disposing of surplus computer equipment.

### **Colorado Department of Public Health and Environment Response:**

- a. Agree. Implemented and ongoing. CDPHE has developed guidelines for the proper disposal and recycling of computer equipment, and, in addition, has worked with a Cathode Ray Tube advisory committee, created by C.R.S. 25-17-105.5, in identifying resources available to industry, government, and the public for proper disposal and recycling of computer equipment. The guidelines include an Electronics Waste Compliance Bulletin, as well as information on the Department website. CDPHE staff is prepared to serve as a technical advisor to the Department of Corrections and other state agencies on these issues of proper disposal and recycling, including working with other agencies to develop specifications for procurement of computer recycling and waste management services. In addition, potential vendors for such services are listed through links on the department's website to "Colorado Recycles" and the Governor's Office of Energy Management and Conservation. Due to its regulatory role and the changing industry, the Department cannot recommend specific vendors of these services.
  - b. Agree. Implementation date: December 31, 2003. The Department will make this guidance available by December 2003
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## Daily Warehouse Sales

The surplus property statute, Section 17-24-106.6(2)(a), C.R.S., requires Surplus Property to dispose of used equipment through either public auction or competitive sealed bidding. To increase sales revenue, in Fiscal Year 2003, Surplus Property initiated a daily warehouse sales program. For its daily warehouse sales, Surplus Property determines the price for each item, and the buyer must pay that price. State agencies, nonprofit organizations, and local governments can purchase these items on a first-come, first-served basis. We found that these daily warehouse retail sales do not qualify as either a public auction or a competitive sealed bid process because there is no advance notice to the public of precisely what is offered for sale on any given day. Nor is it clear that this sales method is a more cost-effective approach than auctioning or soliciting bids for large lots of property.

From July 2002 through November 2002, revenues from Surplus Property's daily warehouse sales totaled \$40,000, or about 8 percent of the almost \$521,000 generated through all sales of surplus property during that same time period. Since daily warehouse sales is a new sales mechanism, it is unclear at this point if this level of revenue from warehouse sales will be sustained. Correctional Industries should undertake a comprehensive analysis of the cost-effectiveness of its various sales methods, taking into account the establishment of proper inventory and other controls including the need to update its perpetual inventory on a daily basis. This would allow Correctional Industries to build a sound business case in support of continuing to use each selling method including the daily warehouse sales. If this assessment demonstrates the cost-effectiveness of daily warehouse sales and development of marketable skills for inmates, the Department of Corrections should pursue statutory changes to permit this option. In addition, all agencies handling their own surplus property should be allowed by statute to utilize this additional sales method if it is proven cost-effective.

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### Recommendation No. 8:

Correctional Industries should evaluate the cost-effectiveness of continuing the daily warehouse sales option, and if determined viable, the Department of Corrections should seek amendments to the surplus property statute to authorize this method of selling surplus property.

## **Department of Corrections Response:**

Agree. Implementation date: Review by December 31, 2003. Correctional Industries will review this process by December 31, 2003 and make a determination as to its continued viability, then will either seek statutory authority or discontinue the practice.

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## **Surplus Property Sales to State Employees**

Section 17-24-106.6(2)(a), C.R.S., provides that “no public employee shall be entitled to purchase any such surplus state property.” It appears that the General Assembly intended to eliminate potential conflicts of interest and afford the general public a fair opportunity to obtain surplus property. Surplus Property and other state agencies enforce the statutory requirement by displaying signs at the public auctions detailing the state employee purchasing prohibition.

We surveyed seven other states regarding their surplus property programs. All of the states we spoke with allow their state employees to purchase surplus property. Several states noted that state employees generate a significant portion of their state's surplus property sales, especially in the area of state fleet motor vehicles. Most of the states we surveyed have some measures or safeguards in place to protect against possible improprieties. Several states have either statutes or regulations which detail that any state employee who was directly or indirectly involved with the purchase, disposal, maintenance, or preparation for sale of the surplus item is prohibited from purchasing that item. Implementing similar safeguards in Colorado could address concerns regarding selling surplus property to state employees.

As long as proper safeguards exist, allowing state employees to participate in surplus property sales could generate additional revenue for both Surplus Property and other state agencies. Correctional Industries should evaluate the costs and benefits associated with allowing state employees to buy surplus property. The analysis should include the cost of implementing effective safeguards to ensure the integrity of the process, based on consultation with other states to identify best practices.

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## Recommendation No. 9:

The Department of Corrections should:

- a. Evaluate the costs and benefits of allowing state employees to participate in buying surplus property along with the general public and, if determined appropriate, seek amendments to the surplus property statute to remove the current prohibition on such purchases.
- b. Amend its Administrative Regulations to implement the statutory change and establish effective safeguards to protect against possible improprieties.

## Department of Corrections Response:

Agree. Implementation date: September 30, 2003. CSPA will contact the State Auditor's survey respondents relating to revenue generated from vehicle sales to state employees and safeguards utilized to limit unfair purchases. CSPA will review by September 30, 2003 existing Fiscal Rules and contact the Department of Personnel & Administration and others as necessary to coordinate such a policy change in an effort to maintain consistent systems throughout Colorado government. If prudent, we will seek change to the surplus property statute during the next session of the General Assembly to enable such transactions.

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## Controls Over Surplus Property

We reviewed the internal controls over the surplus of state property. We found a fundamental lack of controls resulting in Surplus Property's inability to reconcile incoming and outgoing property and ensure that all revenues generated through its sale of surplus property are deposited into the Correctional Industries Account.

We identified several problems including:

- **Inventory Control.** Surplus Property does not maintain an inventory of items received. Agencies complete a declaration form that identifies the items they wish to surplus by inventory or serial number, description, and condition. In order to provide Surplus Property with an accurate list and description of all surplus

property, the information required in the declaration form must be given to Surplus Property whether the agency uses Surplus Property's services or sells or disposes of its own property. Staff at Surplus Property also use this form to gauge the number of staff and inmates they need to pick up the property. We reviewed a sample of declaration forms submitted by agencies for both August and September 2002 and found that many agencies fail to provide an inventory or serial number for the surplus property items. Surplus Property accepts the incomplete documentation and does not attempt to complete it. As a result, Surplus Property cannot always track surplus property using a specific inventory or serial number.

With outgoing property (sales or disposals), we found that Surplus Property does not use the inventory or serial number or other identifying information provided by the surplus agency when documenting the sale of surplus property. Instead, Surplus Property typically documents the sale using a general description of the property. It appears that one reason a general description is used is that Surplus Property frequently groups less desirable items together and sells them in bulk lots at its monthly auctions. Without documentation of sale or disposal, Surplus Property cannot substantiate and validate its inventory. In addition, the lack of controls increases the risk of errors and irregularities and, in the case of hazardous waste disposals (e.g., computers), can leave the State open to financial liability. Finally, Surplus Property does not conduct a year-end physical inventory of items received against items sold. The State's Fiscal Procedures Manual states that inventories greater than \$100,000 must be inventoried annually. In Fiscal Year 2002, Surplus Property generated \$1.2 million through the sale of surplus property. A year-end physical inventory would ensure that all property that should still be in the warehouse can be accounted for and that no items are missing.

- **Segregation of Duties.** We also found that there is no separation of duties for tracking the property picked up from agencies and delivered to the central warehouse. Once the property reaches the warehouse, it is simply unloaded by the same people who picked it up, and there is no independent central receiving function to document receipt of each item. We found that Surplus Property has established separation of duties regarding the collection and deposit of revenues generated through the monthly public auctions, Internet auctions, and daily warehouse sales.

Given the potential for errors and irregularities in the transfer of numerous items of property, it is critical to have in place basic controls for selling or disposing of surplus property. Such statewide standards should include sound inventory controls, documentation supporting financial transactions, and segregation of duties. Adequate

controls would include countersigned shipping documents, central intake and recording of property received, separation of duties involving movement of property and handling of money, and periodic independent reconciliation of records including year-end physical inventory procedures. Acceptable documentation would include complete identifying information, such as an inventory or serial number for every item of surplus property as well as the final destination of the property, and whether purchased or disposed of in a landfill. Surplus Property should document specific sale information including the buyer's name and the sale price. Surplus Property also needs to continue to retain documentation regarding the amount of money generated through the sale of surplus property and how that money was used. We believe that such documentation standards will allow the State to adequately track what happens to its surplus property and accurately account for disposition of sale proceeds. Once these controls are established, Surplus Property should publish uniform guidance to state agencies on effectively implementing their own control systems for surplus property activities.

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### **Recommendation No. 10:**

The Division of Correctional Industries should ensure adequate internal controls over the collection, sale, and disposal of surplus property. The Division should then provide guidance to state agencies regarding appropriate controls for handling surplus property. Internal controls should include:

- a. Developing year-end physical inventory procedures.
- b. Ensuring adequate segregation of duties.
- c. Reconciling amounts received to amounts deposited into the Correctional Industries Account.

### **Department of Corrections Response:**

Agree. Implementation date: September 30, 2003. CSPA will develop written procedures for conducting year-end inventories, segregation of duties, and reconciliation into the Correctional Industries Account at the State Treasury. Additionally, the CSPA will simultaneously post on its website, guidance to other agencies wishing to dispose of their surplus property.

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## Surplus Property Fees

Due to statutory requirements, Correctional Industries requires its individual programs to cover their operating costs and generate a profit. Until recently, however, the cost of operating Surplus Property exceeded the revenues generated by the program. For example, in Fiscal Year 2000, Surplus Property experienced a loss of almost \$126,000. Since Surplus Property provides valuable assistance to state agencies seeking to sell or dispose of their unneeded property, the Correctional Industries Advisory Board required Correctional Industries' to continue to operate the Surplus Property program even though Corrections sought authority to terminate it. To make Surplus Property profitable, Correctional Industries has allowed it to charge a variety of fees. As described below, we found problems with the fees charged.

According to Section 17-24-106.6(6), C.R.S., Correctional Industries has authority to “assess fees from the recipient of any surplus state property, which fees shall be limited to reasonable administrative costs of the division incurred in effecting the collection of surplus state property. All such fees shall be credited to the surplus property fund.” We found that Surplus Property does charge some fees to generate revenues, but these fees are focused on the supplier of the surplus property and not the recipient. For example, Surplus Property charges agencies a pickup and transport fee of \$40 per hour. In Fiscal Year 2002, Surplus Property generated approximately \$11,200 in revenue through this pickup fee. While we believe that some fee for this service is justified, the statute only allows Surplus Property to charge fees against the “recipient” of surplus property, not against the selling or disposing agency. In addition, although the Administrative Regulations indicate that this fee is based on vehicle, fuel, and labor costs, we found that this was not the case. Surplus Property has never calculated its actual costs and therefore does not know if the \$40 fee reflects pickup and transport costs. Correctional Industries needs to establish a cost basis for its fees related to pickup and transportation of surplus property and seek statutory authority to charge fees to the agency surplus property.

Surplus Property also charges agencies who surplus their own property 10 percent of the sale proceeds, even though Surplus Property provided no service. Surplus Property has no statutory authority to levy a fee on the sale of surplus property by other state agencies in order to subsidize its overall operation. This fee is also an arbitrary percentage without any basis in actual costs of running the program. In addition, the fee is rarely recovered by Surplus Property. In Fiscal Years 2001 and 2002, 19 auctions were held by state entities and only 5 payments of this type were ever submitted to Surplus Property. Correctional Industries needs to amend its Administrative Regulations to eliminate this unauthorized 10 percent surcharge.

Statutes require Surplus Property to create and maintain a perpetual inventory of surplus state property and inform state agencies of the availability of such property. As we previously discussed, we believe that Surplus Property should create a electronic inventory of the surplus property in its warehouse and place that information on the Juniper Valley Web site. Surplus Property would also ensure that electronic links exist to the Web sites of state agencies that handle their own surplus property. Correctional Industries may want to consider the establishment of a fee to cover the cost of the creation and maintenance of the required perpetual inventory. Any such fee would have to be based on reasonable administrative costs.

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### **Recommendation No. 11:**

The Department of Corrections should seek statutory authority to assess fees against the seller or disposer of surplus property to cover the reasonable administrative costs related to the pickup and transport of surplus property.

#### **Department of Corrections Response:**

Agree. Implementation date: November 1, 2003. Correctional Industries will request an amendment to the Surplus Property statute during the next session of the General Assembly, identifying CSPA as an operating unit within CI and as such shall be a profit oriented entity.

### **Recommendation No. 12:**

The Department of Corrections should establish procedures to ensure that all fees charged by Surplus Property are based on documented, reasonable administrative costs. Corrections should also amend its Administrative Regulations to eliminate the 10 percent surcharge against surplus property sales by other state agencies.

#### **Department of Corrections Response:**

Agree. Implementation date: August 1, 2003. CPSA will amend its Administrative Regulation to eliminate the 10 percent surcharge as recommended. As discussed above, CSPA is an operating unit under Correctional Industries. We shall seek clarification during the next session of the General Assembly in the Surplus Property statute which enables CSPA to operate as such. The current

State Surplus Property statute is contradictory to the overall mission and statute governing Correctional Industries.

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# Correctional Industries Furniture Products

## Chapter 2

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### Background

Correctional Industries operates as a TABOR enterprise. Its goal is to generate enough revenue to cover its operating costs, make capital investments, and partially reimburse the General Fund for the use of inmate labor. Correctional Industries employs about 1,200 inmates in 43 separate businesses. According to Section 17-24-102, C.R.S., Correctional Industries is meant to operate as a profit-oriented business. At the same time, the statute also requires Correctional Industries to provide as many inmates as possible with meaningful job training and skills to improve their future employment prospects. Correctional Industries representatives stated that due to these statutory requirements, in general, the individual businesses are expected to cover their costs and generate a profit, but some may continue to operate even at a loss as long as they continue to provide meaningful job skills to inmates. Between Fiscal Years 1998 and 2002, Correctional Industries' revenues increased 16 percent, but its overhead costs grew by 127 percent. To continue to meet its statutory mandate to cover its costs and partially reimburse the General Fund, Correctional Industries needs to increase the revenue generated through sales or decrease its expenditures and overhead costs.

### Furniture Production

We examined the revenues and expenditures associated with Correctional Industries' furniture manufacturing shop because there is a statutory preference that state agencies buy from Correctional Industries. Section 17-24-111(1)(a), C.R.S., requires state agencies to purchase office furniture and office systems from Correctional Industries. The only exception to this requirement is if Correctional Industries cannot produce the office furniture or system at a comparable quality and price in a timely manner. In these cases, agencies may seek a waiver that allows them to buy office furniture from another source. The manufacture of office furniture and systems represents one of Correctional Industries' largest manufacturing operations. The furniture shop has seen its revenues decrease from \$5.4 million in Fiscal Year 1998 to \$3.7 million in Fiscal Year 2002. At the same time,

operating expenses have increased. As a result, the furniture shop experienced operating losses in both Fiscal Years 2001 and 2002. This trend is expected to continue in Fiscal Year 2003.

Correctional Industries' furniture shop is heavily dependent on purchases from state agencies. We found that state purchasing agents are dissatisfied with the furniture products and office systems manufactured by Correctional Industries. Surveys we conducted with a sample of agency purchasing representatives indicated concerns regarding the cost of office furniture as well as inconsistent customer service. We also found that a large number of state agencies consistently seek waivers that allow them to purchase office furniture from the private sector. Correctional Industries representatives acknowledge that furniture manufacturing revenues have decreased in recent years and that, overall, the shop has experienced operating losses. These representatives believe that despite the operating losses the furniture manufacturing shop provides valuable job skills and training that cannot be duplicated in a classroom setting. Therefore, Correctional Industries has made the decision to continue operating this program. We believe, however, that Correctional Industries needs to undertake an analysis of the furniture purchases by state agencies to see if opportunities exist for it to better meet the needs of state agencies. By meeting the needs of state agencies, Correctional Industries might be able to increase the amount of revenue it generates through office furniture and systems sales.

## Analyzing Furniture Purchases

The *New Century Colorado Final Report* comments on the fact that the State lacks a comprehensive integrated information system to support the procurement process. The State's Bid Information and Distribution System (BIDS) is a web-based solicitation system that must be supplemented by manual processes to enter purchasing documents including purchase orders and payment vouchers into the Colorado Financial Reporting System (COFRS). As a result, the *New Century Colorado Final Report* noted that the State does not have aggregated information on commodity purchases, including office furniture purchases, to take advantage of volume discounts. We also found that COFRS does not record furniture purchases using one specific purchasing code, and this makes it difficult to calculate the total dollar amount spent on office furniture and systems by state agencies.

Correctional Industries needs to work with the Department of Personnel & Administration (DPA) to devise a method to analyze the State's overall furniture purchases and use this information to better meet the needs of state agencies. Our work indicates that some state agencies may be purchasing a significant amount of office furniture from private vendors without receiving the statutorily required waivers. Statutes require agencies to annually

report purchases from Correctional Industries to the Joint Budget Committee (JBC) as part of their yearly budget request. We found that agencies are not complying with this requirement. Combined with the fact that COFRS does not record furniture purchases using one purchasing code, it is unclear how much non-Correctional Industries office furniture and systems are purchased by state agencies each year.

Knowing the actual amount of office furniture purchases made each year by state agencies would help determine whether enough potential revenue exists for Correctional Industries' furniture manufacturing shop to operate without a deficit. It would also tell the General Assembly the actual amount state agencies spend on furniture at both Correctional Industries and private vendors. Such information could be used by Correctional Industries to analyze the needs of state agencies and develop product lines to meet those needs. It would also provide information on whether volume purchases could be made, which would save the State money. Finally, comparing the total dollar amount of office furniture purchased by state agencies with the amount purchased from Correctional Industries combined with approved waivers would tell both Correctional Industries and DPA whether state agencies are complying with the statutory purchasing preference. Such analysis is particularly important for DPA when it conducts peer reviews of its delegations to state agencies to ensure compliance with statutory purchasing requirements.

We believe DPA and Correctional Industries should work together to modify the current reporting requirement. In addition, DPA could develop specific codes for furniture purchases to be used in COFRS and other agency accounting systems and encourage agencies to use it. These changes would allow the development of aggregate data on the State's furniture purchases and would give Correctional Industries and DPA the ability to analyze purchasing trends and needs as well as compliance with statutory requirements.

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### **Recommendation No. 13:**

The Department of Personnel & Administration and the Department of Corrections should work together to develop a method to track statewide office furniture and office system purchases including those from non-Correctional Industries sources. Once a tracking method is developed, Corrections and DPA should analyze the resulting data to better address the needs of the State and its agencies and to ensure compliance with statutory purchasing requirements.

## **Department of Personnel & Administration Response:**

Agree. Implementation date: August 1, 2003. The Department of Personnel & Administration will develop an additional object code that will differentiate non-capital furniture from other non-capital equipment. This will be implemented for use during Fiscal Year 2003-04 for those agencies using COFRS. Implementation of a tracking system for higher education institutions that do not use COFRS as the primary accounting system will require a separate tracking system. The Department will coordinate with higher education institutions to facilitate this tracking mechanism. In addition, when the Department of Personnel & Administration, State Purchasing Office conducts peer reviews, the State Purchasing Office will review a list of all office furniture purchases and determine whether the agency has a corresponding waiver for those not purchased from Correctional Industries to ensure compliance with statutory requirements.

## **Department of Corrections Response:**

Agree. Implementation date: August 1, 2003. The Department of Corrections, Division of Correctional Industries will work with the Department of Personnel & Administration to develop systems to (a) track by agency the total dollar amount of office furniture and office systems purchased, (b) track by agency the total dollar amount of waivers requested and approved by the Division of Correctional Industries, and (c) track by agency the total dollar amount of office furniture and office systems purchased from the Division of Correctional Industries. We will further complete the cycle by calculating the difference between the three components, which may identify agencies who are circumventing the statutory purchasing requirements, sharing the information between us and reporting the results to the Legislative Audit Committee through the Committee's established follow-up process.

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## **Purchase Waiver Process**

Section 17-24-111(1)(a), C.R.S., requires state agencies to purchase office furniture and systems from Correctional Industries unless they obtain a waiver. According to statute, waivers should only be granted if Correctional Industries cannot produce the office furniture or system at a comparable quality and price in a timely manner. The waivers offer valuable information to Correctional Industries regarding the types of furniture items

purchased from private vendors and the state agencies that would rather have their furniture needs met by the private sector. We examined the waiver process to determine if it meets statutory requirements. We found a lack of standards regarding the request for and approval of waivers.

The statute gives the Department of Personnel & Administration (DPA) the authority to grant the waivers. DPA delegated this authority to Correctional Industries, since it is most familiar with its own products and the time it would take to fill an order. However, there is no written delegation agreement that details the responsibilities of Correctional Industries and DPA. We believe that a written delegation agreement is necessary. In addition, we found that neither DPA nor Correctional Industries has published any guidelines or Administrative Regulations detailing when to use the waiver process or how Correctional Industries determines when to grant a waiver. We found that agency personnel are unsure of certain aspects of the waiver process. For example, agencies have differing definitions of "office furniture" that impact their decisions about whether or not to seek a waiver when purchasing certain items. Agency representatives also reported not seeking waivers when they purchase additional items for which they have already received a previous waiver. Finally, agency personnel surveyed gave differing views regarding whether a waiver is required when the agency knows that Correctional Industries does not manufacture the needed furniture product. The lack of standards and varying agency perceptions may mean that significant amounts of office furniture are being purchased from private vendors outside of the waiver process.

Correctional Industries approves the majority of waiver requests that it receives. From Fiscal Year 2001 through the first quarter of Fiscal Year 2003, 15 state agencies requested a total of 592 waivers representing almost \$1.7 million. Correctional Industries approved 503 (85 percent) totaling \$1.4 million. This represents an estimate of dollars spent by state agencies to purchase office furniture or systems from non-Correctional Industries sources. We reviewed a sample of 74 waiver requests to determine the reason for Correctional Industries' approval or denial of the waiver. For the sample, we found that several of the waivers represented furniture that Correctional Industries offered but could not manufacture and deliver in the requested time frame. We could not, however, determine from the information provided on the waiver request whether agencies requested the waiver in a timely manner. In addition, the waivers do not include any information about how Correctional Industries decides whether or not it can fill a furniture order in a timely manner. We also found that Correctional Industries granted a total of 12 waivers (16 percent) without stating the reason. Therefore, we don't know whether granting these requests met statutory requirements.

We believe that DPA and Correctional Industries need to modify the current waiver process. First, DPA should develop a written delegation agreement authorizing Correctional Industries to grant or deny waivers and detailing any appeal processes available to state agencies. Second, since state agencies have differing views regarding when a waiver may be needed, DPA and Correctional Industries should work together to develop written guidelines governing the waiver process. Guidelines need to include a definition of "office furniture" as well as standards for whether or not a waiver is required if Correctional Industries does not make the furniture or the agency is purchasing the same type of furniture for which it was previously granted a waiver. This would provide state agencies with clear guidance about when to obtain a waiver. In addition, we believe that waiver guidelines should also include a requirement that agencies submit waiver requests for a set period of time prior to actually acquiring the furniture. This might reduce the number of purchases from private vendors due solely to Correctional Industries' inability to meet the specified time frames. Third, the guidelines need to discuss enforcement of the statutory purchasing preference. For example, agencies should be required to show that if the furniture purchase exceeds \$5,000 that the agency complied with statutory requirements for documented quotes or competitive bids after receiving the waiver. Waivers requests contain information on why an agency believes Correctional Industries cannot provide the needed office furniture including price quotes and specifications from a private vendor. Without clarification agencies might believe the waiver gives them the right to purchase from this vendor even if the total amount exceeds \$5,000. In addition as part of its peer review to ensure compliance with the State's purchasing requirements, DPA needs to review a sample of waivers. Finally, Correctional Industries should include information on the waiver request explaining the reason for either granting or denying the waiver.

We believe that improving the current waiver process through the development and enforcement of specific guidelines will more effectively meet both the statutory preference to buy office furniture from Correctional Industries and the DPA's duty to approve exceptions. These changes would also eliminate the problems we identified with an undocumented and standard-deficient delegation of waiver authority by DPA to Correctional Industries.

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### **Recommendation No. 14:**

The Department of Personnel & Administration and the Department of Corrections should work together to develop a written delegation granting Correctional Industries the authority to grant or deny waivers. In addition, these two agencies need to develop specific guidelines for the waiver process. These guidelines should include, but not be limited to,

a definition of "office furniture," details regarding which furniture purchases might be exempt from the waiver requirement, the timing of waiver requests, and how the requirement for a waiver will be enforced.

### **Department of Personnel & Administration Response:**

Agree. Implementation date: August 1, 2003. The Department of Personnel & Administration will work with Correctional Industries to develop a formal waiver delegation by August 1, 2003. This delegation will include requirements agencies must follow in submitting waiver requests and guidelines for granting or denying waivers. When conducting peer reviews, the State Purchasing Office within the Department of Personnel & Administration will review a sample of waivers to ensure that agencies follow proper procurement procedures when not purchasing from Correctional Industries. In addition, the State Purchasing Office will include information in its Basic Procurement Training course reminding agencies that a Correctional Industries waiver triggers the requirement to select a vendor in compliance with Title 24 vendor selection methods.

### **Department of Corrections Response:**

Agree. Implementation date: August 1, 2003. The Division of Correctional Industries will work with the Department of Personnel & Administration to develop a comprehensive definition of office furniture and guidelines for the waiver process. Additionally, the two agencies will develop written delegation to the Department of Corrections, Division of Correctional Industries to grant or deny waivers for furniture purchases on behalf of the Department of Personnel & Administration.

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## **Improving Marketing Practices**

Correctional Industries produces over 5,000 individual office furniture products or components. Correctional Industries representatives maintain that it can produce any office furniture item or system at comparable prices and quality to that available through the private sector. Correctional Industries also advertises its many value-added services including free space design assistance, free furniture repair, online purchasing, and potential rebates. It has seven FTE dedicated to marketing and selling office furniture products including working directly with representatives of individual state agencies.

We found that state purchasing agents have a negative impression of the furniture products produced by Correctional Industries. We surveyed purchasing agents from several state agencies to determine product acceptance, customer service, and sales and marketing efforts. Overall, we found that for a variety of reasons the purchasing agents we surveyed generally had a low opinion of both Correctional Industries products and services. Specifically, these representatives commented that Correctional Industries office furniture and systems tend to be lower quality but more expensive than similar items available from the private sector. In addition, five of the nine survey respondents stated that it takes longer for Correctional Industries to deliver purchased products than it does for private companies. Three agency representatives commented that contacts with their sales representatives are infrequent, and one noted that the representatives do not follow through when they promise to provide information. We also found that some of the purchasing agents we spoke with were unaware of Correctional Industries' value-added benefits. Finally, two agency representatives reported that they only purchase furniture from Correctional Industries because they are required by statute to do so. Correctional Industries, through a combination of telephone surveys and survey cards, seeks customer service information from the recipient of its furniture products. Our review of this survey information shows that for the first three quarters of Fiscal Year 2003 Correctional Industries received on average a 17 percent response rate. Survey responses elicited very favorable comments. This information may indicate a disconnect between state purchasing agents who in many cases control furniture purchases and those individuals who actually use Correctional Industries furniture products.

It is apparent that Correctional Industries' current marketing efforts need to be improved. Each year, state agencies apply for waivers to purchase office furniture from the private sector. According to waiver requests received by Correctional Industries in Fiscal Year 2002 alone, state agencies bought at least \$500,000 worth of office furniture and systems from the private sector. Correctional Industries' furniture shop is heavily dependent upon purchases made by state agencies. Correctional Industries representatives estimate that 80 percent of all furniture shop sales are to state agencies. The furniture shop has seen its revenues decrease from \$5.4 million in Fiscal Year 1998 to \$3.7 million in Fiscal Year 2002. The furniture shop experienced an overall operating loss of \$745,000 in Fiscal Year 2001 and lost an additional \$205,000 in Fiscal Year 2002. Given the State's current economic situation, it is unlikely that state agencies will be able to increase their furniture purchases in the next few years.

Correctional Industries needs to develop methods to demonstrate the value of its furniture through comparison with private vendors' products and tracking its furniture repair history to show that Correctional Industries furniture lasts longer with fewer repairs. Correctional Industries can also use its sales information and the waiver requests to determine if

additional types of furniture are needed. For example, agencies may be seeking lower-priced items than are available through Correctional Industries, indicating a need to develop a line of inexpensive office furniture. Correctional Industries should also expand its marketing to eligible non-state agency customers to increase its sales and reduce its dependence on state agencies.

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### **Recommendation No. 15:**

The Division of Correctional Industries should improve its marketing practices to better meet the needs of state agencies. In addition, Correctional Industries should increase its marketing activities to non-state agencies.

### **Department of Corrections Response:**

Agree. Implementation date: July 1, 2003. The Division of Correctional Industries will begin July 1, 2003 to analyze its current marketing practices and identify improvements necessary to meet the needs of our customers. We are now in the process of modifying our product offering as well as working to expand our customer base to include non-state agencies.

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