



OFFICE OF THE AUDITOR

**DENVER SHERIFF DEPARTMENT
KEEFE COMMISSARY NETWORK, LLC
REVENUE AND CONTRACT COMPLIANCE AUDIT
JANUARY 2009**

*Dennis J. Gallagher
Auditor*



City and County of Denver

201 West Colfax Ave., Dept. 705 • Denver, Colorado 80202 • 720-913-5000, FAX 720-913-5247
www.denvergov.org/auditor

Dennis J. Gallagher
Auditor

January 28, 2009

Mr. William R. Lovingier
Director of Corrections and Undersheriff
Denver Sheriff Department
City and County of Denver

Dear Mr. Lovingier:

Attached is the Auditor's Office Audit Services Division's revenue and contract compliance audit report of the Keefe Commissary Network, LLC contract dated October 1, 2006. The audit was for the period October 1, 2006 through December 31, 2007. The purpose of the audit was to determine if Keefe Commissary Network, LLC and the Denver Sheriff Department complied with the terms of the contract and whether internal controls in place were adequate.

The audit revealed reportable weaknesses related to contract administration, internal controls, and contract compliance. These weaknesses are disclosed in detail within the accompanying report.

If you have any questions, please contact Kip Memmott, Director of Audit Services, at 720-913-5029.

Sincerely,

Dennis J. Gallagher
Auditor

DJG/ect

cc: Honorable John Hickenlooper, Mayor
Honorable Members of City Council
Members of Audit Committee
Ms. Kelly Brough, Chief of Staff
Mr. Claude Pumilia, Chief Financial Officer
Mr. Chris Henderson, Chief Operating Officer
Mr. David Fine, City Attorney

*To promote open, accountable, efficient and effective government by performing impartial reviews and other audit services that provide objective and useful information to improve decision making by management and the people.
We will monitor and report on recommendations and progress towards their implementation.*

Mr. Lovingier and Mr. Archer

January 28, 2009

Page Two

Ms. Lauri Dannemiller, City Council Executive Staff Director

Ms. Beth Machann, Controller

Mr. Alvin LaCabe, Manager of Safety

Mr. Michael Henry, Interim Director

Mr. Mike Archer, Regional Vice President, Keefe Commissary Network, LLC

TABLE OF CONTENTS

Transmittal Letter	1
Table of Contents	3
Auditor’s Report	4
Executive Summary	5
Background, Scope, Objective, and Methodology	6
Findings, Recommendations, and Responses	8
Schedule of Amount Due and Paid and Related Notes	11
Exhibit A – Denver Sheriff Department Response	13



City and County of Denver

201 West Colfax Ave., Dept. 705 • Denver, Colorado 80202 • 720-913-5000, FAX 720-913-5247
www.denvergov.org/auditor

Dennis J. Gallagher
Auditor

AUDITOR'S REPORT

We have completed a revenue and contract compliance audit of the agreement dated October 1, 2006 between Keefe Commissary Network, LLC (Keefe) and the Denver Sheriff Department (DSD). The purpose of the audit was to determine whether Keefe and DSD complied with various terms and conditions of the contract as well as City and County of Denver rules and regulations. This audit was included in the Auditor's Office Audit Services Division's Annual Audit Plan and is authorized pursuant to the City and County of Denver Charter, Article V, Part 2, Section 1, *General Powers and Duties of Auditor*. We conducted our audit in accordance with generally accepted government auditing standards.

The audit revealed Keefe and DSD did not comply with important provisions of the contract related to payment terms, amounts due, insurance, and reporting requirements.

We extend our appreciation to the personnel who assisted and cooperated with us during the audit.

Audit Services Division

A handwritten signature in black ink, appearing to read "K. Memmott".

Kip R. Memmott, MA, CGAP, CICA
Director of Audit Services

Date: January 28, 2009

Staff: Ken Kemple, CISA, CICA, Deputy Director
Mike Widner, CICA, Audit Supervisor
Manijeh Taherynia, CPA, CFE, Senior Internal Auditor
Rebecca Corral, CFE, Senior Internal Auditor

*To promote open, accountable, efficient and effective government by performing impartial reviews and other audit services that provide objective and useful information to improve decision making by management and the people.
We will monitor and report on recommendations and progress towards their implementation.*

**KEEFE COMMISSARY NETWORK LLC
EXECUTIVE SUMMARY
FOR THE PERIOD OCTOBER 1, 2006 THROUGH DECEMBER 31, 2007**

This summary highlights the findings of the revenue and contract compliance audit of the Keefe Commissary Network, LLC (Keefe) contract. The Findings and Recommendations section of the report beginning on page 8 further describes these issues in detail. The responses from the Denver Sheriff Department (DSD) to these findings are contained in Exhibit A.

Finding I - Non-Compliance with Contract Terms Caused Underpayment and Increased Risk to the City

Audit work revealed DSD made verbal agreements with Keefe regarding payment terms and commissions in violation of Executive Order No. 8. Furthermore, we noted DSD failed to properly monitor and enforce Keefe's compliance with contract provisions regarding insurance, financial, and other reporting requirements.

Unauthorized Payment Process - The contract provisions require DSD to remit gross commissary receipts to Keefe on a weekly basis. Keefe is then required to calculate and pay monthly commissions of 44% on commissary sales after deducting appropriate taxes. However, DSD and Keefe enacted a verbal agreement which changed the payment process. Based on the existing verbal agreement, DSD does not make weekly payments. Instead, DSD retains commissions calculated by Keefe's system and pays the contractor monthly for the remaining balance.

Improper Calculation of Commissions - The contract defines commissions due as 44% of gross receipts, net of applicable taxes. However, audit work revealed DSD instructed Keefe to reduce the prices charged to inmates for certain clothing items and, in return, make sales of these items subject to a 20% commission rate. Additionally, audit work noted the combined sales tax rate was incorrectly programmed in Keefe's software which resulted in understated sales tax deductions for the entire audit period. As a result of these two issues, DSD collected \$5,940 less than the commission amount prescribed by the contract. In addition, since Keefe does not actually make payments to DSD, we were unable to assess late payment interest penalties on amounts due.

Non-Enforcement of Contract Provisions - We noted DSD failed to enforce Keefe's compliance with contract requirements related to insurance coverage, submission of monthly and annual financial reports, and evidence of compliance with Payment Card Industry Data Security Standards (PCI DSS) during the audit period.

Recommendations

We recommend DSD assess and collect the \$5,940 due from Keefe. We recommend DSD and Keefe immediately discontinue their verbal agreements and follow the contract provisions until proper contract amendments are enacted. We also recommend DSD monitor and enforce insurance, financial, and other reporting requirements to mitigate risks to the City.

**KEEFE COMMISSARY NETWORK, LLC
BACKGROUND, SCOPE, OBJECTIVE, AND METHODOLOGY
FOR THE PERIOD OCTOBER 1, 2006 THROUGH DECEMBER 31, 2007**

Background

Keefe Commissary Network, LLC (Keefe) entered into an agreement with the Denver Sheriff Department (DSD) effective October 1, 2006 to exclusively provide canteen and commissary services for the inmate population at the Denver County Jail and the Pre-Arrestment Detention Facility. The contract extends through December 31, 2008 and may be renewed for up to four additional years subject to the parties' agreement and execution of such agreement.

The "Undersheriff Prisoner Purchase, Welfare, and Recreation Trust," established by D.R.M.C. Article XV, holds inmate funds in a City trust administered by the Denver Sheriff Department. Keefe has provided a proprietary software program to DSD which records individual inmate account balances, facilitates commissary sales, generates sales reports, and is the accounting system for the Trust Fund. Friends and family can place funds on inmate accounts by credit card, wire transfer, money order, and cash. Inmates can then use the available funds to purchase food, drink, and personal hygiene items from the commissary. All commissary sales proceeds are deposited into the Trust Fund. Under the terms of the contract, DSD is required to remit commissary sales to Keefe on a weekly basis. Keefe is required to pay DSD a commission fee equal to 44% of revenue, net of appropriate taxes, on a monthly basis.

Scope

The audit of the Keefe Commissary Network, LLC contract (PeopleSoft fund/org. 56951/3532000) was for the period October 1, 2006 through December 31, 2007. The audit focused on evaluation of internal controls over processing inmate orders, accounting entries for commissary transactions, and proper reporting of commissary sales and sales commissions. The audit also examined the contractor's compliance with insurance and reporting requirements.

Objective

The objective of our audit was to determine whether Keefe was in compliance with the terms of the contract, commissary sales were properly reported, and sales commissions were accurately calculated and paid. We also assessed DSD's performance in monitoring the contract and their compliance with City rules and regulations.

Methodology

The evidence gathering and analysis techniques used in order to meet the audit objectives included, but were not limited to:

- Evaluating internal controls over recording and reporting inmate commissary sales and refunds;
- Testing and documenting reliability of computer processed data;

- Reconciling, on a test basis, commissary sales and refunds per system generated reports to source documents;
- Tracing, on a test basis, reported commissary sales to accounting records;
- Reviewing sales commission calculations for accuracy;
- Conducting discussions with management; and
- Obtaining and reviewing evidence of insurance, performance bonds, the required monthly and annual financial reports, and proof of compliance with Payment Card Industry Data Security Standards (PCI DSS).

**KEEFE COMMISSARY NETWORK, LLC
FINDINGS AND RECOMMENDATIONS
FOR THE PERIOD OCTOBER 1, 2006 THROUGH DECEMBER 31, 2007**

Finding I - Non-Compliance with Contract Terms Caused Underpayment and Increased Risk to the City

Audit work determined the Denver Sheriff Department (DSD) implemented verbal agreements with Keefe Commissary Network, LLC (Keefe) with respect to payment terms and commissions due in direct violation of Executive Order No. 8, Contracts and Other Written Instruments, which states, "...an amendment is required whenever a provision of the contract needs to be changed. Verbal instructions or written correspondence may not be considered as amendments to a contract." Additionally, we noted DSD failed to properly monitor and enforce contract provisions regarding certain insurance, financial, and other reporting requirements. These issues are described in further detail below:

Unauthorized Payment Process – As shown in Figure 1, the contract requires Keefe to submit an invoice on a weekly basis for gross commissary sales. DSD is then required to pay the entire amount of gross receipts to Keefe. Keefe is then responsible for calculating commissions due to DSD and remitting commission payments on a monthly basis.

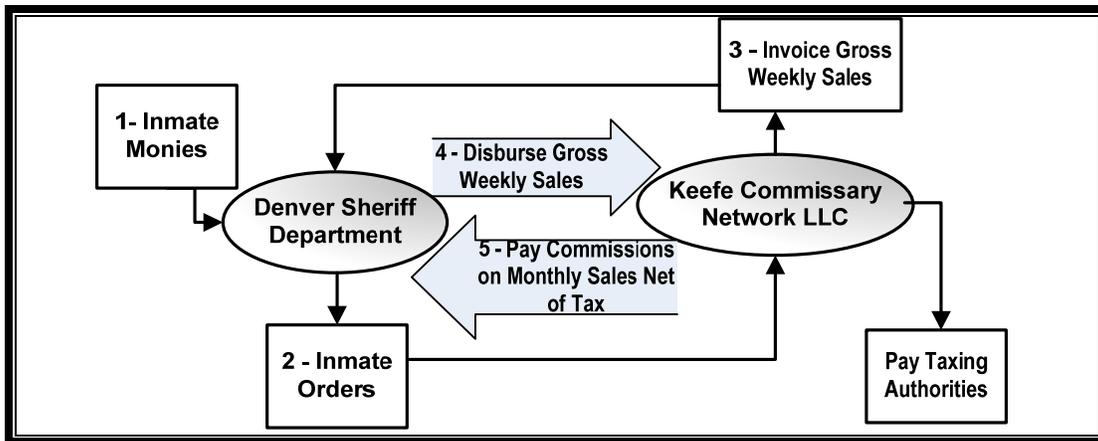


Figure 1 - Payment Process per Contract

However, DSD entered into a verbal agreement with Keefe which altered the payment process. Based upon the current verbal agreement as illustrated in Figure 2, DSD receives weekly invoices from Keefe, but DSD does not remit the gross sales to Keefe. Instead, DSD retains commissions based on the invoice and pays Keefe the remaining balance.

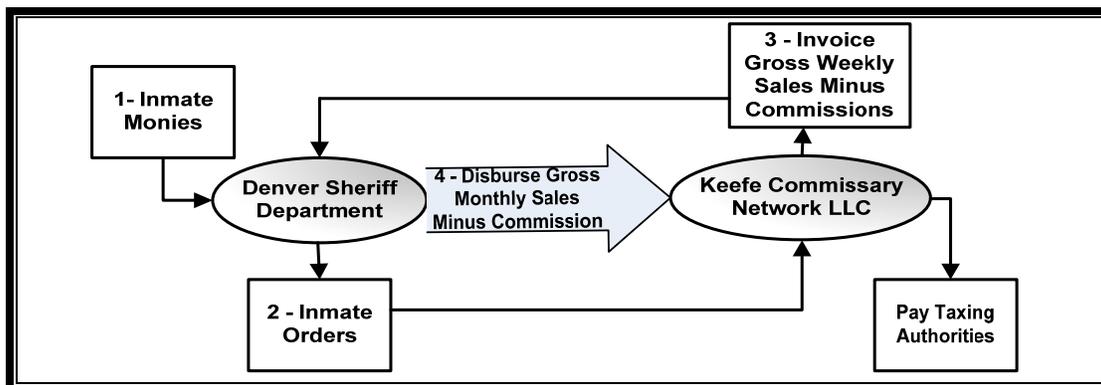


Figure 2 - Payment Process per Verbal Agreement

Improper Calculation of Commissions - The contract defines commissions due as 44% of gross receipts, net of applicable taxes. However, audit work revealed that shortly after entering the contract, DSD and Keefe made an improper verbal agreement which altered the percentage of commission due. Specifically, DSD requested Keefe reduce the prices charged to inmates for certain clothing items and, in return, DSD agreed to receive sales commissions of 20% on these items.

In addition, we noted the combined sales tax rate was incorrectly programmed in Keefe's software at the rate of 7.2% when it should have been applied at 7.6% from October through December 31, 2006 and 7.72% beginning January 1, 2007. Furthermore, DSD failed to identify the erroneous sales tax rate which could have been detected through recalculation and reconciliation of commission amounts due. As a result, Keefe's allowable sales tax deduction from gross sales was understated for the entire audit period.

Ultimately, DSD collected \$5,940 less than the commission amount prescribed by the contract. In addition, since Keefe does not actually make payments to DSD on a monthly basis as highlighted above, we were unable to determine and assess late payment interest penalties on amounts due in accordance with the contract.

Non-Enforcement of Contract Provisions - Executive Order No. 8 outlines DSD's responsibility for monitoring and ensuring compliance with contract terms throughout the life of the contract. However, audit work noted DSD failed to monitor and enforce Keefe's compliance with several contract provisions as highlighted below:

- Based upon our examination of insurance policies, we noted Keefe did not obtain insurance containing professional liability and employee dishonesty coverage as required by the contract. Additionally, DSD did not review the insurance certificates maintained by the contractor to ensure all required types of coverage were included in the policy. Inadequate insurance coverage increases risk of third party liability for both Keefe and DSD.
- Audit work revealed Keefe failed to submit monthly sales summaries certified by an officer of the company, as well as annual CPA certified statements detailing gross receipts, deductions, net receipts, and the resulting sales commissions due as required by the contract. Although DSD can independently generate monthly and annual sales reports from the Keefe system, the financial reporting requirements are intended to provide additional assurance that amounts due and paid are accurately recorded and reported. Moreover, CPA certified annual statements could have detected the erroneous tax rate and mitigated incorrect calculations of commissions due.
- The contract requires Keefe to provide verification of compliance with Payment Card Industry Data Security Standards (PCI DSS) since credit and debit cards are used to fund inmate accounts. However, Keefe failed to submit evidence of quarterly data vulnerability scans or annual audits certifying PCI DSS compliance and DSD did not require these reports throughout the audit period. Despite multiple audit requests, Keefe did not provide these reports. As a result, the City is left with no level of assurance that Keefe has complied with PCI DSS.

Recommendations

1. We recommend DSD assess and collect \$5,940 in sales commissions due from Keefe in accordance with the contract. We recommend DSD fully comply with City contracting rules that prohibit entering into verbal agreements with third parties. Since the contract expires December 31, 2008, the parties will have the opportunity to renegotiate the contract terms, incorporate any desirable changes, and pursue these changes through a proper contract amendment as required by Executive Order No. 8.
2. We recommend DSD work with Keefe to immediately correct the tax rate programmed in the system. Specifically, we recommend DSD monitor combined tax rate changes and ensure tax tables are programmed correctly in Keefe's system. Additionally, we recommend DSD require Keefe to submit the financial reports outlined in the contract to mitigate the risk of improper recording and reporting of sales and subsequent commissions due. DSD's finance personnel should perform monthly and yearly recalculations of commissions in accordance with the contract, reconcile amounts due with Keefe's financial reports, and resolve any discrepancies with Keefe.
3. In order to protect both DSD and Keefe from potential claims by third parties, we recommend Keefe obtain insurance policies which satisfy all the current coverage requirements. Additionally, we recommend DSD review these new policies and, if necessary, consult with Risk Management and the City Attorney's Office to ensure adequacy of the coverage and compliance with the terms of the contract.
4. We recommend Keefe submit evidence of quarterly data vulnerability scans or annual audits verifying compliance with PCI DSS. Further, we recommend DSD require, obtain, and keep on file the proof of compliance with this requirement on a regular basis.

KEEFE COMMISSARY NETWORK, LLC
SCHEDULE OF AMOUNTS DUE AND PAID
FOR THE PERIOD OCTOBER 1, 2006 THROUGH DECEMBER 31, 2007

<u>Periods</u>	<u>Amount Due (Note 1)</u>	<u>Amount Paid (Note 2)</u>	<u>Balance Due DSD/(Keefe)</u>
<u>10/1/06 - 12/31/06</u>			
Sales Commissions	\$136,437	\$135,687	\$750
Total:	\$136,437	\$135,687	\$750
<u>1/1/07 - 12/31/07</u>			
Sales Commissions	\$577,970	\$572,780	\$5,190
Total:	\$577,970	\$572,780	\$5,190
Grand Total	\$714,407	\$708,467	\$5,940

The accompanying notes are an integral part of this schedule.

1. Amounts Due (Note 1)

Sales commissions, as shown in the accompanying schedule, is 44% of net receipts which is defined as all receipts from sales of products under the contract agreement, less applicable sales tax. Counterfeit money or loss from theft shall not be deducted in the calculation of gross receipts.

2. Amounts Paid (Note 2)

All amounts paid in the schedule of amounts due and paid were compiled from the Denver Sheriff Department's cash disbursement records. Amounts paid include those due during the audit period and paid in the ordinary course of business whether or not within the audit period.



JOHN H. HICKENLOOPER
MAYOR

CITY AND COUNTY OF DENVER

DEPARTMENT OF SAFETY

DENVER SHERIFF DEPARTMENT
FINANCE DEPARTMENT
5440 ROSLYN ST. BUILDING 5
DENVER, COLORADO 80216

January 8, 2009

Mr. Kip R. Memmott, CGAP, CICA

Director of Audit Services
Office of the Auditor
City and County of Denver
201 West Colfax Avenue, Dept. 705
Denver, Colorado 80202

Dear Mr. Memmott:

The Office of the Auditor has conducted a performance audit of the Keefe Commissary Network LLC for the audit period beginning October 1, 2006 through December 31, 2007.

This memorandum provides a written response for each reportable condition noted in the Auditor's Report final draft that was sent to us on December 22, 2008. This response complies with Section 20-276 (b) of the Denver Revised Municipal Code (DRMC).

AUDIT FINDING(S): Non-Compliance with Contract Terms Caused Underpayment and Increased Risk to the City

RECOMMENDATION 1: We recommend DSD assess and collect \$5,940 in sales commissions due from Keefe in accordance with the contract. We recommend DSD fully comply with City contracting rules that prohibit entering into verbal agreements with third parties.

- **RESPONSE/ACTION PLAN:** In order to ensure the affordability of undergarments for indigent inmates, we will not invoice Keefe for the \$5,940. We will make sure these 20% commission rate items will be stated in the 2009 Keefe contract.

EXHIBIT A – DENVER SHERIFF DEPARTMENT RESPONSE KEEFE COMMISSARY NETWORK, LLC

JAN-13-2009 11:27

PANA 8060

P.002

State your agreement or reason for disagreement with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of primary individual responsible for implementation
Disagree with Recommendation for collecting \$5,940 in order to ensure the affordability of undergarments for indigent inmates	Will state in 2009 contract To be complete within 60 days	Hli Ly 720-865-4109

RECOMMENDATION 2: We recommend DSD work with Keefe to immediately correct the tax rate programmed in the system. Specifically, we recommend DSD monitor combined tax rate changes and ensure tax tables are programmed correctly in Keefe’s system. Additionally, we recommend DSD require Keefe to submit the financial reports outlined in the contract to mitigate the risk of improper recording and reporting of sales and subsequent commissions due. DSD’s finance personnel should perform monthly and yearly recalculations of commissions in accordance with the contract, reconcile amounts due with Keefe’s financial reports, and resolve any discrepancies with Keefe.

RESPONSE/ACTION PLAN: Although Keefe paid the City & County of Denver the correct sales tax, they are also responsible to state the correct tax rate on their sales reports. We will perform monthly and yearly recalculations of commissions in accordance with the contract and ensure tax rate is correct.

State your agreement or reason for disagreement with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of primary individual responsible for implementation
Agree with Recommendation	Within 60 days	Mohammad Dahleh 720-865-4107

RECOMMENDATION 3: In order to protect both DSD and Keefe from potential claims by third parties, we recommend Keefe obtain insurance policies which satisfy all the current coverage requirements. Additionally, we recommend DSD review these new policies and, if necessary, consult with Risk Management and the City Attorney’s Office to ensure adequacy of the coverage and compliance with the terms of the contract.

➤ **RESPONSE/ACTION PLAN:** We will follow up with Keefe regarding the recommendation to obtain insurance policies to satisfy all current coverage requirements.

State your agreement or reason for disagreement with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of primary individual responsible for implementation
---	---	--

EXHIBIT A – DENVER SHERIFF DEPARTMENT RESPONSE KEEFE COMMISSARY NETWORK, LLC

JAN-13-2009 11:27

PANA 8060

P.003

Agree with Recommendation	Within 60 days	Mohammad Dahleh 720-865-4107
----------------------------------	-----------------------	---

RECOMMENDATION 4: We recommend Keefe submit evidence of quarterly data vulnerability scans or annual audits verifying compliance with PCI DSS. Further, we recommend DSD require, obtain, and keep on file the proof of compliance with this requirement on a regular basis.

➤ **RESPONSE/ACTION PLAN:** We will work with Keefe to submit evidence of quarterly data vulnerability scans or annual audits verifying compliance with PCI DSS.

State your agreement or reason for disagreement with Recommendation	Target date to complete implementation activities (Generally expected within 60 to 90 days)	Name and phone number of primary individual responsible for implementation
Agree with Recommendation	Will state in 2009 contract Within 60 days	Mohammad Dahleh 720-865-4107

Please contact **Mark Valentine** at (720) 865-4108 with any questions.

Sincerely,



Mark Valentine
Director of Finance

cc: Director Bill Lovingier
Chief Ronald Foos

TOTAL P.003