

**STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS –
CORRECTIONAL INDUSTRIES
FINANCIAL AUDIT
For the Year Ended June 30, 2007**

**Performed as Special Assistant Auditors
for the Auditor General, State of Illinois**

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES
FINANCIAL AUDIT
For the Year Ended June 30, 2007

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**STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES**

AGENCY OFFICIALS

DEPARTMENT OF CORRECTIONS:

Director	Roger E. Walker, Jr.
Chief Fiscal Officer	Tony Small
Supervisor of Central Accounting	Mary Ann Bohlen

DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES:

Chief Executive Officer	James R. Underwood
Assistant Chief Executive Officer	Salvatore J. Raymond

Agency office is located at:

1301 Concordia Court
Springfield, IL 62794-9277

**STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES**

FINANCIAL STATEMENT REPORT

SUMMARY

The audit of the accompanying financial statements of the State of Illinois – Department of Corrections – Correctional Industries was performed by E.C. Ortiz & Co., LLP.

Based on their audit, the auditors expressed an unqualified opinion on the agency’s basic financial statements.

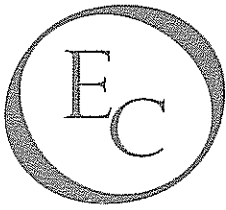
SUMMARY OF FINDING

The auditors identified matters involving the internal control over financial reporting that they considered to be significant deficiencies. The significant deficiencies are described in the accompanying Schedule of Finding on pages 22 to 25 of this report, as finding 07-1, Inadequate Controls Over Financial Reporting. The auditors also consider finding 07-1 to be a material weakness.

EXIT CONFERENCE

The State of Illinois – Department of Corrections – Correctional Industries waived having the exit conference per a letter dated April 30, 2008.

The response to the recommendation was provided by Mary Ann Bohlen in a letter dated April 30, 2008.



INDEPENDENT AUDITORS' REPORT

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying financial statements of the Working Capital Revolving Fund of the State of Illinois, Department of Corrections - Correctional Industries, as of and for the year ended June 30, 2007 as listed in the table of contents. These financial statements are the responsibility of the State of Illinois, Department of Corrections - Correctional Industries' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 2, the financial statements present only the Working Capital Revolving Fund of the State of Illinois, Department of Corrections - Correctional Industries and do not purport to, and do not, present fairly the financial position of the State of Illinois Department of Corrections as of June 30, 2007, and its changes in financial position including cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Working Capital Revolving Fund of the State of Illinois, Department of Corrections - Correctional Industries, as of June 30, 2007, and the changes in financial position and cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued a report dated April 30, 2008 on our consideration of the State of Illinois, Department of Corrections – Correctional Industries’ internal control over financial reporting of the Working Capital Revolving Fund and on our tests of State of Illinois, Department of Corrections – Correctional Industries’ compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The State of Illinois – Department of Corrections – Correctional Industries has not presented a management’s discussion and analysis for the Working Capital Revolving Fund that accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the financial statements.

Our audit was conducted for the purpose of forming an opinion on the State of Illinois, Department of Corrections – Correctional Industries basic financial statements. The supplementary information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, the Comptroller, and State of Illinois, Department of Corrections – Correctional Industries’ management, and is not intended to be and should not be used by anyone other than these specified parties.

E. C. Ortig & Co. LLP

April 30, 2008

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES
WORKING CAPITAL REVOLVING FUND
STATEMENT OF NET ASSETS
June 30, 2007
(expressed in thousands)

ASSETS	
CURRENT ASSETS	
Cash (Note 3)	\$ 925
Receivables:	
Intergovernmental	14
Others	310
Due from other funds (Note 4)	4,344
Inventories (Note 5)	10,595
Prepaid expenses	16
Total current assets	16,204
CAPITAL ASSETS– net (Note 6)	4,580
TOTAL ASSETS	\$ 20,784
LIABILITIES AND NET ASSETS	
CURRENT LIABILITIES	
Accounts payable and accrued expenses	\$ 2,714
Compensated absences (Note 7)	118
Due to other funds (Note 4)	7
Court of Claims (Note 7)	100
Total current liabilities	2,939
NONCURRENT LIABILITIES	
Compensated absences (Note 7)	1,428
Total liabilities	4,367
NET ASSETS	
Invested in capital assets	4,580
Unrestricted	11,837
Total net assets	16,417
TOTAL LIABILITIES AND NET ASSETS	\$ 20,784

See accompanying notes to financial statements.

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES
WORKING CAPITAL REVOLVING FUND
STATEMENT OF REVENUES, EXPENSES AND
CHANGES IN NET ASSETS
For the Year Ended June 30, 2007
(expressed in thousands)

OPERATING REVENUES:	
Charges for sales and services	\$ 36,345
Other revenue	2,088
Total operating revenues	38,433
OPERATING EXPENSES:	
Cost of sales and services	24,644
Selling, general and administrative expenses	12,739
Depreciation	1,316
Total operating expenses	38,699
OPERATING LOSS	(266)
NONOPERATING EXPENSES:	
Loss on disposal of capital assets	(34)
Total nonoperating expenses	(34)
LOSS BEFORE TRANSFERS	(300)
TRANSFERS OUT TO OTHER FUNDS	(580)
CHANGE IN NET ASSETS	(880)
NET ASSETS, BEGINNING OF YEAR, as restated	17,297
NET ASSETS, END OF YEAR	\$ 16,417

See accompanying notes to financial statements.

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES
WORKING CAPITAL REVOLVING FUND
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2007
(expressed in thousands)

CASH FLOWS FROM OPERATING ACTIVITIES	
Cash received from sales and services	\$ 39,198
Payments to suppliers for goods and services	(24,437)
Cash payments to employees for services	(14,652)
Cash receipts from other operating activities	423
Net cash provided by operating activities	<u>532</u>
CASH FLOWS FROM NON-CAPITAL AND RELATED FINANCING ACTIVITY	
Transfers out to other funds	<u>(580)</u>
Cash used in non-capital and related financing activities	<u>(580)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Acquisition of capital assets	(302)
Payments on capital leases	(2)
Net cash used in capital and related financing activities	<u>(304)</u>
NET DECREASE IN CASH	(352)
CASH, BEGINNING OF YEAR	<u>1,277</u>
CASH, END OF YEAR	<u>\$ 925</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES	
Operating loss	\$ (266)
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation	1,316
Changes in assets and liabilities:	
Receivables – Intergovernmental	17
Receivables – others	10
Due from other funds	1,161
Inventories	(1,618)
Prepaid expenses	(8)
Accounts payable and accrued expenses	(170)
Accrued vacation pay, sick leave and holiday pay	92
Court of Claims	(2)
Total adjustments	<u>798</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 532</u>
NONCASH CAPITAL AND RELATED FINANCING ACTIVITY	
Loss on disposal and write off of capital assets	<u>\$ (34)</u>

See accompanying notes to financial statements.

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES
WORKING CAPITAL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
June 30, 2007

1. DESCRIPTION OF FUNDS

Illinois Correctional Industries (ICI) is a division of the State of Illinois, Department of Corrections (Department) and administers the nonshared proprietary fund – Working Capital Revolving Fund - described below. A nonshared fund is a fund in which a single State agency is responsible for administering substantially all financial transactions of the fund.

The fund is accounted for as an internal service fund. Internal service funds account for activities that provide goods and services to other funds, departments, or agencies of the State and its component units, or to other governments, on a cost-reimbursement basis where the State is the predominant participant in the activity.

Working Capital Revolving Fund (Fund) (0301) – Revenues and expenses are derived from goods or services produced by factories, farms, and service programs and charged to State agencies and other non-state entities.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Fund administered by the Department has been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). To facilitate the understanding of data included in the financial statements, summarized below are the significant accounting policies.

A. Reporting Entity

As defined by GAAP, the financial reporting entity consists of a primary government, as well as its component units, which are legally separate organizations for which the elected officials of the primary government are financially accountable. Financial accountability is defined as:

- (1) Appointment of a voting majority of the component unit's board and either (a) the primary government's ability to impose its will, or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government; or
- (2) Fiscal dependency on the primary government.

Based upon the required criteria, this Fund does not have any component units, nor is it a component unit of another entity. However, because the Fund is not legally separate from the State of Illinois (State), it is included in the financial statements of

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WORKING CAPITAL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
June 30, 2007

the State as a proprietary fund. The State's Comprehensive Annual Financial Report (CAFR) may be obtained by writing the State Comptroller's Office, Financial Reporting Department, 325 West Adams Street, Springfield, Illinois, 62704-1871.

The financial statements present only the Working Capital Revolving Fund administered by the State of Illinois, Department of Corrections and do not purport to, and do not, present fairly the financial position of the State of Illinois, Department of Corrections as of June 30, 2007, and changes in its financial position and cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

B. Basis of Presentation

In government, the basic accounting and reporting entity is a fund. A fund is defined as an independent fiscal and accounting entity with self-balancing set of accounts recording cash and/or other resources together with all related liabilities, obligations, reserves, and equities which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. A statement of net assets, statement of revenues, expenses and changes in net assets, and statement of cash flows has been presented for this fund, administered by the Department.

Operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities.

C. Basis of Accounting

The Fund is reported using the economic resources measurement focus and the accrual basis of accounting.

Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flow takes place.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the individual nonshared proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The State also has the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The State has

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NOTES TO FINANCIAL STATEMENTS
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elected not to follow subsequent private-sector guidance for this Fund administered by the Department.

D. Cash

Cash consists principally of deposits held in the State Treasury.

E. Inventories

Inventories consisting of raw materials, work in process, finished goods, operating supplies, and unharvested crops are valued at cost, principally on a first in, first out (FIFO) method. Inventories of harvested crops and livestock are valued at market value as of the balance sheet date.

F. Interfund Transactions

The individual nonshared proprietary fund has the following types of interfund transactions with other funds of the State.

Services provided and used – sales and purchases of goods and services between funds for a price approximating their external exchange value. Interfund services provided and used are reported as revenues in seller funds and expenditures or expenses in purchaser funds. Unpaid amounts at year-end are reported as interfund receivables and payables in the fund balance sheets or fund statements of net assets.

Reimbursements – repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them. Reimbursements are reported as expenditures in the reimbursing fund and as a reduction of expenditures in the reimbursed fund.

Operating transfers – flows of assets (such as cash or goods) without equivalent flows of assets in return and without requirement for repayment. In proprietary funds, transfers are reported after nonoperating revenues and expenses.

G. Capital Assets

Capital assets are stated at cost. Depreciation (including amortization of capital leases) is computed using the straight-line method at rates calculated to amortize assets over their estimated useful life.

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Capitalization thresholds and the estimated useful lives are as follows:

Asset Category	Capitalization Threshold	Estimated Useful Life
Buildings	\$ 100,000	50
Building Improvements	\$ 25,000	20
Equipment	\$ 5,000	3-10

H. Compensated Absences

The liability for compensated absences reported in the Fund consists of unpaid, accumulated vacation, sick leave, and holiday balances for ICI employees. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees' current salary level and includes salary related costs (e.g., social security and medicare taxes).

Legislation that became effective January 1, 1998 capped the paid sick leave for all State Employees' Retirement System members at December 31, 1997. Employees continue to accrue twelve sick days per year, but will not receive monetary compensation for any additional time earned after December 31, 1997. Sick days earned between 1984 and December 31, 1997 (with 50% cash value) would only be used after all days with no cash value are depleted. Any sick days earned and unused after December 31, 1997 will be converted to service time for purposes of calculating employee pension benefits.

I. Net Assets

The individual nonshared proprietary fund displays equity in two components as follows:

Invested in Capital Assets – Consists of capital assets, net of accumulated depreciation, less the outstanding balances of any borrowings that are attributable to the acquisition, construction, or improvement of those assets.

Unrestricted – Consists of net assets that do not meet the definition of “invested in capital assets, net of related debt”.

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J. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

3. CASH

Deposits

The State Treasurer is the custodian of the State's cash for funds maintained in the State Treasury. Deposits in the custody of the State Treasurer as of June 30, 2007 was \$925 (amount expressed in thousands).

Deposits in the custody of the State Treasurer are pooled and invested with other State funds in accordance with the Deposit of State Moneys Act of the Illinois Compiled Statutes (15 ILCS 520). Funds held by the State Treasurer have not been categorized as to credit risk because the Department does not own individual securities. Details on the nature of these investments are available within the State of Illinois' Comprehensive Annual Financial Report.

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES
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NOTES TO FINANCIAL STATEMENTS
June 30, 2007

4. INTERFUND BALANCES AND ACTIVITIES

A. Balances Due to/from Other Funds

The following balances (amounts expressed in thousands) as of June 30, 2007 represent amounts due from other departments and State of Illinois funds which represents sales of goods and services:

<u>State Agency</u>	<u>Amount</u>
Department of Corrections	\$ 2,999
Healthcare & Family Services	703
Department of Human Services	173
Department of Juvenile Justice	199
Department of Commerce and Economic Opportunity	58
Secretary of State	40
Department of Natural Resources	13
Department of Transportation	34
State Police	24
Capital Development Board	20
Department of Public Health	17
Department of Children and Family Services	14
Central Management Services	14
Other State Agencies	36
Total	<u>\$ 4,344</u>

The amount due to other funds totaling \$7 (amount expressed in thousands) as of June 30, 2007 represents amount payable to Central Management Services for state garage services.

- B.** Interfund transfers out totaling \$580 (amount expressed in thousands) for the year ended June 30, 2007 was a mandatory transfer to the General Revenue Fund pursuant to the fiscal year 2007 Budget Implementation Act (PA-094-0839) to help defray the State's operating costs for the fiscal year.

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June 30, 2007

5. INVENTORIES

Inventories (amounts expressed in thousands) as of June 30, 2007, consist of the following:

Finished goods	\$ 5,115
Raw materials	4,550
Operating supplies	668
Work in process	69
Livestock	60
Unharvested crops	106
Stores Inventory	27
	<u>\$ 10,595</u>

6. CAPITAL ASSETS

Capital assets activities (amounts expressed in thousands) for the year ended June 30, 2007 were as follows:

	<u>Balance</u> <u>July 1,</u> <u>2006</u>	<u>Additions</u>	<u>Deletions</u>	<u>Others</u>	<u>Balance</u> <u>June 30,</u> <u>2007</u>
Cost:					
Equipment	\$ 19,788	\$ 156	\$ 157	\$ (3,201)	\$ 16,586
Building and Building Improvements	6,754	-	118	(769)	5,867
Construction in Progress	49	146	-	-	195
Livestock	424	-	-	(424)	-
Capital Lease - Equipment	15	-	-	-	15
	<u>27,030</u>	<u>302</u>	<u>275</u>	<u>(4,394)</u>	<u>22,663</u>
Accumulated Depreciation:					
Equipment	15,649	1,111	154	(2,939)	13,667
Building and Building Improvements	4,447	203	87	(162)	4,401
Livestock	24	-	-	(24)	-
Capital Lease - Equipment	13	2	-	-	15
	<u>20,133</u>	<u>1,316</u>	<u>241</u>	<u>(3,125)</u>	<u>18,083</u>
	<u>\$ 6,897</u>	<u>\$ (1,014)</u>	<u>\$ 34</u>	<u>\$ (1,269)</u>	<u>\$ 4,580</u>

**STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES
WORKING CAPITAL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
June 30, 2007**

7. LONG-TERM OBLIGATIONS

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2007 were as follows:

	<u>Balance</u> <u>July 1, 2006</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2007</u>	<u>Amounts</u> <u>Due Within</u> <u>One Year</u>
Other Long-term obligations:					
Compensated absences	\$ 1,454	\$ 1,402	\$ 1,310	\$ 1,546	\$ 118
Leases payable	2	-	2	-	-
Court of Claims	102	15	17	100	100
	<hr/>				
Totals	\$ 1,558	\$ 1,417	\$ 1,329	\$ 1,646	\$ 218

8. PENSION PLAN

Substantially all of the ICI's full-time employees who are not eligible for participation in another State-sponsored retirement plan participate in the State Employees' Retirement System (SERS), which is a pension trust fund in the State of Illinois reporting entity. The SERS is a single-employer defined benefit public employee retirement system (PERS) in which State employee participate, except for those covered by State Universities, Teachers, General Assembly, and Judge's Retirement Systems. The financial position and results of operations of the SERS for fiscal year 2007 are included in State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2007. The SERS also issues a separate "CAFR" that may be obtained by writing to the SERS, 2101 South Veterans Parkway, Springfield, Illinois, 62794-9255 or by calling (217) 785-7202. The State of Illinois CAFR may be obtained in writing to the State Comptroller's Office, Financial Reporting Department, 325 West Adams St., Springfield, Illinois 62704-1871 or by calling (217) 782-2053.

A summary of SERS benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established, are included as an integral part of the SERS CAFR. Also included is a discussion of employer and employee obligations to contribute and the authority under which those obligations are established.

The Department pays employer retirement contributions in the Fund based upon an actuarially determined percentage of their payrolls. For fiscal year 2007, the employer contribution rate was 11.525%.

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WORKING CAPITAL REVOLVING FUND
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9. POST-EMPLOYMENT BENEFITS

The State provides health, dental and life insurance benefits for certain retirees and their dependents. Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State-sponsored pension plans. Health and dental benefits include basic benefits for annuitants under the State's self-insurance plan and insurance contracts currently in force. Life insurance benefits are limited to five thousand dollars per annuitant age 60 and older.

Costs incurred for health, dental and life insurance for annuitants and their dependents were not separated from benefits provided to active employees and their dependents for the year ended June 30, 2007. However, post-employment costs for the State as a whole for all State agencies and departments for dependent health, dental, and life insurance for annuitants and their dependents are disclosed in the Comprehensive Annual Financial Report of the State. Cost information for retirees by individual fund or State agency is not available. Payments are made on a "pay-as-you-go" basis.

10. COMMITMENTS AND CONTINGENCIES

(1) Operating Leases

ICI is the lessee of a warehouse in Pana, Illinois. The rental payments totaled \$435 (amount expressed in thousands) for the year ended June 30, 2007.

Future minimum payments (amounts expressed in thousands) as required by the operating lease agreements as of June 30, 2007 are summarized as follows:

Year ending June 30,		
2008	\$	434
2009		445
2010		456
Total	<u>\$</u>	<u>1,335</u>

(2) Litigation

ICI is a party to various lawsuits arising out of the normal conduct of its operations. In the opinion of management and its counsel, its liability, if any in or arising from this litigation or any other legal proceedings in which ICI is involved, will be paid from a separate appropriation, and therefore, will not have a material adverse effect on the Working Capital Revolving Fund of ICI.

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11. RISK MANAGEMENT

ICI is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; auto liability; workers compensation; and natural disaster. The State retains the risk of loss (i.e. self insured) for these risks.

12. RESTATEMENT

ICI restated the beginning net asset balance by \$1,269 thousand due to implementing the Illinois Department of Corrections' capitalization and depreciation policy which had not been followed in prior years. (amounts in thousands)

Net assets June 30, 2006, as previously reported	\$ 18,566
Restatement of net assets:	
Implement departmental policy	<u>(1,269)</u>
Net assets June 30, 2006, as restated	<u>\$ 17,297</u>

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES
ANALYSIS OF OPERATIONS

SUMMARY OF OPERATIONS BY INDUSTRY (UNAUDITED)

Fiscal Year 2007

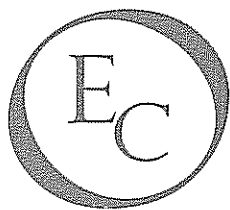
Industry	Revenue	Cost of Sales and Services	Selling, General and Administrative Expenses	Depreciation	Income (Loss)
Illinois River Bakery	\$ 4,899,550	\$ 2,719,659	\$ 1,548,706	\$ 285,831	\$ 345,354
Lincoln Asbestos Abatement	106,832	6,131	429,093	13,098	(341,490)
Decatur Furniture	329,059	396,351	111,136	-	(178,428)
Decatur Sewing	175,285	114,967	174,707	1,809	(116,198)
Decatur Grooming	1,306	8,385	4,264	-	(11,343)
Pana Warehouse	11,196	6,134	4,740	15,104	(14,782)
Jacksonville Modular Furniture Installation	77,486	5,444	505,517	12,190	(445,665)
Lincoln Ind. Garment	331,041	195,308	208,729	4,650	(77,646)
Centralia Furniture	5,919	6,819	-	-	(900)
Centralia Mattress	597,127	390,700	178,136	4,468	23,823
Centralia Sewing	608,026	315,379	310,312	12,347	(30,012)
Graham Furniture	926,881	446,661	451,743	101,492	(73,015)
Graham State Garage	25,675	-	22,646	-	3,029
Dwight Garment	1,157,613	651,579	656,730	17,321	(168,017)
Dwight Helping Paws	5,332	-	2,953	1,279	1,100
Menard Broom & Wax	553,475	381,109	174,229	9,773	(11,636)
Menard Knit	1,703,192	992,884	592,303	88,963	29,042
Menard Farm Meat Processing	1,231,894	865,211	255,084	29,901	81,698
Menard Farm Waste Removal	278,144	-	193,772	21,559	62,813
Logan Refinishing	215,262	164,657	158,330	-	(107,725)
Sheridan Garment Cutting	1,086,104	1,247,775	43,379	15,282	(220,332)

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES
ANALYSIS OF OPERATIONS

SUMMARY OF OPERATIONS BY INDUSTRY (UNAUDITED)

Fiscal Year 2007

Industry	Revenue	Cost of Sales and Services	Selling, General and Administrative Expenses	Depreciation	Income (Loss)
Stateville Furniture	704,339	461,318	195,804	38,537	8,680
Stateville Soap	776,948	447,280	255,469	-	74,199
Stateville Garment	18,856	10,327	-	-	8,529
Vandalia Farm Milk Processing	3,416,953	2,111,479	1,181,423	98,477	25,574
Vandalia Farm Meat Processing	2,108,469	1,401,719	338,991	27,953	339,806
East Moline Laundry	859,659	111,954	620,518	136,056	(8,869)
East Moline Furniture	225,464	184,797	46,355	-	(5,688)
Danville Boxes	602,113	353,637	127,845	46,641	73,990
Danville Sportswear	561,200	362,677	208,576	21,743	(31,796)
Dixon Optical	5,380,688	1,562,664	830,792	80,185	2,907,047
Dixon Sewing	440	239	-	-	201
Hill Meat Processing	2,907,796	2,319,769	662,860	34,187	(109,020)
Hill Milk Processing	2,805,104	2,068,415	686,765	48,856	1,068
Western Illinois Food Processing	5,140,271	4,105,685	1,136,857	69,088	(171,359)
Shawnee Metal Furniture	345,913	226,749	420,159	79,383	(380,378)
Total	<u>40,180,612</u>	<u>24,643,862</u>	<u>12,738,923</u>	<u>1,316,173</u>	<u>1,481,654</u>
Intershop sales	(2,171,100)	-	-	-	(2,171,100)
Other revenue not included above	423,367	-	-	-	423,367
Loss on disposal of capital assets	-	-	-	-	(33,852)
Transfers out to other funds	-	-	-	-	(580,000)
Grand Total	<u>\$ 38,432,879</u>	<u>\$ 24,643,862</u>	<u>\$ 12,738,923</u>	<u>\$ 1,316,173</u>	<u>\$ (879,931)</u>



REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS

Honorable William G. Holland
Auditor General
State of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the financial statements of the working capital revolving fund of the State of Illinois, Department of Corrections – Correctional Industries, as of and for the year ended June 30, 2007, which collectively comprise the State of Illinois, Department of Corrections – Correctional Industries’ basic financial statements and have issued our report thereon dated April 30, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the State of Illinois, Department of Corrections – Correctional Industries’ internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not for the purpose of expressing an opinion on the effectiveness of the State of Illinois, Department of Corrections – Correctional Industries’ internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of Illinois, Department of Corrections – Correctional Industries’ internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity’s ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a

misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying Schedule of Finding as finding 07-1 to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we consider the significant deficiency described in finding 07-1 as a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of Illinois, Department of Corrections – Correctional Industries' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The State of Illinois, Department of Corrections – Correctional Industries' response to the finding identified in our audit is described in the accompanying Schedule of Finding. We did not audit the State of Illinois, Department of Corrections – Correctional Industries' response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, and State of Illinois, Department of Corrections – Correctional Industries' management, and is not intended to be and should not be used by anyone other than these specified parties.

E. C. Artig & Co. LLP

April 30, 2008

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES
For the Year Ended June 30, 2007

SCHEDULE OF FINDING

Current Finding – Government Auditing Standards

07-1. **Finding** (Inadequate internal control over financial reporting)

During fiscal year 2007, the accounting function of Illinois Correctional Industries (ICI) was merged with the Department of Corrections (Department). Accounting records that used to be separately maintained by ICI were maintained by the Department after the consolidation and the Department instituted numerous changes to the record keeping procedures. The preparation of financial statements and Office of the Comptroller Generally Accepted Accounting Principles (GAAP) packages were performed by the Department for fiscal year 2007.

During our audit, we noted the following:

- The Department determined ICI's capitalization policy and dollar thresholds for depreciating State Property were not consistent with the Department's. As a result, a change in estimated useful lives was made across all ICI assets. In addition, our review of the excel spreadsheet used to compute the depreciation expense revealed footing and extension errors.

Capitalization thresholds were changed during the year to be consistent with the capitalization thresholds of the Department. ICI assets below \$5,000 that used to be capitalized and depreciated in previous years were written off during the year. The first draft financial statements provided to the auditors indicated losses from this transaction totaling \$116,000. Further review of this amount indicated this is a balancing amount arrived at during the preparation of the Capital Asset Summary (SCO-538) of the GAAP package.

The culmination of implementing the Department's capitalization policy resulted in a restatement of ICI's beginning net assets. Beginning net assets were reduced by \$1.269 million.

- There were no reconciliations performed between the cash balance per ICI accounting records and the cash balance per Office of the Comptroller's records during the fiscal year. As of June 30, 2007, the balance per ICI accounting records was \$1,155,000 and the balance per Office of the Comptroller's records was \$923,462. The Department cannot reconcile the difference of \$231,538.

The Office of the Comptroller's Statewide Accounting Systems Manual (SAMS) Procedure 09.40.30, page 1, states that cash reconciliation between the balance per Comptroller's and Agency records should be performed monthly and the Comptroller's Office notified of any unreconcilable differences so the necessary corrective action can be taken to locate the differences and correct the accounting records.

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES
For the Year Ended June 30, 2007

SCHEDULE OF FINDING

Current Finding – Government Auditing Standards

- The Department made a decision to stop using the accrual basis general ledger accounting system (Macola) used by ICI in previous years. The Department used the Accounting Information System (AIS) to account for expenditures and receipts. Accruals were manually analyzed and set up at the end of the year. The Department’s property control system was used to account for capital assets and a separate spreadsheet was created solely for depreciation expense computation. These records were used to generate the information to prepare the financial statements provided to the auditors and GAAP Package submitted to the Office of the Comptroller as of and for the fiscal year ended June 30, 2007. Our audit of the financial statement balances revealed significant errors within account balances, which required extensive adjustments. As a result of the audit procedures performed, we recommended fifteen audit adjustments totaling \$8.9 million to various accounts within ICI’s financial records and GAAP package. The majority of the adjustments were to correct account balances for non-recording, overstatements, understatements or errors made during the year.
- Numerous significant differences were noted between the amounts per ICI accounting records and the amounts reported by ICI to the Office of the Comptroller through the GAAP Package as follows:

Account	Per GAAP Package (in 000’s)	Per ICI records before audit adjustments (in 000’s)	Difference (in 000’s)
Inventory	\$ 10,587	\$ 10,595	\$ (8)
Capital Assets	22,072	22,655	(583)
Accumulated Depreciation	(18,665)	(18,728)	(63)
Accounts Payable	3,572	2,767	805
Unrestricted Net Assets	10,834	11,598	(764)
Invested in Capital Assets, Net of Related Debt	3,358	3,927	(569)
Charges for sales and services	39,232	35,915	3,317
Cost of Sales	36,964	22,413	14,551
Depreciation	857	2,601	(1,744)
General and administrative	7,350	12,268	(4,918)
Other non operating expenses	0	116	(116)
Operating transfer in	1	0	1
Operating transfer out	(816)	(580)	(236)

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES
For the Year Ended June 30, 2007

SCHEDULE OF FINDING

Current Finding – Government Auditing Standards

The Department did not maintain an adequate audit trail to account for the amounts reported in the GAAP package. The Department subsequently revised the GAAP package so the amounts reported in the GAAP package agreed to the financial statements.

- Our testing of the compensated absences schedule revealed that 100% of the employees' sick leave balance earned between January 1, 1984 through December 31, 1997 was accrued at the end of the year. As a result, the accrued compensated absences balance was overstated as of June 30, 2007 by \$511,339.

SAMS Procedure 27.20.80, page 1, states sick leave should be recorded as a compensated absence when the benefit is earned, provided it is probable the employee will be compensated for the benefit through cash payments at separation or retirement. Pursuant to 30 ILCS 105/14a, only sick leave accumulated from January 1, 1984 through December 31, 1997 is eligible for compensation at 50%, through cash payments at separation or retirement. This calculation will be based upon sick leave accumulated at the balance sheet date.

ICI is required to prepare annual financial statements of its financial activity to comply with reporting requirements set forth by the Office of the Comptroller. It is the responsibility of ICI and the Department to maintain their accounting records and prepare their financial statements in accordance with generally accepted accounting principles (GAAP), and that the accounting records and financial statements be materially free of errors and omissions.

In addition, The Fiscal Control and Internal Auditing Act, (30 ILCS 10/3001), requires all State agencies to establish and maintain a system of internal fiscal control to provide assurance that revenues, expenditures and transfers of assets, resources, or funds applicable to operations are properly recorded and accounted for to permit the preparation of reliable financial reports.

ICI management indicated the above exceptions were due to staff shortages and changes that occurred as a result of ICI accounting function being transferred to the Department of Corrections.

Because of the significance of the exceptions noted, we consider this to be a significant deficiency in ICI's and the Department's internal control and a material weakness. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects ICI's and the Department's ability to comply with generally accepted accounting principles in its financial and fiscal operations. A material weakness is a significant deficiency or a combination of significant

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES
For the Year Ended June 30, 2007

SCHEDULE OF FINDING

Current Finding – Government Auditing Standards

deficiencies that result in more than a remote likelihood that material noncompliance will not be prevented or detected by ICI's and the Department's internal control.

Inadequate internal control over financial reporting prevent ICI and the Department from preparing financial statements in accordance with accounting principles generally accepted in the United States of America and could result in inaccurate, incomplete and untimely preparation of financial statements. ICI and Department management and employees in the normal course of performing their assigned functions were not able to prevent or detect the overstatement, understatement or errors in the financial and fiscal operations in a timely manner. (Finding Code No. 07-1, 06-1)

Recommendation

We recommend the Department devote sufficient resources to its financial accounting function such that the ICI financial information is properly recorded and accounted for to permit the preparation of reliable financial statements and GAAP package. We also recommend Department accounting personnel be provided sufficient technical resources and training to ensure generally accepted accounting principles are followed in the preparation of year end financial and fiscal information.

Agency Response

Recommendation accepted. The Department takes the reporting of financial information very seriously. As such, the Department has centralized the financial reporting, reconciliation and other accounting processes into one area. The staff involved in the reporting and other accounting functions will receive any needed training and will work to present accurate and complete financial information for the Department and ICI in the future statements