

**STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS –
CORRECTIONAL INDUSTRIES
FINANCIAL AUDIT
For the Year Ended June 30, 2005**

**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, 2005

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

AGENCY OFFICIALS

DEPARTMENT OF CORRECTIONS:

Director

Roger E. Walker, Jr.

DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES:

Chief Executive Officer

James Underwood

Assistant Chief Executive Officer

Salvatore Raymond

Fiscal Officer (on LOA)

Richard Root

Agency office is located at:

1301 Concordia Court
Springfield, IL 62794-9277

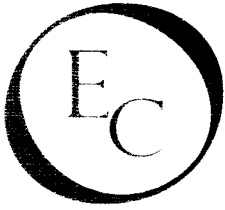
**STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES**

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.



E.C. ORTIZ & CO. LLP
CERTIFIED PUBLIC ACCOUNTANTS

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, 2005 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, 2005, 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, 2005, 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 October 31, 2005 on our consideration of the Department of Corrections – Correctional Industries’ internal control over financial reporting of the Working Capital Revolving Fund and on our tests of the 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 and budgetary comparison information 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.

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 agency management, and is not intended to be and should not be used by anyone other than these specified parties.

E. C. Ortiz & Co. LLP

E.C. ORTIZ & CO., LLP

October 31, 2005

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – CORRECTIONAL INDUSTRIES
WORKING CAPITAL REVOLVING FUND
STATEMENT OF NET ASSETS
June 30, 2005
(expressed in thousands)

ASSETS	
CURRENT ASSETS	
Cash and cash equivalents (Note 3)	\$3,786
Receivables:	
Intergovernmental	56
Others	524
Due from other funds (Note 4)	5,294
Inventories (Note 10)	9,568
Prepaid expenses	17
Total current assets	19,245
PROPERTY, EQUIPMENT, AND LIVESTOCK – net (Note 5)	7,564
Total assets	\$26,809
LIABILITIES AND NET ASSETS	
CURRENT LIABILITIES	
Accounts payable and accrued expenses	\$2,221
Compensated absences (Note 6)	137
Due to other funds (Note 4)	179
Court of Claims (Note 6)	70
Leases payable (Note 6)	9
Total current liabilities	2,616
NONCURRENT LIABILITIES	
Compensated absences (Note 6)	1,201
Leases payable (Note 6)	3
Total noncurrent liabilities	1,204
Total liabilities	3,820
NET ASSETS	
Unrestricted	15,437
Invested in capital assets, net of related debt	7,552
Total net assets	22,989
TOTAL LIABILITIES AND NET ASSETS	\$26,809

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, 2005
(expressed in thousands)

<hr/>	
Operating revenues:	
Charges for sales and services	\$39,545
Freight income	344
	<hr/>
Total operating revenues	39,889
	<hr/>
Operating expenses:	
Cost of sales and services	33,139
Selling, general and administrative expenses	6,462
Depreciation	1,565
	<hr/>
Total operating expenses	41,166
	<hr/>
Operating losses	(1,277)
	<hr/>
Nonoperating revenues (expenses):	
Rental income	345
Operation ceasefire	(1,250)
Loss on disposal of fixed assets	(58)
Interest expense	(5)
Miscellaneous expenses	(40)
	<hr/>
Total nonoperating expenses	(1,008)
	<hr/>
Losses before transfers	(2,285)
	<hr/>
Transfers to other funds	(15,878)
	<hr/>
NET LOSSES	(18,163)
	<hr/>
NET ASSETS, BEGINNING OF YEAR	41,152
	<hr/>
NET ASSETS, END OF YEAR	<u>\$22,989</u>

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, 2005
(expressed in thousands)

CASH FLOWS FROM OPERATING ACTIVITIES	
Receipts from customers	\$37,796
Payments to suppliers	(23,062)
Payments to employees	(14,984)
Payments for other operating activities	(1,041)
Net cash used in operating activities	<u>(1,291)</u>
CASH FLOWS FROM NON-CAPITAL AND RELATED FINANCING ACTIVITIES	
Payments to operation ceasefire	(1,250)
Transfer out to other funds	(15,878)
Cash used in non-capital and related financing activities	<u>(17,128)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Acquisition of property, equipment, and livestock	(1,723)
Lease payments	(22)
Interest paid on capital debt	(5)
Other capital and related financing activities	305
Net cash used in capital and related financing activities	<u>(1,445)</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(19,864)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>23,650</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u><u>\$3,786</u></u>
RECONCILIATION OF OPERATING LOSSES TO NET CASH USED IN OPERATING ACTIVITIES	
Operating losses	<u>(\$1,277)</u>
Adjustments to reconcile losses to net cash used in operating activities:	
Depreciation	1,565
Decrease (increase) in:	
Receivables - Intergovernmental	(36)
Receivables – others	(150)
Due from other funds	(1,902)
Inventories	675
Prepaid expenses	2
Increase (decrease) in:	
Accounts payable and accrued expenses	(231)
Accrued vacation pay, sick leave and holiday pay	182
Due to other funds	(94)
Court of Claims	(25)
Total adjustments	<u>(14)</u>
NET CASH USED IN OPERATING ACTIVITIES	<u><u>(\$1,291)</u></u>

See accompanying notes to financial statements.

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – ILLINOIS CORRECTIONAL INDUSTRIES
WORKING CAPITAL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

1. DESCRIPTION OF FUND

Illinois Correctional Industries (ICI) is a division of the State of Illinois, Department of Corrections (Department) and administers the nonshared proprietary 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 more 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 the State as a proprietary fund. The State's Comprehensive Annual Financial Report

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – ILLINOIS CORRECTIONAL INDUSTRIES
WORKING CAPITAL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

(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, 2005, 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 elected not to follow subsequent private-sector guidance for this Fund administered by the Department.

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – ILLINOIS CORRECTIONAL INDUSTRIES
WORKING CAPITAL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

D. Cash

Cash consists principally of deposits held in the State Treasury and cash on hand.

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. Property, Equipment, and Livestock

Property, equipment, and livestock are stated at cost. In some cases original cost could not be verified, and the cost was estimated from the available fixed assets records. Raised livestock is stated at the market value as of the date transferred to fixed assets. Depreciation (including amortization of capital leases) is computed using the straight-line method at rates calculated to amortize assets over their estimated useful life.

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – ILLINOIS CORRECTIONAL INDUSTRIES
WORKING CAPITAL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

Capitalization thresholds and the estimated useful lives are as follows:

Asset Category	Capitalization Threshold	Estimated Useful Life
Buildings	100,000	10-60
Building Improvements	25,000	10-45
Equipment	5,000	5-25
Livestock	1,000	7

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, Net of Related Debt – 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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DEPARTMENT OF CORRECTIONS – ILLINOIS CORRECTIONAL INDUSTRIES
WORKING CAPITAL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

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 and cash equivalents for funds maintained in the State Treasury. Deposits in the custody of the State Treasurer (or in transit) and cash on hand (amounts expressed in thousands) at June 30, 2005 were as follows:

Fund	Deposits in Custody of the State Treasurer	Cash on Hand	Fund Total
Working Capital Revolving Fund	\$3,346	\$440	\$3,786

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.

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DEPARTMENT OF CORRECTIONS – ILLINOIS CORRECTIONAL INDUSTRIES
WORKING CAPITAL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

4. INTERFUND BALANCES AND ACTIVITIES

A. Balances Due to/from Other Funds

The following balances (amounts expressed in thousands) at June 30, 2005 represent amounts due from other departments and State of Illinois funds:

State Agency	Amount	Description/Purpose
Department of Corrections	\$2,340	Due from various funds for
Department of Public Aid	1,807	Purchases of goods
Department of Human Services	557	and services
Department of Public Health	199	
Department of Historic Preservation	146	
Capital Development Board	92	
State Fire Marshall	24	
Executive Ethics Commission	23	
Department of Veterans Affairs	22	
Central Management Services	13	
Department of Commerce & Community Affairs	11	
State Treasurer	10	
Other State Agencies	50	
Total	\$5,294	

The following balances (amounts expressed in thousands) at June 30, 2005 represent amounts due to other departments and State of Illinois funds.

State Agency	Amount	Description/Purpose
Department of Corrections	\$150	Personal services
Department of Central Management Services	28	Revolving funds services
Other State Agencies	1	Miscellaneous
Total	\$179	

STATE OF ILLINOIS
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WORKING CAPITAL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

B. Interfund transfers out (amount expressed in thousands) for the year ended June 30, 2005 was as follows:

Fund	Amount	Description/Purpose
General Revenue Fund	<u>\$15,878</u>	Mandatory transfer pursuant to 30 ILCS 105/8.43 and 105/8h

5. PROPERTY, EQUIPMENT, AND LIVESTOCK

Property, equipment, and livestock activities (amounts expressed in thousands) for the year ended June 30, 2005 were as follows:

	<u>Balance</u> <u>July 1,</u> <u>2004</u>	<u>Additions</u>	<u>Deletions</u>	<u>Net</u> <u>Transfers</u>	<u>Balance</u> <u>June 30,</u> <u>2005</u>
Cost:					
Equipment	\$18,901	\$1,472	\$463	(\$176)	\$19,734
Building and Building Improvements	7,119	-	2	(389)	6,728
Construction in Progress	40	-	-	-	40
Livestock	58	251	21	-	288
Capital Lease - Equipment	50	-	11	-	39
	<u>26,168</u>	<u>1,723</u>	<u>497</u>	<u>(565)</u>	<u>26,829</u>
Accumulated Depreciation:					
Equipment	\$14,355	\$1,273	\$462	(\$150)	\$15,016
Building and Building Improvements	4,286	274	1	(370)	4,189
Livestock	41	6	17	-	30
Capital Lease - Equipment	29	12	11	-	30
	<u>18,711</u>	<u>1,565</u>	<u>491</u>	<u>(520)</u>	<u>19,265</u>
	<u>\$7,457</u>	<u>\$158</u>	<u>\$6</u>	<u>(\$45)</u>	<u>\$7,564</u>

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – ILLINOIS CORRECTIONAL INDUSTRIES
WORKING CAPITAL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

6. LONG-TERM OBLIGATIONS

A. Changes in Long-Term Obligations

Changes in long-term obligations (amounts expressed in thousands) for the year ended June 30, 2005 were as follows:

	<u>Balance</u> <u>July 1, 2004</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2005</u>	<u>Amounts</u> <u>Due Within</u> <u>One Year</u>
Other Long-term obligations:					
Compensated absences	\$1,156	\$755	\$573	\$1,338	\$137
Leases payable	27	-	15	12	9
Court of Claims	95	10	35	70	70
	<hr/>				
Fund totals	\$1,278	\$765	\$623	\$1,420	\$216

B. Capital Lease Obligations

ICI leases office equipment for use in the Fund. The historical cost and accumulated depreciation of assets under capital lease in the Working Capital Revolving Fund at June 30, 2005 were \$39 (amount expressed in thousands) and \$30 (amount expressed in thousands), respectively. Although these lease terms may vary, certain leases are renewable subject to appropriation by the General Assembly. If renewal is reasonably assured, leases requiring appropriation by the General Assembly are considered non-cancelable leases for financial reporting. Future minimum lease payments (amounts expressed in thousands) at June 30, 2005 are as follows:

Year ending June 30,	
2006	\$11
2007	3
	<hr/>
	14
Less: amounts representing interest	2
	<hr/>
Present value of minimum lease payments	\$12

STATE OF ILLINOIS
DEPARTMENT OF CORRECTIONS – ILLINOIS CORRECTIONAL INDUSTRIES
WORKING CAPITAL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

7. PENSION PLAN

Substantially all of the Agency'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 2005 are included in State of Illinois' Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2005. The SERS also issued a separate "CAFR" that may be obtained in 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 2005, the employer contribution rate was 16.107%. Effective for pay periods beginning December 31, 1991, the State opted to pay the employee portion of retirement for most State agencies (including ICI) with employees covered by the State Employees' and Teachers' Retirement Systems. Generally, this "pickup" of employee retirement was part of the fiscal year 2005 budget process. The pickup is subject to sufficient annual appropriations and those employees covered may vary across employee groups and State agencies.

8. 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.

STATE OF ILLINOIS
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WORKING CAPITAL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2005

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, 2005. 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.

9. COMMITMENTS AND CONTINGENCIES

A. Operating Leases

Correctional Industries is the lessee of a warehouse in Pana, Illinois. The rental payments totaled \$411 (amount expressed in thousands) for the year ended June 30, 2005.

Future minimum payments (amounts expressed in thousands) as required by the operating lease agreements as of June 30, 2005 are summarized as follows:

Year ending June 30,	
2006	\$413
2007	423
2008	434
2009	445
2010	456

Total	\$2,171

B. Litigation

The State’s liability exposures, including worker’s compensation, vehicle, employee fidelity and surety, legal representation and employee indemnification, general liability are retained. Following are reportable conditions involving ICI (a working capital fund-301 of the State). In addition, ICI could be exposed to additional risks that are not known at this time.

STATE OF ILLINOIS
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WORKING CAPITAL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
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As of the date of this report, the following are investigations underway involving ICI:

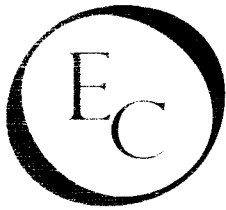
- Contract payments in the asbestos industry area of ICI. ICI disputes the legal validity of the claim, but it is probable that ICI will ultimately be found liable to a certain extent and for an estimated range from \$75,000 to 110,000. ICI recorded the probable losses totaling \$120,000 including interest.
- A claim against ICI for an alleged breach of contract regarding the purchase of equipment. The case is in the discovery stage and there is a good chance of making a successful defense or achieving settlement for a nominal sum. The liability is possible but cannot be measured as of to date. No accruals were made in the books.

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 Illinois Correctional Industries 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 Illinois Correctional Industries.

10. INVENTORIES

Inventories (amounts expressed in thousands) at June 30, 2005, consist of the following:

Raw materials	\$3,726
Work in process	132
Finished goods	4,944
Operating supplies	524
Livestock	198
Unharvested crops	37
Stores Inventory	7
	<hr/>
	\$9,568



E.C. ORTIZ & CO. LLP
CERTIFIED PUBLIC ACCOUNTANTS

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 business-type activities of the State of Illinois – Department of Corrections – Correctional Industries, as of and for the year ended June 30, 2005, which collectively comprise State of Illinois – Department of Corrections – Correctional Industries’ basic financial statements and have issued our report thereon dated October 31, 2005. 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 to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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*

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, and agency management, and is not intended to be and should not be used by anyone other than these specified parties.

E. C. Ortiz & Co., LLP

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October 31, 2005