

REPORT OF THE
OFFICE OF THE AUDITOR GENERAL
TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE

282.4

DEFICIENCIES IN CORRECTIONAL INDUSTRY
PRODUCT COST DETERMINATIONS

DECEMBER 1977



Joint Legislative Audit Committee

OFFICE OF THE AUDITOR GENERAL

California Legislature



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December 19, 1977

The Honorable Speaker of the Assembly
The Honorable President pro Tempore of the Senate
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members of the Legislature:

Your Joint Legislative Audit Committee respectfully submits the Auditor General's report on accounting deficiencies in the California Correctional Industries administered by the Director of Corrections. Sales to state and local government during fiscal year 1976-77 exceeded \$16 million.

The Director reports the allocation of administrative charges to each industry by a different method than that used by the Auditor General. He will attempt to reconcile the different methods in order to arrive at more accurate estimations of actual costs.

By copy of this letter, the Department is requested to advise the Joint Legislative Audit Committee within sixty days of the status of implementation of the recommendations of the Auditor General that are within the statutory authority of the Department.

The auditors are Harold L. Turner, Audit Manager; Robert J. Maloney and Walter M. Reno.

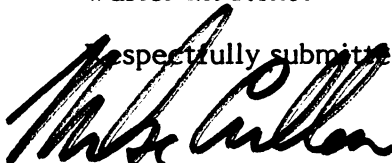
Respectfully submitted,

MIKE CULLEN
Chairman

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SUMMARY

Thirty-one separate industries located in 11 of the 12 correctional institutions in the Department of Corrections comprise the California Correctional Industries. Approximately 2,100 inmates and 224 freemen are employed in the program. Correctional Industries' sales to state and local government agencies exceeded \$16,000,000 during fiscal year 1976-77. The Correctional Industries program is intended to be self-supporting based on sales of goods and services to government agencies. To date the Correctional Industries program in total has operated in a self-sufficient manner.

Our analysis disclosed that the cost accounting system utilized by Correctional Industries does not compute net income or loss by individual industry. Accordingly, Industries' management is not fully apprised of the operating results of each industry. Using the program's unaudited financial records we determined that 18 of 28* correctional industries incurred a collective net loss exceeding \$1.5 million during fiscal year 1976-77. We determined the financial status of each industry by allocating support costs on the basis of our best estimate of effort expended for each industry (Table 1, page 9).

* In determining individual industry profitability, we combined the financial data on the three farms at California Institution for Men, Deuel Vocational Institution and Correctional Training Facility with data on the dairies because the majority of the farming operations support the dairies.

By allocating support costs, we found that ten industries operated at a net profit of \$1.2 million and that two industries--license plates and specialty printing--supplied 72 percent of these ten industries' operating profit.

Our observations regarding the accomplishment of Correctional Industries' objectives are included in the "Other Pertinent Information" section of this report.

INTRODUCTION

We conducted a cost analysis of California Correctional Industries pursuant to a resolution by the Joint Legislative Audit Committee and under the authority vested in the Auditor General by Section 10527 of the Government Code. This report is the last in a series of four reports on the Department of Corrections.

The objective of our analysis was to determine the profitability of individual industries within Correctional Industries. The analysis was based on the unaudited financial records of the Department of Corrections for fiscal years 1975-76 and 1976-77. In addition, we observed the industrial operations at ten institutions and conducted interviews with production managers, factory supervisors and inmates.

Correctional industries are located at the following 11 institutions:

- California State Prison at Folsom
- California State Prison at San Quentin
- Sierra Conservation Center (SCC), Jamestown
- California Correctional Institution (CCI), Tehachapi
- Correctional Training Facility (CTF), Soledad
- Deuel Vocational Institution (DVI), Tracy
- California Institution for Men (CIM), Chino
- California Medical Facility (CMF), Vacaville
- California Men's Colony (CMC), San Luis Obispo
- California Institution for Women (CIW), Frontera
- California Rehabilitation Center (CRC), Corona

We did not visit the textile industry at the Sierra Conservation Center since it is the smallest of the institutional operations, but we did analyze its cost data in the overall review.

Background

Correctional Industries constitutes a work activity program to employ inmates in the production of goods that are sold to state and local government agencies. California state law mandates that state agencies shall "make maximum utilization of" correctional industry products. State law also allows other governmental agencies, such as cities or counties to purchase goods from correctional industries.

As of June 30, 1977, 31* correctional industries were operating in 11 of the State's 12 correctional institutions. Appendix A identifies each industry by institution and Appendix B identifies the product line by industry.

The policy of Correctional Industries is to operate at no cost to the General Fund. The Correctional Industries Revolving Fund was established in 1945. The revenue from the sale of prison industries' products offsets the costs of the program. Correctional industry sales for fiscal year 1976-77 exceeded \$16,000,000.

* In determining individual industry profitability, we combined the financial data on the three farms at CIM, DVI and CTF with data on the dairies because the majority of the farming operations support the dairies. We then considered 28 individual industries.

Approximately 2,100 inmates produce the goods and services provided by Correctional Industries. Within the 11 institutions there are 191 employees involved in institutional administration, accounting and program management. A central administration located in Sacramento employs 33 additional persons and performs management, administrative, accounting and marketing functions for all 11 institutions.

The objectives of Correctional Industries are:

- To provide a constructive work program for inmates at no cost to the General Fund
- To provide inmates with training in developing work skills and work habits as a means of improving employment opportunities after release
- To reduce the cost of maintaining the prison system by selling products and providing services.

The findings in this report are related to the cost and profitability of the correctional industries. We did not attempt to determine whether the program is meeting its multiple objectives. We do, however, offer our observations regarding the accomplishment of these objectives in the "Other Pertinent Information" section of this report.

We did not perform a full financial audit of the institutions or their financial statements and therefore we do not express an opinion on them. This disclaimer of opinion is required by Rule 58.2 of the California Administrative Code, Title 16, when the name of certified public accountants is associated with unaudited financial statements, or portions thereof, such as those attached to this report.

STUDY RESULTS

PROFITS AND LOSSES OF INDIVIDUAL
CORRECTIONAL INDUSTRIES ARE
INACCURATELY DETERMINED

The profits and losses of individual industries as reported by Correctional Industries are inaccurate because its cost accounting system does not assign support costs to specific industries. The cost accounting system charges direct production costs to each industry but does not allocate indirect support costs of administration, accounting and marketing in a manner that reflects a reasonable estimate of actual efforts expended for these functions.

According to the Correctional Industries' unaudited fiscal year 1976 77 financial statements, 24 industries had a gross profit of \$3,157,000 while 7 industries had a gross loss of \$600,000. This does not include the support costs associated with administration and marketing. We combined the allocated support costs of certain related industries and found that 18 of the 28* correctional industries operated at a combined loss of \$1,559,000 during fiscal year 1976-77. This was offset by a combined operating profit of \$1,200,000 by the remaining 10 industries, resulting in an overall net loss of \$359,000 for the fiscal year. (Table 1 on page 9 exhibits the results of our analysis.)

* In determining individual industry profitability, we combined the financial data on the three farms at CIM, DVI and CTF with data on the dairies because the majority of the farming operations support the dairies. We then considered 28 individual industries.

To evaluate effectiveness and profitability we allocated support costs on the basis of our best estimate of support effort expended. This method enables decisions to be made based upon the performance of specific industries and identifies the impact of support effort on each industry. The allocation method currently used by the program's management does not allow such evaluation. Appendix C discusses the technical aspects and uses of both methods of cost allocation. Our allocation bases are described in Appendix D of this report.

Table 1 shows the net operating profit and loss for fiscal year 1976-77 of the 28 correctional industries using a commonly accepted method and Correctional Industries' method of cost accounting. Column 5 depicts recomputed operating profits or losses of each industry, taking into consideration reasonable allocations of all operating costs. Column 3 reflects Correctional Industries' method which does not allocate support costs to each industry. Instead, Correctional Industries only deducts the total support cost from the combined operations of all industries. Note the substantial impact of full cost allocation in Column 5 as compared to Column 3.

It is important to note that the effect of either method of accounting on the combined industries' operating results is the same. However, substantial changes occur among the profits and losses of the individual industries when full cost allocations are made to each industry.

TABLE I
COMPARISON OF PROFIT/LOSS BY INDUSTRY
FISCAL YEAR 1976-77
(ROUNDED TO NEAREST THOUSAND)
(Unaudited)

(1) Industry	(2) Institution	(3) Gross Profit/Loss Computed By Correctional Industries	(4) Allocated Support Costs Computed By Auditor General	(5) Net Operating Profit/Loss
License Plates	Folsom	\$ 590,000	\$ (73,000)	\$ 517,000
Specialty Printing	CMC, San Luis Obispo	405,000	(59,000)	346,000
Book Bindery	CMF, Vacaville	259,000	(138,000)	121,000
Laundry	CIM, Chino	111,000	(26,000)	85,000
Clothing Factory	CMC, San Luis Obispo	209,000	(140,000)	69,000
Mattress and Bedding	DVI, Tracy	113,000	(69,000)	44,000
Laundry	CMC, San Luis Obispo	47,000	(37,000)	10,000
Clothing Factory	SCC, Sierra	69,000	(64,000)	5,000
Shoe Factory	CMC, San Luis Obispo	116,000	(113,000)	3,000
Clothing Factory	DVI, Tracy	1,000	0	1,000
Dry Cleaning	CIM, Chino	0	0	0
Knitting Mill	CMC, San Luis Obispo	53,000	(63,000)	(10,000)
Detergent Plant	San Quentin	105,000	(121,000)	(16,000)
Dairy	CIM, Chino	255,000**	(137,000)	(19,000)
Field Crops	CIM, Chino	(137,000)**		
Clothing Factory	CTF, Soledad	(17,000)	(3,000)	(25,000)*
Lens Grinding Factory	CMF, Vacaville	(10,000)	(16,000)	(26,000)*
Tobacco Factory	CMC, San Luis Obispo	(13,000)	(16,000)	(29,000)*
Orchard	CMF, Vacaville	(12,000)	(25,000)	(37,000)*
Clothing Factory	CIW, Frontera	43,000	(81,000)	(38,000)*
Metal Signs	Folsom	3,000	(78,000)	(75,000)*
Dairy	DVI, Tracy	177,000**	(91,000)	(87,000)*
Field Crops	DVI, Tracy	(173,000)**		
Metal Fabrication	DVI, Tracy	143,000	(231,000)	(88,000)*
Furniture Factory	San Quentin	148,000	(238,000)	(110,000)*
Clothing Factory	CCI, Tehachapi	7,000	(129,000)	(122,000)*
Furniture Factory	CIM, Chino	39,000	(169,000)	(130,000)*
Clothing Factory	CRC, Corona	21,000	(157,000)	(136,000)*
Metal Fabrication	Folsom	58,000	(236,000)	(178,000)*
Dairy	CTF, Soledad	169,000**	(133,000)	(202,000)*
Field Crops	CTF, Soledad	(238,000)**		
Furniture Factory	CTF, Soledad	16,000	(248,000)	(232,000)*
Total Gross Profit from Operations		\$2,557,000		
Less Institutional Administration		\$1,900,000		
Central Administration		<u>1,016,000</u>	<u>(2,916,000)</u>	<u>\$(2,916,000)</u>
Net Operating Income (Loss)		<u>\$ (359,000)</u>		<u>\$(359,000)</u>

* Indicates industries with material losses.
Losses were construed to be material if they exceeded five percent of sales.

** Dairy and field crop operations were combined for our analysis.

The difference between the two accounting systems is evidenced as follows. According to the correctional industries' unaudited financial statements, the furniture factories of San Quentin; CIM, Chino; and CTF, Soledad, contributed a gross profit of \$203,000 to the industries' operations during fiscal year 1976-77. This amount was based on total sales less direct material and manufacturing costs. The profit, however, was not reduced by its appropriate share of the support costs associated with the administration of the factories, the marketing efforts to sell the products or the charges to the General Fund for each furniture industry; hence, it is overstated to that extent, or by \$675,000.

When we allocated support costs based upon our best estimate of the full support efforts expended for the furniture factories, a method considered more appropriate in business operations, the factories' estimated net loss for fiscal year 1976-77 was \$472,000.

Table 2 illustrates the difference in the two accounting methods, using the furniture industries as an example.

Allocating support costs would also impact on two industries in which total sales significantly exceeded costs: the specialty printing operation at CMC, San Luis Obispo which produces license plate validation stickers and the license plate operation at Folsom.

TABLE 2
 PROFIT IMPACT RESULTING FROM
 DIFFERENCE IN COST METHOD--FURNITURE FACTORIES
 FISCAL YEAR 1976-77
 (Unaudited)

	<u>San Quentin</u>	<u>CIM, Chino</u>	<u>CTF, Soledad</u>	<u>Totals</u>
Correctional Industries' Gross Profit From Operations	\$ 148,000	\$ 39,000	\$ 16,000	\$ 203,000*
Support Costs Allocated by the Auditor General	<u>(258,000)</u>	<u>(169,000)</u>	<u>(248,000)</u>	<u>(675,000)**</u>
Net Operating Profit (Loss)	<u>\$ (110,000)</u>	<u>\$ (130,000)</u>	<u>\$ (232,000)</u>	<u>\$ (472,000)</u>

- * Correctional Industries computes gross profit from operations based upon total sales less direct material and manufacturing costs.
- ** The Auditor General support cost computations include institutional administration expenses and central office expenses including marketing and General Fund charges.

License plates and validation stickers produced for the Department of Motor Vehicles (DMV) represent a fairly stable market, with easily projected production requirements. The marketing and accounting efforts required to support license plates and stickers are minimal since there is only one customer (DMV) placing a small number of large orders during the year. However, support costs for administration, accounting and marketing are currently charged to DMV in proportion to the amount of revenue generated by licenses and stickers rather than in proportion to the amount of effort expended to process and sell these products. Table 3 illustrates the effect of allocating support costs in proportion to our best estimate of actual support expenditures.

TABLE 3

STATEMENT OF REVENUE AND COSTS
 LICENSE PLATE AND SPECIALTY PRINTING
 FISCAL YEAR 1976-77
 (Unaudited)

	<u>License Plate Factory</u>	<u>Specialty Printing Plant</u>	<u>Totals</u>
Revenue	<u>\$1,625,000</u>	<u>\$1,048,000</u>	<u>\$2,673,000</u>
Production Costs	\$1,001,000	\$ 642,000	\$1,643,000
Administrative Support Costs	<u>107,000</u>	<u>60,000</u>	<u>167,000</u>
Total Costs	<u>1,108,000</u>	<u>702,000</u>	<u>1,810,000</u>
Excess of Revenue Over Costs	<u>\$ 517,000</u>	<u>\$ 346,000</u>	<u>\$ 863,000</u>

Correctional Industries' officials indicate that the price charged for license plates and validation stickers is commensurate with their best estimate of prevailing market price.

The dairy operations at DVI, Tracy; CTF, Soledad; and CIM, Chino, are other examples in which the cost reporting system causes misconceptions about the profitability of individual correctional industries. According to the correctional industries' financial statements, the dairies at CTF, DVI and CIM contributed over \$600,000 in gross profit to the revolving fund's operations during fiscal year 1976-77. This amount does not include the manufacturing costs and sales revenue associated with the dairies field crop operations nor the support costs associated with the administration of dairy activities or the marketing of dairy products. The three field crop operations at CIM, DVI and CTF were combined with the dairies because the majority of the farming operations support the dairies.

When we included revenue and production costs associated with field crops and support costs associated with the dairies' administration and selling efforts, the combined dairy and field crop industries operated at a loss. This net loss was \$308,000 for fiscal year 1976-77, as illustrated by Table 4.

TABLE 4
PROFIT IMPACT RESULTING FROM
DIFFERENCE IN COST METHOD--DAIRIES
FISCAL YEAR 1976-77
(Unaudited)

	<u>CIM, Chino</u>	<u>DVI, Tracy</u>	<u>CTF, Soledad</u>	<u>Totals</u>
<u>Correctional Industries Computation</u>				
Dairy Gross Profit from Operations	\$ 255,000	\$177,000	\$ 169,000	\$ 601,000
Field Crop Loss from Operations	<u>(137,000)</u>	<u>(173,000)</u>	<u>(238,000)</u>	<u>(548,000)</u>
Net Gross Profit from Operations	118,000*	4,000*	(69,000)*	53,000
<u>Auditor General Computation</u>				
Allocated Support Costs	<u>(137,000)</u>	<u>(91,000)</u>	<u>(133,000)</u>	<u>(361,000)</u>
Net Operating Profit (Loss)	<u>\$ (19,000)</u>	<u>\$(87,000)</u>	<u>\$ (202,000)</u>	<u>\$(308,000)</u>

* For analytical purposes we combined the financial data on the three farms at CIM, DVI and CTF with the data on dairies because the majority of the farming operations support the dairies.

Other Causes for Correctional Industries' Losses

Production personnel assert that the Correctional Industries' central administration has placed customer desires ahead of the objective of providing a constructive work program for inmates at no cost to the

General Fund. Our analysis and discussions with industries program personnel disclosed two additional causes for correctional industries' losses.

Custom Orders for Furniture

Institutional furniture factory production managers stated that custom orders for products outside the normal product line are seriously hampering their industrial production efforts; that this has resulted in losses to their operations; and that the selling price of special orders is established before the determination of the actual costs of production.

Custom orders require preparation of special working blueprints, re-training of inmate production workers and re-tooling of machinery. This extra production effort interrupts standard line production and causes delays in the normal production effort. The extent of the losses resulting from custom orders has not been determined.

Production Overcommitment in Textiles

Overcommitment of production capacity in the clothing factories is another cause for losses. Various institutional clothing industries have been unable to meet production schedules. To maintain good customer relations, central administration has purchased, rather than produced, finished products such as pants and shirts from private commercial enterprises and sold those products to correctional industry customers below cost. Production services, such as making shirts for a specific institution, have also been contracted by central administration.

During fiscal year 1976-77, the correctional clothing factories purchased approximately \$500,000 in finished products and production services from commercial vendors. In most instances, the correctional industries' purchase price for the finished products exceeded the selling price charged to customers. The losses from these purchases were estimated by the industries' accounting staff to exceed \$95,000.

CONCLUSION

The Correctional Industries' accounting system does not allocate administrative, marketing and accounting costs to individual industries in a manner that reflects a reasonable estimate of actual efforts expended for these operations. This hampers the Department's ability to evaluate individual industry effectiveness and profitability. Eighteen industries lost over \$1.5 million during fiscal year 1976-77. License plates and specialty printing accounted for \$860,000 of the \$1.2 million operating profit of the remaining ten industries.

RECOMMENDATION

To assist Correctional Industries management in making product pricing decisions, performing cost analysis, and evaluating the utility of the individual industries and the impact of the overall support activity, Correctional Industries should augment their present cost accounting system with a system which relates support costs to the support effort expended and identifies the true profit or loss of each industry.

BENEFITS

Implementing a cost accounting system which determines the profitability of individual industries would enable Correctional Industries to assess the cost of each industry as it relates to the program. A cost assessment on a separate industry basis would enable management to better direct each industry and the program toward meeting its objectives.

OTHER PERTINENT INFORMATION
REQUESTED BY THE LEGISLATURE

Accomplishment of Correctional
Industries' Objectives

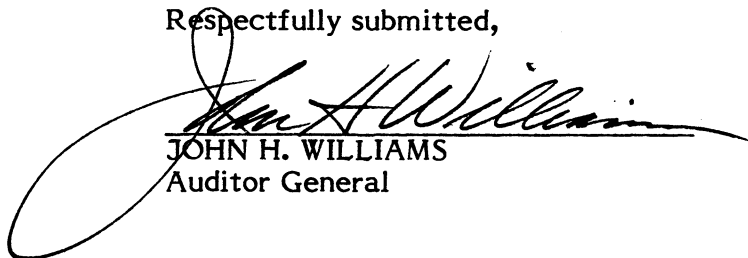
As previously cited in this report, the objectives of Correctional Industries are:

- To provide a constructive work program at no cost to the General Fund
- To provide inmates with training in developing work skills and work habits as a means of improving employment opportunities after release
- To reduce the cost of maintaining the prison system.

During our visits to the ten institutions and in discussions with production managers and their staffs, we found no evidence of any guidelines or evaluation system to measure inmate work skills or work habit effectiveness. Further, we found no evidence of any systemwide method or procedure to determine whether an inmate's employment opportunity, upon release, was enhanced by employment in the correctional industries.

The industries do reduce the cost of maintaining the prison system through the revenue generated from the sale of products. This revenue defrays some of the custody and control costs that would otherwise be paid by the State General Fund were the program not in existence. We did not determine the extent to which these costs are defrayed.

Respectfully submitted,



JOHN H. WILLIAMS
Auditor General

December 12, 1977

Staff: Harold L. Turner, Audit Manager
Robert J. Maloney
Walter M. Reno

State of California

M e m o r a n d u m

Mr. John H. Williams
Auditor General
Office of the Auditor General
Suite 750
925 L Street
Sacramento, CA 95814

Date: December 12, 1977

File No.:

Subject: Auditor General's
Draft Report on
Correctional
IndustriesFrom: **Department of Corrections, Sacramento 95814**

Thank you for the opportunity for my staff to review your draft report and provide a written response prior to publishing. Not being fully aware of those who might review this report, I feel that some additional general comments must be offered as further expansion of your stated findings.

Correctional Industries uses a modified direct costing system of accounting to report gross contribution of individual enterprises much the same way that private manufacturing industry uses this type of system. The theory is that one should not hold the Production Manager responsible for cost items out of his sphere of control. Correctional Industries uses a full cost accounting system for the consolidated financial statements for the entire program (all industries lumped together), and a full cost absorption system for estimating purposes or planning new products or enterprises.

In view of the requirement prescribed in the Penal Code that the Director shall set prices as near prevailing market price as possible (not based on costs of production as is done in private industry), the combination of direct costing and full costing affords an economical system that is well suited for special studies of limited scope concerning current marketing tactics such as meeting competitor's prices in particular areas and facilitates current control of operations by providing a basis for immediate remedial action.

The means of accomplishing this system were incorporated in the Accounting Manual in 1975, by a C.P.A. from the Department of Finance, Audit Division, under contract with Correctional Industries in response to a demand by the Department of Finance to upgrade the accounting manual. Correctional Industries is now operating under this approved system.

The method used by the auditor to allocate administrative charges to each individual enterprise shows ten enterprises to be profitable and 18 to be unprofitable. The method used by Correctional Industries on occasion to measure profit/loss of individual enterprises or to check selling price/cost ratios shows 9 of the 10

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enterprises still to be profitable, with two of the 18 moving from the auditor's unprofitable list into the profitable range and one of the auditor's profitable enterprises moving into the unprofitable range. The degree of profitability or loss differs substantially with the two methods for each enterprise. See attached revised Table 1.

Correctional Industries will review its method of estimating and allocating administration costs to specific enterprises in light of these differences in degree of profit/loss in an attempt to determine that administration costs are approximations of the true costs involved.

The Department of Corrections has determined over a number of year's experience that it is in the best interest of the State to retain a variety of Correctional Industries that may not be profitable at any particular time in order to assure an adequate market and/or potential productive capacity to handle on short notice any fluctuations in inmate population. These fluctuations are more easily handled in an industrial operation than other programs which are budgeted from the General Fund, since the Correctional Industries Revolving Fund has a greater degree of flexibility to add or reduce program size.

While the Production Manager of each institution may not have officially reported allocations of administration costs for each enterprise, the central office does estimate these costs as necessary for planning and long range evaluations. It is recognized that the auditor questions the accuracy of the method used by Correctional Industries in estimating these costs.

Correctional Industries attempts to determine production capacity and to establish a planned production rate at the beginning of each budget year. In some cases the actual production rate obtained during the budget year exceeds or falls behind the planned rate. This is due to shortages of workers, lockdowns, poor operator skills and motivation. In many instances where sales volume exceeds production rates, it is at least in part due to the fact that production rates are far below production capacity as well as (in some cases) sales orders exceeding planned production.

On page 14, under "custom order furniture" the statements are true; however, this section could be rewritten to make it clearer. It is customary in negotiating or bidding for custom work that an estimate be prepared to set the bid price. This must be done before the actual costs of production are known. While the estimate may occasionally be low on some items in a project, the overall price of custom jobs is usually one that is competitive with private industry. What some factory people were trying to tell the auditor

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was that custom jobs, while they produce a good revenue per unit produced, disrupt the production of standard items to the point that total revenue and margin would have been greater if the factory could have produced only standard items for the period of time the custom job was in the shop.

The auditor should have pursued this issue to determine if this inference is true or false. What alternatives are open to keep factories loaded with production when the market for standard items is less than rated factory capacity? Could the factories produce both custom and standard lines if the inmate manpower and supervision were available in the authorized numbers for the full work period?

Correctional Industries, in its role of providing work for inmates at no cost to the General Fund, is a vital part of this department's program. It fills a definite need that cannot be satisfied by any other entity without considerable increased cost and burden upon the internal operations and control of our institutions.



J. J. ENOMOTO
Director of Corrections

Attachment: Table 1 (Revised)

TABLE 1 (Revised)
COMPARISON OF PROFIT/LOSS BY INDUSTRY
FISCAL YEAR 1976-77
(Rounded to nearest thousand)

(1) Industry	(2) Institution	(3) Gross Profit/Loss Computed by Correctional Industries	(3A) * Actual Profit/Loss per Stmts.	(4) Allocated Support Costs Computed by Auditor General	(4A) Admin. Charges Computed by Correctional Industries	(5) Net Operating Profit/Loss	(5A) Net Operating Profit/Loss Computed by Corr. Ind.
License Plates	Folsom	\$ 590,000		\$ (73,000)	\$ (290,000)	517,000	\$ 300,000
Specialty Printing	CMC, San Luis Obispo	405,000		(59,000)	(169,000)	346,000	236,000
Book Bindery	CMF, Vacaville	259,000	249,000	(138,000)	(133,000)	121,000	116,000
Laundry	CIM, Chino	111,000		(26,000)	(41,000)	85,000	70,000
Clothing Factory	CMC, San Luis Obispo	209,000		(140,000)	(140,000)	69,000	69,000
Mattress and Bedding	DVI, Tracy	113,000		(69,000)	(93,000)	44,000	20,000
Laundry	CMC, San Luis Obispo	47,000		(37,000)	(69,000)	10,000	(22,000)
Clothing Factory	SCC, Sierra	69,000		(40,000)	(40,000)	5,000	29,000
Shoe Factory	CMC, San Luis Obispo	116,000		(113,000)	(114,000)	3,000	2,000
Dry Cleaning	CIM, Chino	ϕ		ϕ		ϕ	
Knitting Mill	CMC, San Luis Obispo	53,000		(63,000)	(52,000)	(10,000)	1,000
Detergent Plant	San Quentin	105,000		(121,000)	(121,000)	(16,000)	(16,000)
Dairy	CIM, Chino	255,000		(137,000)	(251,000)	(19,000)	(133,000)
Field Crops	CIM, Chino	(137,000)		(8,000)	ϕ	(25,000)	ϕ
Clothing Factory	CTF, Soledad	(17,000)		(16,000)	ϕ	(26,000)	ϕ
Lens Grinding Factory	CMF, Vacaville	(10,000)		(16,000)	(11,000)	(29,000)	(24,000)
Tobacco Factory	CMC, San Luis Obispo	(13,000)		(25,000)	(10,000)	(37,000)	(22,000)
Orchard	CMF, Vacaville	(12,000)		(81,000)	(68,000)	(38,000)	(25,000)
Clothing Factory	CIM, Frontera	43,000		(78,000)	(37,000)	(75,000)	(34,000)
Metal Signs	Folsom	3,000		(91,000)	(155,000)	(87,000)	(151,000)
Dairy	DVI, Tracy	177,000		(231,000)	(138,000)	(88,000)	5,000
Field Crops	DVI, Tracy	(173,000)		ϕ	(1,000)	1,000	ϕ
Metal Fabrication	DVI, Tracy	143,000		(258,000)	(208,000)	(110,000)	(60,000)
Textile	DVI, Tracy	1,000		(129,000)	(127,000)	(122,000)	(120,000)
Furniture Factory	San Quentin	148,000		(169,000)	(69,000)	(130,000)	(30,000)
Clothing Factory	CCI, Tehachapi	7,000		(157,000)	(63,000)	(136,000)	(42,000)
Furniture Factory	CIM, Chino	39,000		(236,000)	(166,000)	(178,000)	(108,000)
Clothing Factory	CRC, Corona	21,000		(133,000)	(178,000)	(202,000)	(247,000)
Metal Fabrication	Folsom	58,000					
Dairy	CTF, Soledad	169,000					
Field Crops	CTF, Soledad	(238,000)					
Furniture Factory	CTF, Soledad	16,000	(1,000)	(248,000)	(172,000)	(232,000)	(173,000)
Total Gross Profit from Operations		\$2,557,000	\$2,557,000				
Less Institutional & Central Admin.		(2,916,000)		(2,916,000)			
Net Operating Income (Loss)		\$ (359,000)				\$ (359,000)	\$ (359,000)

* Note: Column 3A same as 3, except as indicated.

CORRECTIONAL INDUSTRIES BY INSTITUTIONS

California Institution for Men (CIM), Chino	Field Crops Dairy and Beef Ranch Furniture Factory Laundry Dry Cleaning
California Correctional Institution (CCI), Tehachapi	Clothing Factory
California Medical Facility (CMF), Vacaville	Orchard Book Bindery Lens Grinding Factory
California Men's Colony (CMC), San Luis Obispo	Knitting Mill Shoe Factory Tobacco Factory Laundry Clothing Factory Specialty Printing
Sierra Conservation Center (SCC), Jamestown	Clothing Factory
Correctional Training Facility (CTF), Soledad	Field Crops Dairy Furniture Factory Clothing Factory
Deuel Vocational Institution (DVI), Tracy	Field Crops Dairy Mattress and Bedding Metal Fabrication Clothing Factory
California State Prison at Folsom	License Plate Factory Metal Fabrication Metal Signs
California State Prison at San Quentin	Furniture Factory Detergent Plant
California Institution for Women (CIW), Frontera	Clothing Factory
California Rehabilitation Center (CRC), Corona	Clothing Factory

TYPE OF GOODS MANUFACTURED
AND SERVICES SPONSORED BY INDUSTRY

Dairy	Dairy Livestock Fluid Milk Beef Ranch Livestock Miscellaneous Foodstuffs
Field Crops	Field Crops Sugar Beets Vegetable Crops
Furniture	Wood Desks Wood Tables Chairs and Lounge Furniture Dormitory Furniture Library Equipment Library Shelving Miscellaneous Metal Tables Educational Materials Educational Room Furniture Miscellaneous Educational Products Wood Credenzas Educational Block Sets Educational Cabinets Educational Caddys Metal Chairs
Laundry	Laundry Services
Dry Cleaning	Dry Cleaning Service
Clothing Factories	Men's Shirts and Trousers Dresses Miscellaneous Clothing Flags Gloves Men's Underwear Women's Underwear Jackets Hospital Garments
Orchard	Canned Fruits Field Crops

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Book Bindery	Binders Diploma Covers Miscellaneous Clothing Special Signs
Knitting Mill	Hosiery
Shoe Factory	Boots Oxford Work Shoes Hi-top Work Shoes Dress Oxfords Gloves
Tobacco Factory	Chewing Tobacco Cigarette Tobacco Pipe Tobacco Cigarette Papers
Specialty Printing	Printed Matter
Mattress and Bedding	Mattresses and Pillows
Metal Fabrication Factory	Miscellaneous Wood Furniture Metal Desks Metal Tables Metal Chairs Landor Line Furniture Metal Lockers Dormitory and Cell Equipment School Seating Miscellaneous Metal Products Educational Block Sets Educational Cabinets Educational Caddys Educational Room Furniture Miscellaneous Educational Products
License Plate Factory	License Plates
Metal Signs	Highway Signs Miscellaneous Metal Products
Detergent Plant	Laundry Detergent Dishwashing Products Janitorial Products Utility Detergent Miscellaneous Detergents

COMPARISON OF DIRECT AND
ABSORPTION COSTING SYSTEMS

The differences between the profit and loss figures presented by the Correctional Industries method of accounting and the method used by the Auditor General lie in the treatment of overhead (support) expenses. The Correctional Industries method does not associate or charge overhead expenses to specific industries, but rather accounts for them as a total cost to be charged to the entire program. The method we used (absorption costing) recognizes overhead as a cost to be associated with each industry when evaluating that industry's profitability or losses.

Direct costing is a method used by management to evaluate and control the direct costs of production. This is accomplished by comparing past direct cost accumulations with current direct costs to identify changes in per unit costs. Changes in direct costs of production can be identified through a direct costing system since only those costs under the production manager's control are associated with the industry he manages. However, direct costing alone does not provide the means to evaluate the ability of an industry to recover all the costs associated with the product produced.

Absorption costing is both an accounting and management method traditionally used in the private sector to identify all the costs associated with a product for pricing purposes. Through this method, the

appropriate nonproduction expenses (marketing, administration, accounting) are charged to the production effort to properly determine the costs that must be recovered through the sale of a product in order to break even.

The nonproduction expenses are allocated to each industry in proportion to the amount of nonproduction effort expended. By so allocating nonproduction expenses, each industry is assigned all costs associated with the production and distribution of its products. This information is necessary to determine the appropriate prices to charge for products and to evaluate the extent to which an industry is supporting itself through the sale of products. Because Correctional Industries operate at no cost to the State General Fund, full product costing is necessary to assure that all costs are recovered by adequate pricing.

Direct and absorption costing systems are designed to meet specific informational needs. Neither system, on its own, can provide all the cost information necessary to effectively manage the Correctional Industries. However, used together, both systems can provide the tools to enhance effective fiscal management of the entire program.

METHODS USED TO ALLOCATE OVERHEAD
TO EACH INDUSTRY

Correctional industry expenses consist of four major components: manufacturing expenses, institutional administrative expenses, central administration expenses and General Fund charges to the Correctional Industries Revolving Fund. Manufacturing expenses are directly associated with a production effort, but the institutional administrative expenses, the central administration expenses and the General Fund charges must be allocated to the production efforts.

Costs are allocated to distribute support expenses to the industries based upon objective and quantifiable indicators of effort expended. This procedure permits the determination of net income or loss for each industry.

Institutional Administrative Expenses

Our method of allocating institutional administrative overhead was coordinated with three institutional accounting officers.

The institutional administrative expenses were divided into four categories and allocated by different bases to the industries. The bases used were inmate production hours, volume of processed production documents, square footage of floor space occupied and previously allocated institutional administrative expenses.

Inmate wages and inmate benefits were distributed based upon inmate production hours of each industry. Civil service salaries and staff benefits were distributed based upon the volume of processed production documents related to each industry. Utilities and rent expenses were allocated based upon the square footage occupied by each industry.

The remaining institutional administrative expenses were distributed to the industries in the same proportion as the previously allocated institutional administrative expenses.

Central Office Expenses

Correctional Industries central office expenses were classified into three categories: marketing, production and administrative/accounting. Marketing expenses were distributed between the industries based upon the number of sales orders written for each industry. Production expenses were distributed between the industries based upon the production managers' estimates of the amount of time spent working for each industry.

The central office administrative/accounting expenses were distributed based upon the proportion of marketing and production expenses previously allocated.

General Fund Charges

General Fund charges were distributed to the industries in the same proportion as the central office expenses.

Office of the Auditor General

cc: Members of the Legislature
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Office of the Lieutenant Governor
Secretary of State
State Controller
State Treasurer
Legislative Analyst
Director of Finance
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Assembly Majority/Minority Consultants
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