Executive Office of the Governor

Office of The Chief Inspector General

Prison Rehabilitative Industries and Diversified Enterprises, Inc., Industries Training Corporation and Affiliates

Audit Number 2004-4
Date: February 28, 2005

STATE OF FLORIDA

Office of the Governor

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JEB BUSH
GOVERNOR

February 28, 2005

Honorable Jeb Bush
Governor of Florida
The Capitol
Tallahassee, FL 32399

Dear Governor Bush:

Attached is Audit Report No. 2004-4 detailing the findings from our audit of the Prison Rehabilitative Industries and Diversified Enterprises, Inc. (PRIDE), Industries Training Corporation (ITC) and Affiliates. The audit was conducted by the staff of the Chief Inspector General's Office with assistance from Deette Preacher, CPA, P.A., an independent contractor. Responses to the audit findings and recommendations obtained from PRIDE and ITC have been incorporated in the final report.

If you have any questions or would like to discuss this further, please contact me.

Sincerely,

Derry Harper
Chief Inspector General

DH/kbm

Attachment

cc: James Crosby, Secretary, Dept. of Corrections
Denver Stutler, Chief of Staff
William Large, Deputy Chief of Staff
Maria Leiva, Chairman, PRIDE
Jack Edgemon, Interim CEO, PRIDE
Randall May, Chairman, ITC
Pamela Davis, CEO, ITC
Deette Preacher, CPA

PRISON REHABILITATIVE INDUSTRIES AND DIVERSIFIED ENTERPRISES, INC., INDUSTRIES TRAINING CORPORATION AND AFFILIATES

AUDIT REPORT NUMBER 2004-4

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EXECUTIVE SUMMARY

The Office of the Chief Inspector General performed an audit of Prison Rehabilitative Industries and Diversified Enterprise, Inc. (PRIDE), Industries Training Corporation (ITC) and its affiliated entities for the period January 1, 1999, through June 30, 2004. The audit objectives were designed to assess the overall effectiveness and efficiency of the financial operations of PRIDE and its affiliates in order to determine whether they were operating in accordance with the purposes for which PRIDE was statutorily created.

The findings in this report revealed significant decline in the financial condition of PRIDE, ITC and its affiliates. In addition, the findings revealed a breakdown in accountability, as well an inadequate system of internal controls.

PRIDE's response addressed and generally agreed with our findings and recommendations. Responses from both PRIDE and ITC are included in this report.

Synopsis of Findings:

- The organizational and operational relationship between PRIDE and ITC continues to be flawed in large measure because PRIDE initially adopted a corporate and governance structure which was inconsistent with the Florida Statutes applicable to managing and leasing correctional work programs.

- Management's system of internal controls was inadequate to ensure effective, efficient, and proper use of resources.

- PRIDE experienced a significant financial decline from July 1, 1999 to December 31, 2003, recently resulting in cash flow difficulties.

- ITC is a financially troubled entity and its current financial condition raises concerns as to whether it will be able to continue to operate.

- PRIDE did not enter into a formal contract with ITC, although required by the letter agreement dated June 30, 1999. Currently, no formal contract exists.

- Payments made to ITC by PRIDE for management services have not been in accordance with the June 30, 1999 agreement or sound business practices.

- PRIDE has loaned/advanced funds to ITC and its affiliates interest-free, without any stated terms of repayment. Also, amounts recorded in PRIDE's financial records as due from ITC and ITC affiliates have been reduced by significant amounts for reasons that were sometimes questionable.

- Management had not established a policy setting limits on the amount of funds that can be used to support ITC and its affiliates. The lack of such a policy has resulted in significant advances being made to ITC and its affiliates at the expense of PRIDE's financial welfare.

- The amounts paid to PRIDE and ITC executives were not reasonable considering the companies' financial condition.

BACKGROUND

In 1981, the Legislature passed legislation to provide for a not-for-profit corporation to lease and manage the correctional work programs of the Department of Corrections (Department). Once such not-for-profit corporation was organized, no other not-for-profit corporation could be organized for this purpose. The corporation's board would be made up of members appointed by the Governor and confirmed by the Senate. In December 1981, Prison Rehabilitative Industries and Diversified Enterprises, Inc. (PRIDE) was incorporated and, in 1983, the Legislature authorized PRIDE to assume the responsibilities of managing the Department's correctional work programs. The Department transferred to PRIDE certain assets of the correctional work program. PRIDE recorded these transfers at estimated fair market value. In addition to these transfers, various lease agreements between PRIDE and the Department provided for PRIDE to use certain land, buildings, and equipment in the operation of its correctional work programs.

PRIDE's mission as stated in Section 946.501(2), Florida Statutes, in administering the correctional work program is, "in order of priority:

(a) To provide a joint effort between the department, the correctional work programs, and other vocational training programs to reinforce relevant education, training, and postrelease job placement and help reduce recommitment.
(b) To serve the security goals of the state through the reduction of idleness of inmates and the provision of an incentive for good behavior in prison.
(c) To reduce the cost of state government by operating enterprises primarily with inmate labor, which enterprises do not seek to unreasonably compete with private enterprise.
(d) To serve the rehabilitative goals of the state by duplicating, as nearly as possible, the operating activities of a free-enterprise type of profitmaking enterprise."

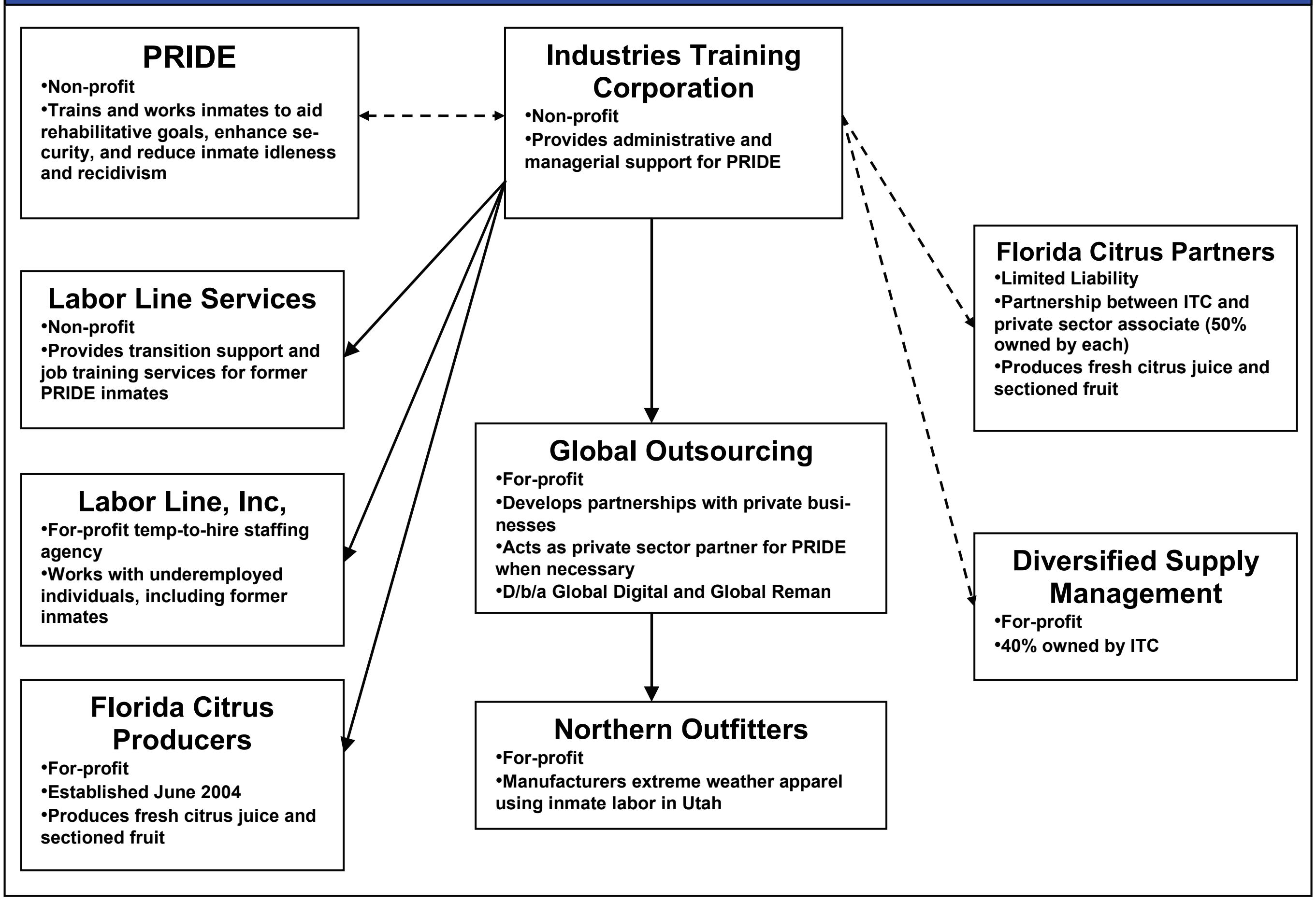
To assist PRIDE in its mission, the Legislature granted it certain privileges. PRIDE has sovereign immunity, which shields it from liability in the same manner as the State. In addition, PRIDE is not subject to the authority of any state agency, except the auditing and investigatory powers of the Legislature and the Governor. Legislation also granted purchasing preference for PRIDE, meaning that state agencies must buy its products when they are of similar quality and price to those offered by outside vendors.

PRIDE operates a variety of industries including furniture manufacturing, agriculture, digital print technologies, textiles, and services. PRIDE receives no funding from the Legislature and is totally supported by the earnings it generates from the sale of its products. The majority of its sales are to state agencies. In fiscal year 2003 (January 1 – December 31), PRIDE provided 1,995 inmate work positions at 21 prisons throughout Florida and generated $60.9 million in sales. Exhibit 1 of this report lists PRIDE's Board of Directors.

Since the mid 1990's, the PRIDE Board has been considering ways to improve PRIDE's performance, specifically in the area of job creation and market diversification. At PRIDE's strategic planning workshop in August 1997, the Board developed a model for how PRIDE could expand its reach, diversify its market, and increase inmate jobs. They anticipated PRIDE would maintain and expand government markets and identify other markets that could be developed for the products produced in the current industries. The Board felt that creating a "strategic leadership" company would assist PRIDE in developing a variety of relationships, either through joint ventures, acquisition, or the creation of other companies. Also, the cost of the administrative support services, i.e.: human resources, information resources, finance and accounting, etc., would be shared by all other companies, thus reducing the overall cost to PRIDE. The Board also concluded that creating a "partnership outsourcing" company could benefit PRIDE by targeting and focusing on the commercial for-profit sectors that were determined to be best suited for the prison environment. RISE, an affiliate of PRIDE, would expand its transitional support services and expand into a temporary employment company providing job placement opportunities for inmates released from prison, in addition to the PRIDE workers.

A business development consultant was hired in 1998 to develop a comprehensive growth strategy for a for-profit company to enhance PRIDE's effectiveness. The PRIDE Board approved the consultant's proposal and subsequent business plan to create separate but related companies. The intent of the creation of these new companies was to help PRIDE find ways to increase the number of inmate jobs and to expand its social mission. In addition, PRIDE wanted to establish clear criteria for the separation of markets and the allocation of capital resources between the proposed businesses. Effective July 1, 1999, PRIDE formed Industries Training Corporation (ITC), a tax exempt organization, for the purpose of entering into relationships and managing prison work programs for PRIDE and any other tax exempt, governmental and for-profit sectors located in the state and the United States. In addition, ITC created the following affiliates to assist in its mission:

FIGURE 1—CORPORATE STRUCTURE OF PRIDE, ITC & AFFILIATES



Labor Line, Inc. (LLI); Labor Line Services, Inc. (LLS) and Global Outsourcing, Inc. (Global) and purchased its wholly owned subsidiary, Northern Outfitters. ITC also formed private partnerships to create Florida Citrus Partners (FCP), in which ITC has 50% ownership and Diversified Supply Management Company (DSM) in which ITC has 40% ownership. PRIDE considers ITC and its affiliates related parties for financial reporting purposes. The members of ITC's Board of Directors are listed in Exhibit 1 of this report. Figure 1 above illustrates the corporate structure of PRIDE, ITC and the affiliates.

In fiscal year 2003 (January 1 - December 31), ITC and its affiliates generated $20,256,522 in sales.

SCOPE, METHODOLOGY AND OBJECTIVES

The Chief Inspector General initiated this audit in response to a request by the Governor to conduct a review of PRIDE, ITC and the affiliates. This request was made in response to concerns raised in the Office of Program Policy Analysis and Government Accountability (OPPAGA) Special Report No. 03-68, PRIDE Benefits the State But Needs to Improve Transparency in Operations, issued December 2003.

The objectives of the audit were to determine:

- Whether management's system of internal control was adequate to ensure effective, efficient, and proper use of resources;
- Whether management established policies regarding investment best practices and whether management followed those policies;
- Whether the organizational relationships between PRIDE, ITC and the related affiliates are appropriate;
- Whether the relationships between key

employees of PRIDE, ITC and the related affiliates are appropriate and do not contain any conflicts of interest;

- Whether the salaries of PRIDE and ITC senior management are reasonable and in accordance with similar positions in other organizations; and

- Whether the organization is fulfilling its statutory purpose to duplicate as nearly as possible the operating activities of a profit-making enterprise.

To meet these objectives, we reviewed transactions and selected activities occurring during the period January 1, 1999 through June 30, 2004 and additional activities through December 2004. Our methodology included the following:

- Interviews with members of both Boards of Directors, and selected officers and managers
- Analyses of financial records and documents
- Review of minutes of meetings of the PRIDE and ITC Boards of Directors
- Review of statutes, corporate charters, bylaws, policies and procedures
- Review of financial reports, including audited and unaudited financial statements
- Review of annual reports
- Examination of selected financial transactions and supporting documentation
- Examination of personnel files

Our audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* published by the Institute of Internal Auditors.

FINDINGS AND RECOMMENDATIONS

<u>Audit Finding #1</u>

The organizational and operational relationship between PRIDE and ITC continues to be flawed in large measure because PRIDE initially adopted a corporate and governance structure which was inconsistent with the Florida Statutes applicable to managing and leasing correctional work programs.

In early 1999 the PRIDE Board of Directors approved a number of initiatives for the stated purpose of expanding sales outside the historical outlets of the State of Florida and local governments. One of the initiatives was to create additional entities.

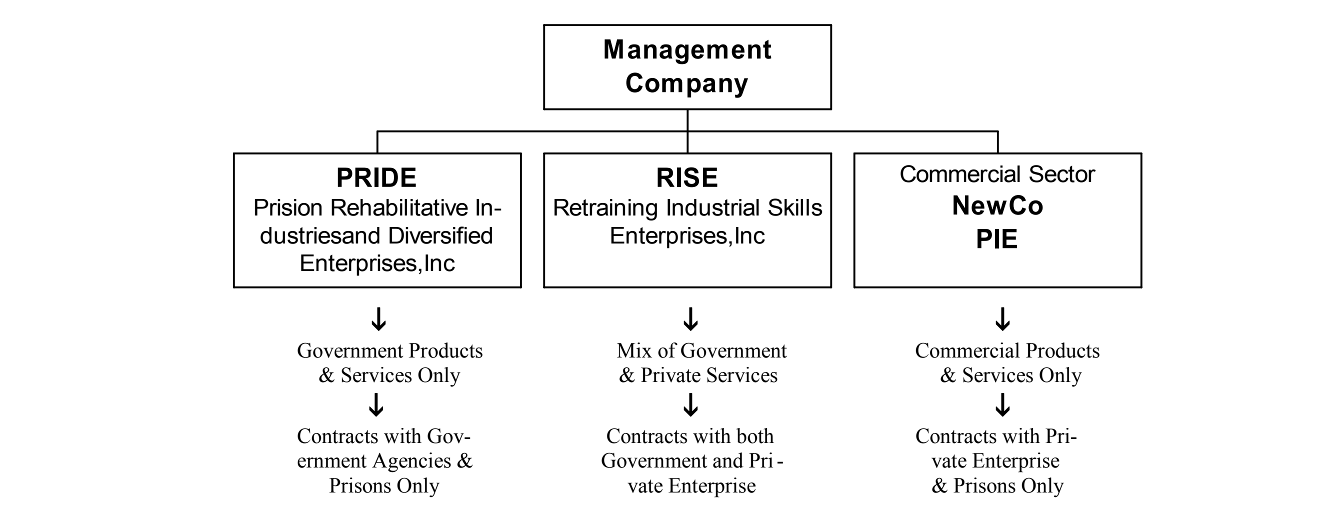
A consultant was engaged to develop a comprehensive business plan to determine the feasibility of establishing a for-profit operation under the Prison Industry Enhancement (PIE) program[1] within the PRIDE corporate structure. The consultant proposed restructuring PRIDE under a management company format as illustrated in Figure 2.

The structure shows a management company as a holding company with PRIDE, RISE, and a for-profit company as subsidiaries. Industries Management Corporation was established as the management company (the name was later changed to Industries Training Corporation – ITC) and Global Outsourcing, Inc. was created as the for-profit entity. In ITC's 1999 and 2000 financial statements, PRIDE's accounts were consolidated with ITC and its affiliates. (PRIDE issued separate, audited financial statements.) The CFO explained that including PRIDE as a subsidiary of ITC was considered appropriate since PRIDE and ITC had the same individuals serving on their respective Boards of Directors. In our interviews with Board members, at least one indicated that PRIDE is subordinate to ITC.

The creation of a management company organizationally superior to PRIDE appears to be contrary to Section 946.502(1), Florida

[1] PIE programs are authorized by Federal law for the purpose of allowing goods manufactured in prison industries to be sold in the competitive retail market. To ensure that the prison industries do not have an unfair advantage due to the small salary amounts paid to their inmates, the inmates working in PIE programs must be paid the current prevailing wage

FIGURE 2—CONSULTANT-PROPOSED REVISED CORPORATE STRUCTURE



Statutes, which provides, "It is the intent of the Legislature that a not-for-profit corporation lease and manage the correctional work programs of the Department of Corrections. Section 946.502(2), Florida Statutes provides, "It is further the intent of the Legislature that once one such not-for-profit corporation is organized, no other not-for-profit corporation be organized for the purpose of carrying out this part . . .."

In Report No. 03-68 dated December 2003, OPPAGA staff reported that PRIDE had failed to adequately maintain the distinction between itself and its related businesses. They go on to state, "The relationship between PRIDE, ITC and the other corporations is intertwined and difficult to separate. For example, PRIDE and ITC have some common managers, common board members, and use the same offices." (See Exhibits 1 and 2.)

The structure of the organization should promote the mission of the organization and each unit within the organization should function to further that mission. Private corporations in some instances have wholly owned subsidiaries. The purposes of wholly owned subsidiaries may be to spread risk so that a judgment against one subsidiary could not be enforced against other subsidiaries and subsidiaries are sometimes created to compete in different markets. Although these may have been the reasons for which PRIDE created ITC, PRIDE's decision to create entities outside the control of PRIDE does not appear to be justified. While the original consultant's report may have brought to light a reasonable means of expanding PRIDE, it does not appear that other options/proposals/alternatives were considered. Other options may have provided a means by which PRIDE could have expanded its sales market with companies created as PRIDE subsidiaries.

We made inquiries of senior executives and board members as to the reasons for creating ITC as a separate entity. Generally, the reasons expressed were: (1) to expand PRIDE's sales base into non-State and private market segments; (2) the reluctance of private firms to do business with PRIDE because of concerns about the perceived ability of government to examine their records once they entered into a business relationship with PRIDE, and (3) to market products without the stigma associated with inmate-produced goods.

We question, at least to some degree, the validity of these bases for establishing the separate entities because:

- PRIDE does not control ITC or any of its affiliates, therefore PRIDE has no voice in how any profits would be distributed or used. We saw no evidence of how the activities of the companies increased PRIDE's sales. Rather, PRIDE's sales have ranged from $60,930,000 to $65,278,000 over the last 3 years, which is a significant decrease from the sales of $93,677,000 reported in 2000.

- Section 946.517, Florida Statutes, provides that "corporation [PRIDE] records are public records; however, proprietary confidential business information shall be confidential and exempt from the provisions of s. 119.07(1) and s. 24(a), Art. I of the State Constitution. … 'Proprietary confidential business information' means information regardless of form or characteristics, that is owned or controlled by the corporation; is intended to be and is treated by the corporation as private and the disclosure of the information would cause harm to the corporation's business operations." This information includes "information relating to private contractual data, the disclosure of which would impair the competitive interest of the provider of the information." Such an exemption from public records disclosure laws appear to cover the records of private companies doing business with PRIDE.

- In our interviews with staff of prison industry programs in other states, several indicated they are fairly successful in dealing with private companies even though their products are produced using inmate labor. We realize that some major companies have a strict policy against establishing a relationship with prison industries, but considering the success of some other states' programs, there are companies that do not have such a policy and could provide a sales market for PRIDE products.

Although the erroneous financial reporting methodology of 1999 and 2000 was corrected in 2001, vestiges of ITC's superiority continued (e.g. PRIDE's CEO was also ITC's President/CEO and PRIDE's CFO and internal auditor are organizationally responsible to the ITC President/CEO). Currently, PRIDE is taking steps to clarify the relationship between PRIDE and the related entities. We noted that:

- Separate bank accounts have been established,

- An effort has been made to formalize the June 30, 1999 letter agreement,

- Loan documents have been drafted which outline the provisions for the repayment of amounts ITC and its affiliates owe PRIDE,

- ITC's President/CEO is no longer PRIDE's CEO and

- ITC's financial statements no longer include PRIDE account balances.

Recommendation:

Given ITC's poor financial performance and current financial state, we recommend that PRIDE discontinue its relationship with ITC. If the Board chooses to continue the relationship, it should be re-structured so PRIDE is superior to ITC and its affiliates in form and substance and PRIDE ultimately benefits from operations of the related entities.

Audit Finding #2

Management's system of internal controls was inadequate to ensure effective, efficient, and proper use of resources.

State resources were transferred to PRIDE for the purpose of leasing and managing the correctional work programs of the Florida Department of Corrections (Department). The PRIDE Board of Directors had a fiduciary responsibility to safeguard those assets and manage the correctional work programs in a manner that would provide income to expand the program and make lease payments to the Department. An adequate system of internal control was necessary to satisfy the obligations set forth in the Florida Statutes and the related lease agreements.

Authoritative accounting literature defines internal control as a process affected by an entity board of directors, management and other personnel. The process should be designed to provide reasonable assurance regarding achievement of objectives relating to: (1) reliability of financial reporting, (2) effectiveness and efficiency of operations, and (3) compliance with applicable laws and regulations. The foundation for all other components of internal control, providing discipline and structure, is the control environment, which sets the tone of the organization. There are seven control environment factors.

a. Integrity and ethical values
b. Commitment to competence
c. Board of directors or audit committee
d. Management's philosophy and operating style
e. Organizational structure
f. Assignment of authority and responsibility
g. Human resources policies and procedures

Our review raised questions as to the adequacy of controls related to items (c) - the board of directors, (e) - organizational structure and item (f) – assignment of authority and responsibility.

The Board of Directors

An entity's control consciousness is influenced significantly by the entity's board of directors or audit committee. Attributes include the board or audit committee's independence from management, the experience and stature of its members, the extent of its involvement and scrutiny of activities, the appropriateness of its actions, the degree with which difficult questions are raised and pursued with management, and its interaction with internal and external auditors.

Our review disclosed that the PRIDE Board of Directors is not sufficiently independent from management. PRIDE's Board asked Deloitte Consulting LLP to conduct a management assessment. The report indicated,

> "There is a perception among several interviewees [selected board members, employees and outside stakeholders] that the Board member nomination and selection process is not independent from the CEO, impairing the Board's ability to provide oversight and effective governance."

Our interviews of PRIDE Board members disclosed that the majority of the Board "trusted" the PRIDE management team and did not always provide vigorous oversight when warranted. An antagonistic relationship between the Board of Directors and senior management would be detrimental to operations of the organization but the Board of Directors should be sufficiently independent to provide an appropriate level of oversight. The Board of Directors did not have staff and therefore they depended on senior managers to provide information needed for making important decisions.

The Board's involvement and scrutiny of activities and the degree with which difficult questions were raised and pursued with management seemed limited. Our review of the Board packets (documents provided to Board members for review before the meetings), and the Board meeting minutes did not always document vigorous scrutiny and questioning on major decisions. For example, our review of the documents provided to the Board relating to the December 9, 2002 Board meeting disclosed a one page document providing a summary of the reasons for the asset write down ($5,279,190 receivable reduction described in Finding No. 7) and estimates of the amounts involved. The meeting minutes indicated:

> The finance committee had previously met to review the financial results. Mike Smith shared the summary of the results and reviewed the recommendation of the asset write-downs of procurement management, business development and inmate placement. Upon a motion by Ed Peddie, seconded by Marcelo Alvarez, the recommended write-downs were unanimously approved.[2]

This is an example of the limited documentation available on key decisions made by the Board. PRIDE has a Finance Committee that is responsible for determining that accurate and adequate accounts of the property and business transactions of the corporation are kept. We could not determine the level of scrutiny provided by this critical committee regarding the receivable reductions because minutes are not recorded at their meetings.

[2] Mike Smith is the Chief Financial Officer of PRIDE and ITC; Ed Peddie and Marcelo Alvarez are PRIDE Board members.

<u>Organizational Structure/Assignment of Authority and Responsibility</u>

An entity's organization structure provides the framework within which its activities for achieving entity-wide objectives are planned, executed, controlled, and monitored. Some of the dual positions held raise concerns. As shown in Exhibit 2, Pamela Davis served as PRIDE's Chief Executive Officer (CEO) (until July 2004) and serves as the President/CEO of ITC and several affiliates. Robert (Mike) Smith serves as the Chief Financial Officer (CFO) for both PRIDE and ITC (reporting to the President/CEO of ITC) and treasurer for several affiliates. These assignments appear to place the CEO and CFO in positions with competing interests. PRIDE has the line of credit and holds most of the assets, while ITC is the entity that has not had a profitable year and consistently needs to borrow funds to cover operating expenses. We noted several instances in which decisions made by the CEO and CFO would improve the financial condition of one company while impairing the financial condition of the other. For example:

- The CFO approved the PRIDE payments to ITC for administrative services which were based on PRIDE sales with no subsequent determination by the CFO as to ITC's actual cost for providing the services, as required by the June 30, 1999 agreement. (See Finding No. 6)

- The CFO recommended that the PRIDE Board approve the significant reduction of the amount due from ITC. The reasons for the deduction are questionable. (See Finding No. 7).

Although the managers indicated that they finitely discharge their duties for each entity, the appearance of a conflict of interest cannot be disputed.

Also related to efficient operations, internal auditors contribute to the monitoring of activities and the results of their reviews are reported directly to the Audit Committee. PRIDE had established an internal audit position and the Audit Committee met with the Internal Auditor twice a year. However, the PRIDE internal audit manual, dated July 1, 1990, states that the Internal Audit Department is a staff function reporting to the President. An August 4, 2004 ITC organizational chart showed the internal auditor as an employee of ITC reporting to the President/CEO; however, ITC's Internal Auditor has access to PRIDE's information and financial records. During the audit, ITC's Internal Auditor was designated as our liaison and initial contact for scheduling interviews and obtaining PRIDE records. However, PRIDE's most recent organizational chart does not show an internal audit section. Without an effective internal audit function, the Board does not have an independent, internal source of information regarding the propriety of actions taken by management.

<u>**Recommendation:**</u>

The PRIDE Board should review the present management structure and implement a system of internal controls adequate to ensure the objectives of the enterprise are fulfilled.

<u>**Audit Finding #3**</u>

PRIDE experienced a significant financial decline from July 1, 1999 to December 31, 2003, recently resulting in cash flow difficulties.

PRIDE's audited financial statements indicated that, as of June 30, 1999, net assets exceeded $42 million. In 1999, the PRIDE Board of Directors approved the creation of ITC and ITC created affiliates and partnerships. However, due to declining sales, discontinued operations, asset transfers to ITC and asset write-downs (fair market value reductions), PRIDE's net assets had dropped to approximately $26 million as of December 31, 2003, a reduction of $16 million over a four year period. From 1999 to 2003, PRIDE's annual sales have ranged from a high of $93,677,025 in 2000 to a low of $60,930,006 in 2002, resulting in an average of $65 million for the period. Figure 3 shows the disposition of PRIDE's funds from July 1, 1999 through December 31, 2003.

PRIDE has made substantial financial contributions, both in direct contributions and loans, to the startup of ITC and the other entities. Despite their poor financial performance, PRIDE has continued to approve loans to these failing entities, so that as of December 31, 2003, ITC and its affiliate, FCP,

FIGURE 3—PRIDE DISPOSITION OF FUNDS

	Disposition of Funds		
Year	Gain/(Loss) From Operations	Gain/(Loss) from Discontinued Operations	Asset Decreases Related to ITC & Affiliates
1999 (6 months)	$ (5,673.00)		$ (3,468,765.00)
2000	$ (1,057,299.00)	$ (653,083.00)	
2001	$ (2,076,931.00)	$ (5,575,671.00)	
2002	$ 2,876,225.00	$ 815,444.00	$ (5,279,190.00)
2003	$ (2,183,825.00)		

owed PRIDE a total of $5,351,459, with no stated terms of repayment. Also, PRIDE's bank line of credit was structured so that PRIDE and ITC were cross-collateralized, meaning that both entities could draw down funds from PRIDE's line of credit and each was responsible for the outstanding obligation. PRIDE used the funds to finance its operations and repaid its obligation from operating revenues. ITC also drew funds from this account as authorized by its Chief Financial Officer (who is also PRIDE's Chief Financial Officer). The amounts borrowed by ITC limited PRIDE's access to cash it may have needed to fund its prison industry units' operations. PRIDE's cash balances for the period 1999 through 2003 have decreased by an average of $600,000 each year. On January 1, 1999, PRIDE's cash balance exceeded $3 million and had decreased to approximately $250,000 as of December 31, 2003. In its current financial state, PRIDE has not been able to meet its financial obligations. Based on information provided to us by ITC's Internal Auditor, the terms of the cross-collateralized line of credit were revised in November 2004 to make the amount due from PRIDE separate from the amount due from ITC. Under the revised arrangement, if the bank requires payment of the outstanding balances, PRIDE is no longer responsible for ITC's debt.

To obtain a clearer picture of PRIDE's financial state, we used data from the 2003 audited financial statements and calculated ratios that indicated the solvency, profitability and efficiency of PRIDE's operations. Our analyses indicated that PRIDE is having difficulty meeting its current obligations. During our fieldwork in September 2004, PRIDE senior management confirmed that PRIDE was experiencing short-term cash flow problems. PRIDE's solvency status is questionable because if PRIDE needs funds for operations, they have very few assets they can convert to cash. Much of the surplus property once owned by PRIDE and available to convert to cash has been sold, transferred by gift to ITC or cannot be sold because the buildings are located on state-owned land. The efficiency ratios show that PRIDE is efficient in using its assets to generate sales. However, the profitability ratios indicate PRIDE's assets, sales and net income are not generating a return on the investment and therefore PRIDE is not considered a profitable entity. The details for each ratio, including how it is calculated, what it represents, what is a desirable ratio and PRIDE's ratio at December 31, 2003 are contained in Exhibit 3 of this report.

<u>Recommendation:</u>

We recommend that PRIDE take measures to reduce and eventually eliminate the trend toward financial and economic decline. These efforts should include a careful review of how PRIDE's funds are used and the elimination of financial support for any business ventures, including ITC and its affiliates, which are not generating profits for PRIDE.

<u>Audit Finding #4</u>

ITC is a financially troubled entity and its current financial condition raises concerns as to whether it will be able to continue to operate.

FIGURE 4—PRIDE DISPOSITION OF FUNDS

Period Ended	Revenues - ITC and Subsidiaries	PRIDE Support Payments	Revenue Attributed to PRIDE
December 31, 1999 *	$ 5,002,994	$ 5,002,994	100.00%
December 31, 2000	14,718,054	9,905,388	67.30%
December 31, 2001	17,868,492	9,183,504	51.39%
December 31, 2002	16,484,325	6,246,744	37.90%
December 31, 2003	20,256,522	6,639,053	32.77%
June 30, 2004 **	9,760,601	3,439,506	35.24%
TOTAL	$ 84,090,988	$ 40,417,189	48.06%

* July - December only
** January - June only

ITC provides management services to PRIDE and ITC affiliates. As shown in Figure 4, ITC is heavily dependent upon PRIDE as a funding source.

Not only is PRIDE one of ITC's major customers, PRIDE has provided financial support in other ways. In 1999, PRIDE made a significant contribution by transferring by gift to ITC land and buildings. When the properties were sold by ITC, they retained the profits. Also, ITC had access to additional funds through PRIDE's line of credit. During our audit period, ITC was not considered creditworthy and since they could not obtain their own line of credit, they used PRIDE's line of credit to obtain working capital. (ITC's Internal Auditor indicated that as of November 2004, ITC no longer has access to PRIDE's line of credit.) Despite the infusion of PRIDE's assets to the start-up and operations of ITC, financial records indicate ITC has not been profitable since its inception. Net losses each year have been as follows:

1999 (July - Dec.)	$ (130,182.00)
2000	(1,399,102.00)
2001	(4,882,701.00)
2002	(1,869,527.00)
2003	(1,265,145.00)
TOTAL	$ (9,546,657.00)

A financial analysis and calculation of financial ratios for solvency, efficiency and profitability present a bleak picture for ITC. ITC is not solvent in that it has few assets which can be used to pay its current liabilities. The company has no net worth, meaning its liabilities exceed its assets. While ITC appears to be efficient in using its revenues to pay its suppliers, it is not as efficient in collecting its receivables. ITC has not generated any profits therefore there are no returns on assets or sales. The details for each ratio, including how it is calculated, what it represents, what is a desirable ratio and ITC's ratio at December 31, 2003 are contained in Exhibit 4.

Our conclusion is that ITC is not a viable business entity that can promote PRIDE's goals and missions. ITC is an entity struggling to survive. If PRIDE withdrew its support, ITC could not survive in its present form. ITC and its affiliates would have to significantly downsize operations and staff, expand their sales markets, reduce overhead and search for new customers and funding sources. The benefits PRIDE envisioned in the creation of ITC and its affiliates have not been realized and have, to a degree, contributed to the financial decline of PRIDE.

Recommendation:

Given ITC's financial failures and the effect it is having on PRIDE's financial condition, we recommend that the PRIDE Board of Directors sever its relationship. However, if PRIDE chooses to continue the relationship, the basis for that decision should be documented. A key element to be considered by the Board is whether further support of ITC and its affiliates is an effective and efficient use of resources.

Audit Finding #5

PRIDE did not enter into a formal contract with ITC, although required by the letter agreement dated June 30, 1999. Currently, no formal contract exists.

ITC provides assistance, management services and support to PRIDE. The terms under which ITC will operate are set forth in a letter agreement dated June 30, 1999. Per the letter agreement, the central goal of PRIDE and ITC is to work toward the implementation of Prison Industries Enhancement (PIE) Programs. To meet the goal, ITC agreed to perform services such as:

- Training and recruiting employees to work for PRIDE;
- Analyzing data to determine enterprises, people and locations which will complement PRIDE's mission, particularly with respect to PIE programs;
- Providing accounting and payroll support;
- Providing computer support;
- Providing assistance in accounts receivable and collection;
- Entering into banking and financing arrangements;
- Providing human resources services;
- Arranging for employee health, pension, and other benefits;
- Providing assistance in selecting legal representation and
- Providing assistance in acquiring, leasing, constructing and mortgaging real and personal property.

ITC and PRIDE were to develop a more extensive operating agreement to accomplish the goals and purposes of PRIDE with respect to the PIE Programs. The parties contemplated finalizing the operating agreement by December 31, 1999, with a 10-year term. The letter agreement was executed by the President/CEO of ITC (who was also the CEO of PRIDE) and the CFO of PRIDE (who also became the CFO of ITC).

Our audit disclosed that the comprehensive agreement has not been executed. When asked why a formal agreement had not already been executed, PRIDE senior management indicated, "we just didn't get around to it". In June 2004, a proposed agreement was drafted and was to be presented to the Board for approval. At the request of the Chief Inspector General, final approval was deferred until the completion of this audit. Since June 30, 1999, the letter agreement has been the complete agreement of the parties; however, several key issues have arisen over the past five years that are not addressed in the letter agreement, including:

- The repayment terms for money borrowed from PRIDE by ITC,
- The extent to which ITC could use funds from PRIDE's line of credit,
- Transfer of land and buildings from PRIDE to ITC and
- Details of PRIDE initiatives assumed by ITC and ITC's responsibilities.

The provisions relating to such critical issues should have been outlined in a formal document. Without formalization of those provisions, there is no assurance that these matters will be handled in a consistent manner when decisions must be made.

Recommendation:

Given ITC's current financial condition and its inability to meet the goals of the June 30, 1999 agreement, it does not appear reasonable for PRIDE to enter into a formal contract with ITC. We recommend that the PRIDE Board of Directors sever its relationship with ITC. However, if the Board chooses to continue that relationship, the justification should be documented and a formal contract detailing the responsibilities of each party should be immediately executed.

Audit Finding #6

Payments made to ITC by PRIDE for management services have not been in accordance with the June 30, 1999 agreement or sound business practices.

Effective June 30, 1999, a letter agreement was executed between PRIDE and ITC to set forth the terms under which ITC would provide assistance, service and support to PRIDE. With regard to fees to be paid to ITC by PRIDE, the agreement provides:

> "The initial fees for services rendered by ITC will be estimated based on PRIDE's estimated budget as reflected in its financial statements for the period ending June 30, 2000. PRIDE and ITC will work together to schedule, in reasonable detail, the fee to be paid by PRIDE for each of the services outlined in the agreement. The fees will be paid quarterly in advance and will be based on estimated costs incurred by ITC in providing the services. The fee will be adjusted annually to reflect actual costs to ITC of providing the services. PRIDE shall have the right to audit any calculation of these fees."

PRIDE's financial records indicate that PRIDE has made payments totaling $40,417,189 to ITC during the period July 1, 1999 through June 30, 2004 (see chart in Finding No. 4). During 2000 and 2001, ITC's management services fee was calculated at 10% of PRIDE's budgeted revenues. For 2002 and 2003, ITC charged PRIDE a flat rate of 10% of PRIDE's gross sales. Each year, the administrative services fee was included in PRIDE's budget which was approved by the Board; however we found no evidence that the Board was aware of the methodology being used to determine the amounts to be paid to ITC. The ITC charges were not calculated in accordance with the methodology outlined in the June 30, 1999 agreement. Also, payment for services based on the receiving agency's budget or sales are not normal business practice. As of June 30, 2004, neither PRIDE nor ITC had determined actual costs and the amounts paid had not been adjusted accordingly. The possibility exists that ITC may have overcharged PRIDE.

In formalizing the administrative support services agreement between PRIDE and ITC, the June 2004 proposed contract provided that, in addition to PRIDE paying all costs and expenses paid in connection with the performance of the services, the administrative service fee paid to ITC would be 10% of the gross amount of PRIDE's total support and revenues realized from all sources and would be paid until PRIDE and ITC could agree on a fixed monthly amount.

One additional observation is that ITC's cost of providing administrative services may be high. We found no evidence that this possibility was explored because the PRIDE Board/ management did not obtain quotes or bids from other companies as a means of determining the reasonableness of the amounts being charged by ITC. The failure of the PRIDE Board and management to properly monitor the fees paid to ITC has possibly resulted in PRIDE further subsidizing ITC operations to PRIDE's detriment.

Recommendation:

We recommend that PRIDE immediately exercise its right to audit the calculation of fees charged by ITC in prior years. PRIDE should require immediate repayment of any amounts overpaid to ITC. Also, if PRIDE's relationship with ITC continues, the Board should take steps to ensure that ITC is the best company to provide administrative services and that the fee being charged is reasonable. The fee payment calculation should conform to best business practices.

Inspector General's Comment:

In response to Finding No. 6, the PRIDE Chairman indicates that, although PRIDE believes that there have been overpayments in the past, the actual computation of those overpayments would be very difficult and very time consuming to perform. Further, even if an acceptable management service fee could be computed for prior periods, and even if it was less than the actual fee paid, based upon the information in Finding No. 4, it is unlikely that PRIDE would be able to collect on the overpayments. Given ITC's current financial status, the ability to collect any overpayment

FIGURE 5—PRIDE RELATED PARTY RECEIVABLES

As of Dec. 31	Current	Long-Term	Total
1999	$ -	$ -	$ -
2000	$ 3,867,777.00	$ -	$ 3,867,777.00
2001	$ 807,331.00	$ 8,682,751.00	$ 9,490,082.00
2002	$ 1,196,915.00	$ 8,463,973.00	$ 9,660,888.00
2003	$ 1,511,000.00	$ 3,840,459.00	$ 5,351,459.00

does seem unlikely. However, ITC is continuing to operate. In the event that the company does become profitable in the future, PRIDE may have legal recourse for collecting overpayment of fees. As PRIDE continually monitors the likelihood of collecting its receivables due from ITC, periodically PRIDE should also evaluate the feasibility of calculating ITC's cost and the possibility of collecting a refund for any amounts overpaid.

In the response from ITC's Chairman, he indicates ITC does not believe there have been past overpayments. Without a review to determine the actual costs to ITC for the services it provided to PRIDE, that assumption cannot be verified.

Audit Finding #7

PRIDE has loaned/advanced funds to ITC and its affiliates interest-free, without any stated terms of repayment. Also, amounts recorded in PRIDE's financial records as due from ITC and ITC affiliates have been reduced by significant amounts for reasons that were sometimes questionable.

Since the creation of ITC and its affiliates, PRIDE has advanced funds to them for the purpose of funding ITC initiatives. Currently, there are no stated terms of repayment. The related party receivables (amounts due from ITC and its affiliates) that have been reported in PRIDE's financial statements are listed in Figure 5.

The amounts shown for 2002 and 2003 are net of Board-approved reductions of $5,279,190 and $4,106,546, respectively. Our findings on each of these reductions are addressed below.

2002 Reduction of the Amount Due from ITC's Affiliates

In 2002, PRIDE management requested approval from the Board to reduce the amounts due from RISE[3] ($1,572,926 reduction), Global ($1,945,042 reduction) and DSM ($1,775,622 reduction) totaling $5,293,590. The Board approved a reduction of $5,279,190. PRIDE's 2002 Annual Report indicates:

> PRIDE and ITC concluded that ITC would not benefit from certain initiatives as PRIDE had assumed responsibility for administering them. As a result, it was agreed that PRIDE would assume the initial and the majority of the operational costs of these initiatives. Management identified these initiatives, isolated the costs and adjusted the amount due from ITC.

We were unable to verify which PRIDE initiatives were transferred to ITC (see Finding #5) and which initiatives were re-assumed by PRIDE. The validity of the reasons for the reduction of receivables is questionable. We noted:

- RISE became Labor Line, Inc, (LLI) and Labor Line Service (LLS) which are both currently subsidiaries of ITC. RISE's mission to assist PRIDE inmates and the mainstream population in finding jobs was assumed by LLI. LLI generates income by

[3] RISE (Renewed for Industries, Services and Employment) was a tax exempt organization established to provide job placement and related services for ex-offenders and other underemployed persons. In addition, RISE organized a network of services that enhance the participants' ability to stay on the job. These services included support during the transition of ex-offenders from prison to the community. The organization was supported by PRIDE through an operations agreement to secure job placement for 400 PRIDE inmates upon their release.

providing temporary employment services to hard-to-place individuals, such as low income or under employed persons. ITC staff estimates that approximately 60% of the individuals on LLI's staff available for temporary employment are ex-offenders. LLS assumed Rise's second mission, which was to provide transitional (from prison back to the community) support to PRIDE inmates upon their release from prison. PRIDE pays a monthly fee to LLS for providing this service for PRIDE inmates. Currently, LLS provides services only to former PRIDE inmates. It appears that Labor Line, Inc. and Labor Line Services, not PRIDE, have assumed the RISE initiative.

- Global's current mission is to establish private enterprise partners that would increase inmate jobs and provide inmate training. The reduction in the amount owed to PRIDE was related to organization and process development costs for this purpose, which appear to be directly related to the mission of Global.

- DSM's mission was to purchase and provide services and products from and to minority-owned vendors and customers. ITC is a 40% shareholder in the company. As an ITC initiative, it is unclear as to why this company's obligation to PRIDE was written off rather than being assumed by ITC.

While PRIDE's financial statements explained the reduction in receivables as being a result of PRIDE assuming responsibility for certain initiatives, the information presented to the Board for approval of the asset write downs indicated a different reason. The information provided to the Board indicated the reductions were necessary because certain obligations may have been over-valued given the market conditions at the time. In order to reflect a more conservative valuation, a write down was recommended. Board minutes and corresponding documents did not provide an explanation of how these project costs were determined to be over-valued and how the more conservative valuation amounts were calculated. Minutes were not available from meetings of the Finance Committee, which should have been involved in this decision making process.

Neither explanation provides a clear justification for the 2002 reduction.

<u>2003 Reduction of Amount Due from ITC</u>
The $4,106,546 reduction in 2003 related to PRIDE's pension obligations to ITC. PRIDE's 2003 Annual Report indicates:

> This obligation relates to the fact that for the years ended December 31, 2002 and 2003, the defined benefit pension plan was underfunded due to market losses and changes in actuarial assumptions. The obligation represents PRIDE's share of the additional pension expense incurred by ITC. It was actuarially determined based on the participation of PRIDE employees in the plan, PRIDE employees account for approximately 93% of the total obligation. It was recognized by reducing PRIDE's receivable from ITC.

This transaction did not result in a decrease in the amount by which the pension plan was under funded; it simply shifted the obligation from PRIDE to ITC. Given ITC's current financial condition, concerns are raised as to how they (ITC) will pay the obligation when it becomes due. As of June 30, 2004, sponsorship of the defined benefit pension plan has been transferred back to PRIDE. As a result, the $4.1 million effectively paid by PRIDE to ITC at December 31, 2003 for its share of the unfunded pension liability must be transferred back to PRIDE. PRIDE staff indicated that the appropriate accounting entries have been drafted and will be included in the accounting records and financial statements for the fiscal year ended December 31, 2004.

<u>Recommendation:</u>

We recommend that the PRIDE Board determine whether either of the explanations for the 2002 accounts receivable reduction– assumption of initiatives or adjustment for overvaluation of assets - is valid. Documentation should be obtained from management providing the details of the transactions and the basis for the decision to request the reduction. If it is determined that the transaction, or any portion thereof, was not valid, PRIDE should demand payment of the invalid amount.

In addition, if PRIDE chooses to continue its relationship with ITC, documents should be prepared to memorialize the bases on which the decision was made to allow the $5,279,190 reduction in receivables.

For the 2003 write-down, the appropriate PRIDE staff should monitor the proposed accounting entry to ensure that it is properly recorded at fiscal year end.

Audit Finding #8

Management had not established a policy setting limits on the amount of funds that can be used to support ITC and its affiliates. The lack of such a policy has resulted in significant advances being made to ITC and its affiliates at the expense of PRIDE's financial welfare.

Risk assessment is the entity's identification and analysis of relevant risks to achieve its objectives, forming a basis for determining how risks should be managed. Such an assessment should have been made by PRIDE's management prior to recommending advances to support the activities of ITC and its affiliates and should have been reviewed by the PRIDE Board prior to approving the advances especially since PRIDE was concerned about its own decreasing sales volume and revenues.

The PRIDE Board of Directors approved the use of PRIDE resources to provide funding to ITC or business ventures established by ITC. Criteria for the basis of decisions relating to the amounts advanced to the affiliates were not provided for our examination. PRIDE did not have an overall plan outlining the criteria whereby PRIDE's resources would be evaluated and a determination made as to the specific amount of venture capital that was available for the new businesses. Such a plan should include criteria that would be used as a basis for approving or disapproving a specific funding proposal, procedures for evaluating PRIDE's financial condition to determine the level of funding that could be safely committed, the balance to be achieved between profitability and achievement of the societal mission and the criteria for deciding whether to continue or discontinue support of the project.

Consider PRIDE's relationship with Florida Citrus Producers. This entity is a recently created affiliate of ITC that was established to take over the operations of the citrus processing operation in 2004 as Florida Citrus Partners (FCP) was winding down operations due to a legal dispute between ITC and its partner. At the July 22, 2004 PRIDE Board meeting, ITC indicated that it could no longer manage and run the operation. PRIDE's Board Chairman indicated that since PRIDE owned most of the FCP assets, a determination should be made regarding taking over the operations or allowing ITC to shut it down. Per the minutes, after significant discussion, the PRIDE Board unanimously approved a $390,000 line of credit to ITC for the continuation of Florida Citrus Producers operation through December 2004. This decision was made without the benefit of an investment policy, during a time when PRIDE was experiencing immediate cash flow problems and ITC's ability to pay its current receivable to PRIDE was doubtful. A clearly defined investment plan outlining the level of support PRIDE would provide to Florida Citrus Producers or any other entity would have provided some assurance that all risks were considered and the decision made was based on a proper consideration of those risks. (Note: At the September 16, 2004 Board meeting, PRIDE management advised the Board that PRIDE did not have the money to fund the line of credit approved for Florida Citrus Producers. The Board unanimously agreed to withdraw the line of credit extended on July 22, 2004.)

Recommendation:

PRIDE should establish a financially sound policy for evaluating all investments. Future investment decisions should be firmly grounded in a plan geared to attaining the projected return on the investment.

Audit Finding #9

The amounts paid to PRIDE and ITC executives were not reasonable considering the companies' financial condition.

In many ways, PRIDE and ITC function like private sector businesses. Private sector practice would dictate that salary increases for senior managers be based on operational performance of the company. Given the recent state of the economy, the decline in PRIDE and ITC revenues and net assets, and in comparison to the level of compensation provided to managers in similar programs in other states and not-for-profit organizations, it appears that the amount of compensation provided to some PRIDE and ITC executives is excessive.

In performing our analysis of salary increases, we made the assumption that an average annual increase of 10% or less was reasonable. That assumption is conservative and may be too high relative to the declining financial condition of the entities and the current U.S. salary trends. Using this assumption, the salary increases (including bonuses) given to some senior managers appeared to be unreasonable. From 1998 to 2004, the increases given to PRIDE's President and Vice President of Operations and ITC's President/CEO and CFO averaged more than 14% annually. (See Exhibit 5.)

We obtained the Association Executive Compensation and Benefits Study, Fourteenth Edition, produced by the American Society of Association Executives. We used this document to help assess the reasonableness of the ITC President/CEO's compensation. The total compensation of the President/CEO falls within the salary range for a CEO within a trade association with a budget of $15 million or more (the industry type of the organizations within this category were not determinable). However, in a separate analysis, we noted that the total compensation paid to the ITC President/CEO exceeded the $245,250 maximum annual salary for CEOs surveyed in the manufacturing category. Based on our review of information obtained from prison industry programs in other states, PRIDE and ITC executives' salaries greatly exceeded (and in some cases were more than double) that paid to the chief executives managing those programs, including California, which generates annual revenues of approximately $160 million.

The Chairman of the Board approves the salaries and bonuses for the executive management team. Accountability for the results of decisions made which have adversely affected the financial status of the entities appears to be lacking.

Our review also disclosed that a supplemental executive retirement plan was initiated by ITC effective October 1, 2001. The ITC plan provided for supplemental retirement benefits for senior managers. Ten years of service was required to qualify for benefits. Benefits were payable over a 15 year period calculated at 40% for 10 years of service, 45% for 11 years but less than 16 years of service, 50% for 16 years but less than 20 years of service, and 60% for over 20 years of service. These amounts will be reduced by amounts received from the defined benefit plan. Payments into the supplemental retirement plan totaled $357,226 as of June 30, 2004. Currently, ITC's President/CEO and CFO and Global's COO qualify for this plan.

Recommendation:

We recommend that the PRIDE and ITC Boards revisit their policies for calculating salary increases and bonuses. Not only should the attainment of operational goals (e.g., number of products produced; meeting contract deadlines, etc.) be considered but goals related to the financial growth of the company should also be included. The attainment of those goals and the company's ability to pay should be the basis for determining the amount of salary increases given. Justification for the supplemental executive retirement plan should be documented.

EXHIBIT 1—PRIDE AND ITC BOARD OF DIRECTORS

PRIDE Board of Directors
(prior to December 31, 2004)

Maria Camila Leiva, Chairman
Pamela Davis, CEO (until July 22, 2004)
Jack Edgemon, Interim CEO
(as of September 29, 2004)
John F. Bruels, President
(until July 22, 2004)
Kenneth L. Mellem
Lawrence W. Hamilton
Marcelo A. Alvarez
William G. Dresser
Richard L. Hanas
Walter B. "Mike" Hill
James V. Crosby
Edward C. Peddie
Carol S. Spalding
Gwendolyn W. Stephenson
Derrick D. Wallace (until July 22, 2004)

ITC Board of Directors
(prior to December 31, 2004)

Randall L. May, Chairman
Pamela Davis, President/CEO
Maria Camilla Leiva (until December 16,2004)
Kenneth Mellem (until December 22, 2004)
Lawrence Hamilton (until December 31, 2004)
Marcelo Alvarez (until December 17, 2004)
Cecilia Bryant
R. Ray Goode
James E. Huff
Roy Harrell, General Counsel

Exhibit 2—Key Employees, PRIDE, ITC and Affiliates—1999-2004

	Date Filed*	Pamela Davis	Mike Smith	Mike Jouret	Mike Harrell	Jack Edge-mon	Bea Bat-tistoni	Bob Bury	Esther Knightly
PRIDE, Inc.	12/14/81	CEO **	CFO			VP – Ops., Interim CEO **			AS****
ITC	4/22/99	P/CEO, D	VP, CFO	IA					S
Labor Line Services, Inc.	1/18/96	CEO, D	T						S
Labor Line, Inc.	9/13/99	CEO, D	T				VP		S
Florida Citrus Partners, LLC	7/8/99	Mgr			Mgr				
Florida Citrus Producers, Inc.	6/10/04	D			Mgr				D
Diversified Supply Mgt, Inc.	6/6/02	D	AT						AS
Northern Out-fitters	11/4/93							P	
Global Out-sourcing, Inc.	1/5/99	CEO, D	T		COO				S
Global Reman Services, Inc.	6/10/04	D							

Legend

CEO ....Chief Executive Officer
CFO.....................................Chief Financial Officer
COO ....Chief Operating Officer
P ....President
VP .... Vice President
IA ....Internal Auditor
T .... Treasurer
Mgr.. Manager
D..Director
S .... Secretary
A..Assistant

Note: Excluding Northern Outfitters, the Department of State, Div. Of Corp. database lists all organizations above as *Active* and the principal and mailing addresses for all organizations are 12425 28th St. North; Suite 103; St. Petersburg, Florida 33716.

* Date corporation documents filed with Department of State, Division of Corporations.
** Ms. Davis served as CEO until July 22, 2004. Mr. Edgemon was appointed as Interim CEO, effective September 29, 2004.
*** Mr. Smith served as CFO until November 30, 2004.
**** Ms. Knightly served as Assistant Secretary until May 2003.

EXHIBIT 3—PRIDE RATIO ANALYSES AS OF DECEMBER 31, 2003

PRIDE's Ratio Analysis at December 31, 2003	PRIDE's Ratio	Standard Ratio	Favorable/ Unfavorable
Quick Ratio	.68:1	Greater than 1:1 is desirable	Unfavorable
Current Ratio	1.7:1	2:1 or higher	Unfavorable
Current Liabilities to Net Worth Ratio	38%	50% or less is desirable	Favorable
Total Liabilities to Net Worth Ratio (Debt to Equity)	Approximately 50%	Not to exceed 100%	Favorable
Fixed Assets to Net Worth	67%	75% or less	Favorable
Collection Period Ratio	37 days	40 days or less	Favorable
Assets to Sales Ratio	59%	Greater than 25%, lower than 75%	Favorable
Sales to Net Working Capital Ratio	9.11	Less than or equal to 11	Favorable
Accounts Payable to Sales Ratio	6.41%	8.5% or lower	Favorable for 12/31/03
Return on Sales	-3.35%	Should be positive	Unfavorable
Return on Assets	-5.64%	Should be positive	Unfavorable
Return on Net Worth	-8.41	Should be positive	Unfavorable
Gross Margin Percentage	12.8%	33% manufacturing & 82% for services. Combined weighted average 60%	Unfavorable
Operating Expenses as a Percentage of Sales	13%	Range from 18% to 43%	Favorable
Total Expenses as a Percentage of Sales	103.3%	61% to 87.5%. Combined weighted average 76.6%	Unfavorable

PRIDE's ratio analyses are as follows:

Quick Ratio: ***Unfavorable*** - A solvency ratio that measures the extent to which a business can cover its current liabilities with those current assets readily convertible to cash, a ratio greater than 1:1 is desirable.[4] PRIDE's ratio of 68% or (.68:1) at December 31, 2003 shows that the company is not in a liquid position and may have difficulties in meeting its current obligations without further leveraging or selling off of property and equipment. PRIDE has not been considered in a liquid position since December 31, 1999.

[4] Source—American Express Small Business Resources Understanding Financial Ratios

Current Ratio: ***Unfavorable*** - A solvency ratio that measures the degree to which current assets cover current liabilities. The higher the ratio, the more likely the company will be able to meet its liabilities. A ratio of 2:1 or higher is standard.[5] PRIDE's current ratio is 1.7:1 and has not been over 2:1 since December 31, 2000.

Current Liabilities to Net Worth Ratio: ***Favorable*** **–** A solvency ratio that indicates the amount due creditors within a year as a percentage of the net assets or net worth. A ratio less than or equal to 50% is desirable and according to Dun & Bradstreet,[6] a business starts to have trouble when this relationship exceeds 80%. For PRIDE this ratio at December 31, 2003 is 38% and has never exceeded 50%.

Total Liabilities to Net Worth Ratio (Debt to Equity): ***Favorable*** **–** A solvency ratio that shows how all of the company's debt relates to the equity or net assets. The higher this ratio, the less protection there is for creditors. Generally, this ratio should not exceed 100% because at this point creditors would have more at stake than owners. PRIDE's ratio is approximately 50% at December 31, 2003, total liabilities have never exceeded net worth.

Fixed Assets to Net Worth: ***Favorable*** **–** A solvency ratio that shows the percentage of assets centered in fixed assets compared to total equity. According to Dun & Bradstreet,[7] the higher this percentage is over 75%, the more vulnerable a concern becomes to unexpected hazards and business climate changes. Capital is frozen in the form of property and equipment and the margin for operating funds becomes too narrow to support day-to-day operations. For PRIDE, this ratio was 67% and has never exceeded 75%.

Collection Period Ratio: ***Favorable*** **–** An efficiency ratio that is helpful in analyzing the collectibility of accounts receivable, or how fast a business can increase its cash supply. For PRIDE, the collection period has been approximately 37 days for the last three years. Generally, where most sales are for credit, any collection period more than one-third over normal selling terms (40 for 30-day terms) is indicative of some slow-turning receivables. Because PRIDE operates in multiple industries a general collection period of 37 days indicates no slow turning accounts receivable.

Assets to Sales Ratio: ***Favorable*** **–** An efficiency ratio that rates sales to the total investment that is used to generate those sales. This ratio ties in sales and the total investment that is used to generate those sales. Abnormally low percentages (above the upper quartile) can indicate overtrading, which may lead to financial difficulties if not corrected. Extremely high percentages (below the lower quartile) can be the result of overly conservative or poor sales management, indicating a more aggressive sales policy may need to be followed.[8] PRIDE's assets to sales ratio is 59% on December 31, 2003 and indicates no issues.

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[5] Source—American Express Small Business Resources Understanding Financial Ratios
[6] Source—Dun & Bradstreet—Fourteen Key Business Ratios
[7] Source—Dun & Bradstreet—Fourteen Key Business Ratios
[8] Source—Dun & Bradstreet—Fourteen Key Business Ratios

Sales to Net Working Capital Ratio: ***Favorable*** **–** An efficiency ratio that measures the number of times working capital turns over annually in relation to net sales. This relationship indicates whether a company is overtrading or conversely carrying more liquid assets than needed for its volume. PRIDE's sales to working capital ratio is 9.11 times. An average range of annual sales to net working capital listed as 11.0 and under as measured by insurance industry analysts.[9] A high turnover may indicate that the business relies extensively upon credit granted by suppliers or the bank as a substitute for an adequate margin of operating funds.

Accounts Payable to Sales Ratio: ***Favorable*** **–** An efficiency ratio that measures how the company pays its suppliers in relation to the sales volume being transacted. For PRIDE this ratio was 6.41% as of December 31, 2003. A low percentage would indicate that the entity generally pays its suppliers when bills are due. Whereas a higher percentage would indicate that the entity may be using suppliers to help finance operations. PRIDE appears to have a ratio indicating that its suppliers are being paid on time or within 23 days (6.41% * 365 days). This may not be indicative of the daily account balances during the fiscal year.

Return on Sales: ***Unfavorable*** **–** A profitability ratio that measures profits after taxes on the year's sales (profits earned per dollar of sales). PRIDE's return on sales was –3.35% for the year ended December 31, 2003 and since 1999 has averaged –3.43%, therefore no return on sales has been recognized.

Return on Assets: ***Unfavorable*** **–** A profitability ratio that is the key indicator of profitability according to Dunn & Bradstreet.[10] PRIDE's return on assets for the year ended December 31, 2003 was –5.64% and since 1999 has averaged –4.85%, again showing no return.

Return on Net Worth: ***Unfavorable*** **–** A profitability ratio that measures the ability of a company's management to realize an adequate return on the capital invested. PRIDE's return on net worth for the year ended December 31, 2003 was –8.41 and has averaged -7.00 percent since 1999, again showing no return.

Gross Margin Percentage: ***Unfavorable*** **–** A profitability ratio that measures gross profit as a percentage of sales. For PRIDE this percentage was 12.8% as of December 31, 2003 and averaged 11.1% for all years since 1999 indicating a very slim gross margin. When compared to a composite of businesses with similar product mixes,[11] these businesses had a gross margin percentage of ranging from 33% for manufacturing to 82% for service businesses and a weighted average of 60% based on the same proportion of sales as PRIDE.

Operating Expenses as a Percentage of Sales: ***Favorable*** **–** A profitability ratio that measures operating expenses as a percentage of sales. This ratio for PRIDE was 13.0% for the year ended December 31, 2003. The average for all years since 1999 was 13.4% indicating very low operating expenses. A composite of business with similar product mixes,[12] shows these businesses had operating expenses ranging between 18% and 43% of sales.

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[9] Source—Surety Company of the Pacific Ratio Table
[10] Source—Dun & Bradstreet—Fourteen Key Business Ratios
[11] Source—BizStats.com—Average Profitability and Expense Percentages for U.S. Small Businesses
[12] Source—BizStats.com—Average Profitability and Expense Percentages for U.S. Small Businesses

Total Expenses as a Percentage of Sales: *Unfavorable* – A profitability ratio that measures total expenses as a percentage of sales. This ratio for PRIDE was 103.3% of sales and averaged 104.2% since 1999, indicating a serious and chronic profitability issue. Compared to a composite of businesses with similar product mixes[13] that show the total expenses ranged from 61% to 87.5% and a weighted average of 76.6% for these businesses.

[13] Source—BizStats.com—Average Profitability and Expense Percentages for U.S. Small Businesses

EXHIBIT 4—ITC RATIO ANALYSES AS OF DECEMBER 31, 2003

ITC's Ratio Analysis at December 31, 2003	ITC's Ratio	Standard Ratio	Favorable/ Unfavorable
Quick Ratio	.75:1	Greater than 1:1 desirable	Unfavorable
Current Ratio	1:1	2:1 or higher	Unfavorable
Current Liabilities to Net Worth Ratio	-78%	50% or less is desirable	Unfavorable
Total Liabilities to Net Worth Ratio (Debt to Equity)	-256%	Not to exceed 100%	Unfavorable
Fixed Assets to Net Worth	-35%	75% or less	Unfavorable
Collection Period Ratio	Avg 61 days	40 days or less	Unfavorable
Assets to Sales Ratio	45%	Greater than 25%, Less than 75%	Favorable
Sales to Net Working Capital Ratio	No working Capital	Less than or equal to 11	Unfavorable
Accounts Payable to Sales Ratio	2.31%	8.5% or lower	Favorable
Return on Sales	-2.98%	Should be positive	Unfavorable
Return on Assets	-1.27	Should be positive	Unfavorable
Return on Net Worth	No history of any returns on investments	Should be positive	Unfavorable

ITC's ratio analyses are as follows:

Quick Ratio: *Unfavorable* - A solvency ratio that measures the extent to which a business can cover its current liabilities with those current assets readily convertible to cash, a ratio greater than 1:1 (100%) is desirable.[14] ITC's ratio of 75% (.75:1) at December 31, 2003 shows that the company is not in a liquid position and may not be able to pay its current liabilities. ITC has not been considered liquid since December 31, 2000.

Current Ratio: *Unfavorable* - A solvency ratio that measures the degree to which current assets cover current liabilities. The higher the ratio, the more likely the company will be able to meet its liabilities. A ratio of 2:1 (200%) or higher is desirable.[15] ITC's current ratio is nearly 1:1 and has not been over 2:1 since December 31, 1999.

Current Liabilities to Net Worth Ratio: *Unfavorable* - A solvency ratio that indicates the amount due creditors within a year as a percentage of the net assets. According to Dun & Bradstreet,[16] a business starts to have trouble when this relationship exceeds 80%. For ITC this ratio at December 31, 2003 is -78% and has never exceeded 50%.

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[14] Source—American Express Small Business Resources Understanding Financial Ratios
[15] Source—American Express Small Business Resources Understanding Financial Ratios
[16] Source—Dun & Bradstreet—Fourteen Key Business Ratios

Total Liabilities to Net Worth Ratio: ***Unfavorable*** - A solvency ratio that shows how all of the company's debt relates to the equity or net assets. The higher this ratio, the less protection there is for creditors. ITC's ratio is approximately –256% at December 31, 2003, net worth has never exceeded total liabilities.

Fixed Assets to Net Worth: ***Unfavorable*** - A solvency ratio that shows the percentage of assets centered in fixed assets compared to total equity. According to Dun & Bradstreet,[17] the higher this percentage is over 75%, the more vulnerable a concern becomes to unexpected hazards and business climate changes. Capital is frozen in the form of property and equipment and the margin for operating funds becomes too narrow to support day-to-day operations. For ITC, this ratio was -35% and was at 74% at December 31, 2000 but has never exceeded 75%.

Collection Period Ratio: ***Unfavorable*** - An efficiency ratio that is helpful in analyzing the collectibility of accounts receivable, or how fast a business can increase its cash supply. For ITC, the collection period averages 61 days. Generally, where most sales are for credit, any collection period month than one-third over normal selling terms (40 for 30-day terms) is indicative of some slow-turning receivables. ITC appears to have slow-turning receivables. This may indicate that ITC may have accounts receivable that are uncollectible or that ITC grants terms in excess of 30 days.

Assets to Sales Ratio: ***Favorable*** - An efficiency ratio that rates sales to the total investment that is used to generate those sales. This ratio ties in sales and the total investment that is used to generate those sales. Abnormally low percentages (above the upper quartile) can indicate overtrading, which may lead to financial difficulties if not corrected. Extremely high percentages (below the lower quartile) can be the result of overly conservative or poor sales management, indicating a more aggressive sales policy may need to be followed.[18] ITC's assets to sales ratio are 45% on December 31, 2003 and indicates no issues.

Sales to Net Working Capital Ratio:***Unfavorable*** **–** An efficiency ratio that measures the number of times working capital turns over annually in relation to net sales. Should be viewed in conjunction with the assets to sales ratio. ITC's sales to working capital ratio is over extraordinarily high because it has virtually no working capital at December 31, 2003.

Accounts Payable to Sales Ratio: ***Favorable*** - An efficiency ratio that measures how the company pays its suppliers in relation to the sales volume being transacted. For ITC this ratio was 2.31% as of December 31, 2003. A low percentage would indicate a healthy ratio. A high percentage indicates the firm may be using suppliers to help finance operations.

Return on Sales: ***Unfavorable -*** A profitability ratio that measures profits after taxes on the year's sales (profits earned per dollar of sales). ITC's return on sales for the year ended December 31, 2003 was –2.98% and since 1999 has averaged –8.57%, therefore no return on sales has ever been recognized.

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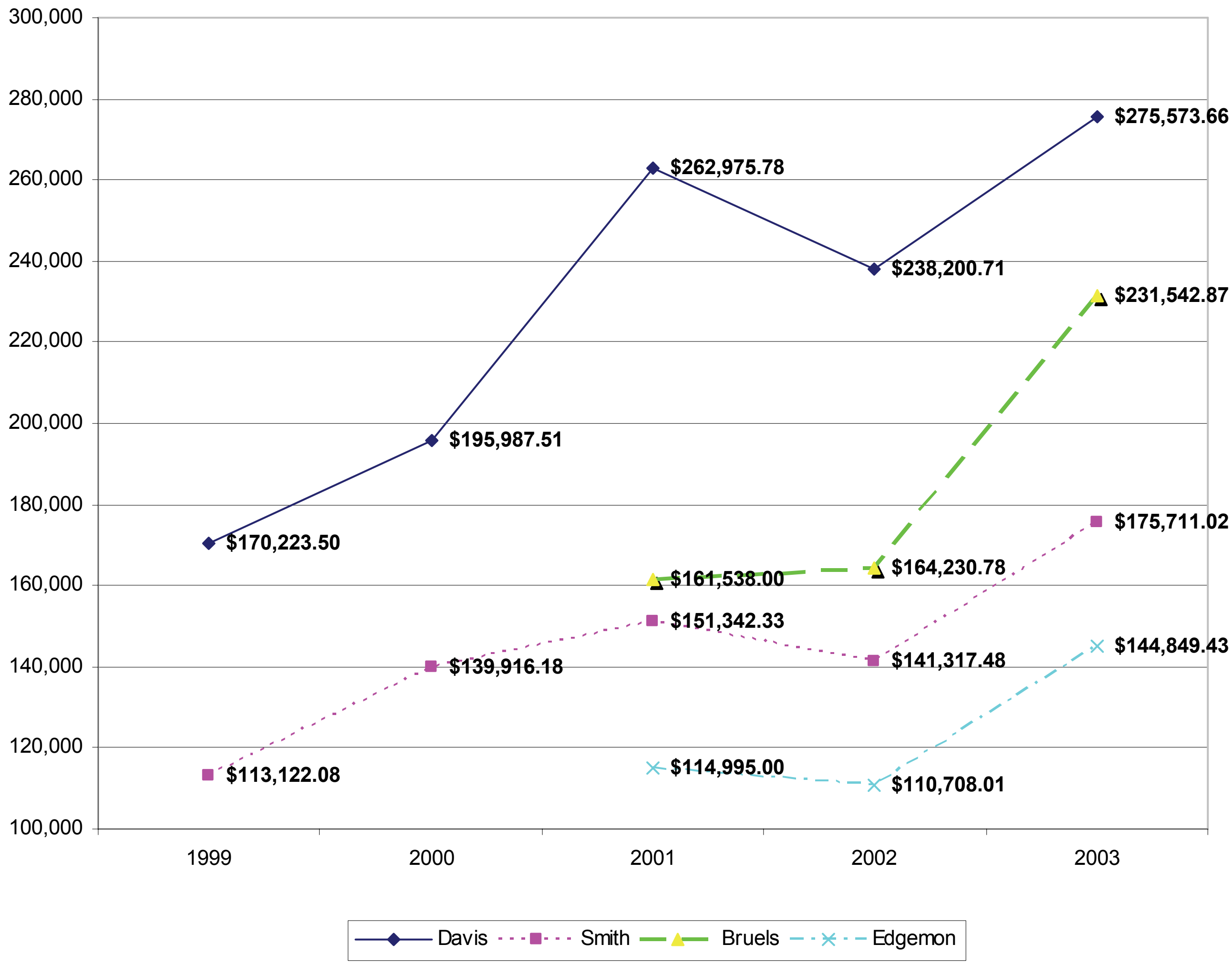
[17] Source—Dun & Bradstreet—Fourteen Key Business Ratios
[18] Source—Dun & Bradstreet—Fourteen Key Business Ratios

Return on Assets: ***Unfavorable*** - A profitability ratio that is the key indicator of profitability according to Dun & Bradstreet.[19] ITC's return on assets for the year ended December 31, 2003 was –1.27% and the average since 1999 has been –12.87%, again showing no return.

Return on Net Worth: ***Unfavorable*** - A profitability ratio that measures the ability of a company's management to realize an adequate return on the capital invested. ITC has never provided a return on investment.

[19] Source—Dun & Bradstreet—Fourteen Key Business Ratios

Exhibit 5—Salary progression for Key PRIDE and ITC Employees—1999-2003



Note 1: The amounts shown are total compensation consisting of salary and bonuses.
Note 2: The 2001 salary shown for Bruels (PRIDE's President) is annualized based on his actual salary for the period August 1, 2001 (employment date) through December 31, 2001.

PRIDE
ENTERPRISES

January 13, 2005

RECEIVED
JAN 19 2005

Mr. Derry Harper
Chief Inspector General
Ms. Kim Mills
Director of Auditing
Office of the Inspector General
The Capitol
Tallahassee, Florida 32399-0001

Dear Mr. Harper & Ms. Mills:

Attached please find our comments and actions planned in response to your preliminary audit report.

Sincerely,

Maria Camila Leiva

Maria Camila Leiva
Chairman of the Board
PRIDE, Inc.

cc: Governor Jeb Bush

12425 28th Street N., St. Petersburg, FL 33716
Tel: 727-572-1987 ■ SunCom 568-1300 ■ Fax: 727-570-3370 ■ Website: www.peol.com

AUDIT DISCUSSION

The Inspector General staff has reviewed the records and activities of PRIDE for the period from January 1999 through December 2004. We believe the audit was a constructive process that objectively evaluated the organizational structure of PRIDE, its management practices and controls, and its organizational relationship with ITC and affiliates. The following paragraphs highlight some of the points that we feel are germane to the audit findings.

During the three-month audit, PRIDE fully cooperated with the auditors and made full disclosure of all requested information. The PRIDE Board is made up of volunteers that are well respected in their field and brings a level of expertise to the board that is useful and necessary. The board is willing and able to implement the recommendations and determined to ensure that PRIDE continues to successfully complete its mission.

Although the audit report was generally critical of the business operations of PRIDE and the oversight performance of the Board of Directors, it is important to note that there were no findings of any wrongdoing by anyone associated with PRIDE.

PRIDE has completed the organizational and operational separation from ITC and its affiliates. Dual management and dual board positions between PRIDE and ITC no longer exist. Further, processes are being put into place by PRIDE management that will improve the quality and timeliness of information supplied to the Board of Directors, which will enhance their oversight capabilities.

We acknowledge that PRIDE has experienced cash-flow problems in the past, which were noted in the audit findings. However, our financial position has greatly improved within the past six months and we are confident that PRIDE can manage any short-term cash-flow difficulties in the future; PRIDE expects to see significant growth in both revenue and income during 2005.

PRIDE is committed to its statutory mission of enhancing vocational training for inmates, promoting security in state correctional institutions, and reducing the cost of state government by effectively administering a correctional work program that replicates, to the extent possible, a free enterprise environment. PRIDE's Mission has a noble purpose, one that PRIDE employees strive to achieve daily. The value of the PRIDE Mission to the State of Florida should be recognized, as it was in the December 2003 OPPAGA report.

It should be noted that PRIDE does not receive government funding. PRIDE funds all of its operations, vocational training and job placement services entirely from the proceeds of its business operations. PRIDE's customers are not mandated by statute to buy from PRIDE. Instead, we, like every successful company, are dedicated to earning our customers' business based upon the merits of our products and services.

AUDIT FINDINGS

Finding # 1: The organizational and operational relationship between PRIDE and ITC continues to be flawed in large measure because PRIDE initially adopted a corporate and governance structure which was inconsistent with the Florida Statutes applicable to managing and leasing correctional work programs.

Recommendation: Given ITC's poor financial performance and current financial state, we recommend that PRIDE discontinue its relationship with ITC.

Discussion: The organizational aspects of PRIDE and ITC were aided by outside professionals. Operational aspects evolved with and without this guidance but were favorably commented on by the Office of Program Policy Analysis and Government Accountability (OPPAGA) Report of December 2003. OPPAGA suggested more transparency however. We take both the Inspector General's and OPPAGA's comments very seriously and will continue to implement all recommendations.

Response: Recommendation has been implemented, specifically: PRIDE has discontinued its organizational and contractual relationship with ITC. It has terminated the ITC service agreement and separated its bank accounts from ITC. There are no dual management positions or common Board Members between PRIDE and ITC. Lastly, the inmate transition services have been re-assumed by PRIDE from Labor Line Services.

Finding # 2: Management's system of internal controls was inadequate to ensure effective, efficient and proper use of resources.

Recommendation: PRIDE Board should review the present management structure and implement a system of internal controls adequate to ensure the objectives of the enterprise are fulfilled.

Discussion: We generally agree that internal controls were potentially flawed by organizational structure and dual management responsibilities. Dual CEO and CFO positions potentially compromised the independence and objectivity of information provided to the Board. In addition, the internal audit position should have been a PRIDE position reporting directly to the PRIDE Board Audit Committee, which would have then ostensibly received better and more unbiased information. Finally, we recognize that the composition of the Board of Directors, whose bylaws designates the PRIDE CEO as a board member, can unintentionally provide management with an opportunity to influence the board member selection process.

Response: The PRIDE Board has taken action as recommended and will conduct continuing reviews. To date, the PRIDE Board has taken steps to strengthen PRIDE's internal controls. For example, the PRIDE Bylaws have been amended to remove the CEO/President as a member of the Board of Directors. All dual management positions and dual board memberships have been eliminated. All board meetings, including committee meetings, are voice recorded and have formal minutes prepared. Lastly, the internal auditor has been re-designated as a PRIDE position reporting directly to the PRIDE Board Audit Committee.

Finding # 3: PRIDE experienced a significant financial decline from July 1, 1999 to December 31, 2003, recently resulting in cash flow difficulties.

Recommendation: We recommend that PRIDE take measures to reduce and eventually eliminate the trend toward financial and economic decline. These efforts should include a careful review of how PRIDE's funds are used and the elimination of financial support for any business ventures, including ITC and its affiliates, which are not generating profits for PRIDE.

Discussion: In the audit discussion, there were two comments that we feel deserve clarification. First, the report states that: "In its current financial state, PRIDE has not been able to meet its financial obligations." This statement would have been more factual if the phrase, "in a timely manner", would have been added. PRIDE has consistently met all of its payroll, tax, vendor, and bank obligations and it has NEVER defaulted on any outstanding obligation. As of September, payment of invoices is averaging 40 days, which is only 10 days over normal terms. Although that is certainly not our goal, it is neither uncommon in business nor indicative of a company that is unable to meet its financial obligations.

Secondly, the statement that "PRIDE is not considered a profitable entity" is a technically accurate but misleading statement. PRIDE has been and continues to be profitable when viewed strictly on the basis of its overhead and operating units. In addition to the State of Florida's belt tightening as a result of September 11th and the subsequent major decline in sales to the State, PRIDE's net operating income has been severely impacted by the unfavorable financial performance of ITC and its affiliates as well as the cost of the services provided by those entities.

As a result of the closure/consolidation of several unprofitable business units and the reduced payment of service fees, PRIDE has realized a significant cost savings in the fourth quarter. However, despite the cost saving achievements and the gross profit generated from ongoing operations, the final end of the year income statement will reflect a net operating loss of approximately $13 million. The loss will be the direct result of a voluntary reserve established to offset the potentially uncollectable ITC and Related Party debt owed to PRIDE. The reserve is a non-cash event and will not adversely impact PRIDE's ability to pay any of its obligations. The reserve does not forgive the debt owed to PRIDE by ITC; PRIDE will continue its collection efforts.

Response: Agree with the recommendations and offer the following actions as examples of implementation:

- PRIDE has established a periodic review mechanism for under performing business units. During the past six months, this review has resulted in the closure of 3 businesses, the consolidation of 3 more, the establishment of profitability improvement plans with quarterly reviews for an additional four business units.

- Implemented a Cash Conservation Plan in July that focused operating unit management attention on reducing their accounts receivable, inventory levels, operating expenses, and non-safety related capital spending.
- Re-defined in September 2004 the process for new business/business expansion funding to require, as a minimum, the following steps: preparation of a detailed business plan with clearly defined goals and metrics; submission of the plan to the Board for review and funding decision; for the first year, a quarterly management review (with a corresponding report to the Board) of the new venture's performance to plan.
- Initiated in August 2004 an adjacent market expansion strategy as part of an overall company focus on revenue growth.
- Proposed a conservative 2005 budget that should generate a significant net operating income while also generating sufficient cash to support operations and reduce short-term debt.

Finding # 4: ITC is a financially troubled entity and its current financial condition raises concerns as to whether it will be able to continue to operate.

Recommendation: Given ITC's financial failures and the effect it is having on PRIDE'S financial condition, we recommend that the Board of Directors sever its relationship with ITC.

Discussion: Since PRIDE does not have access to ITC financial information, we cannot elaborate on the findings or provide comment as to ITC's current financial status. We can confirm that the ITC and Related Party debt to PRIDE increased approximately $7.2 million in 2004, of which $5.1 million was related to PRIDE's re-assumption of the pension obligation.

Response: Recommendation has been implemented. Specifically, the PRIDE Board Members, who were also ITC Board Members, have resigned from the ITC Board of Directors effective December 2004. All dual PRIDE-ITC management positions were eliminated as of 11-30-04. Finally, all operating agreements and contracts with ITC and its affiliates were mutually and unconditionally terminated as of 12-31-04.

Finding # 5: PRIDE did not enter into a formal contract with ITC, although required by the letter agreement dated June 30, 1999. Currently no formal contract exists.

Recommendation: Given ITC's current financial condition and its inability to meet the goals of the June 30, 1999 agreement, it does not appear reasonable for PRIDE to enter into a formal contract with ITC. We recommend that the PRIDE Board of Directors sever its relationship with ITC.

Discussion: Concur with the findings. The letter agreement should have been formalized and should have included provisions for the conduct of financial transactions, the formalization of ITC debt to PRIDE, and asset controls. It was inexplicably never formalized.

Response: No formal contract with ITC has been executed or is contemplated. The letter agreement of June 30, 1999 has been terminated effective 12-31-04. As noted in the response to Finding # 4, the PRIDE Board of Directors has severed its relationship with ITC and its affiliates.

Finding # 6: Payments made to ITC by PRIDE for management services have not been in accordance with the June 30, 1999 agreement or sound business practices.

Recommendation: We recommend that PRIDE immediately exercise its right to audit the calculation of fees charged by ITC in prior years. PRIDE should require immediate repayment of any amounts overpaid to ITC.

Discussion: It appears as though the 10% of revenue value was an initial estimate of the budgeted costs for the management services. Inexplicably, there was no validation of this estimate to the actual service costs as required by the agreement, perhaps because the computation of the actual cost requires the allocation of several fixed cost elements. The allocation of fixed costs is a somewhat subjective process and the allocation changes over time based upon staff and workload variations. To exacerbate the compliance issue, the existence and exact terms of the agreement were not generally known to all board members or to all management staff.

Response: Commencing in October 2004, PRIDE computed the cost of the services provided by ITC in accordance with the June 30, 1999 agreement. PRIDE's estimate of the service costs was $132,000 per month for the fourth quarter of 2004. ITC has disputed this cost estimate, so the matter has been referred to a PRIDE Board Member and a CPA firm for resolution. Until the matter is resolved, PRIDE has based the October, November, and December service payments on the $132,000 per month estimate, not the 10% of revenue (sales) value. Future payments are not an issue since the ITC management service contract has been terminated effective 12-31-04.

PRIDE did not plan to estimate the management service costs for prior years and to compare that value with the 10% of revenue payment. Although we believe that there have been overpayments in the past, the actual computation of those over payments would be very difficult and very time consuming to perform. As noted in the discussion, the allocation of fixed cost elements varies over time depending upon the volume of business and the needs of the various businesses at that time. Therefore, the proper overhead allocations become more difficult to determine as we go back to prior periods; thus the cost estimates become correspondingly less accurate. Lastly, even if an acceptable management service fee could be computed for prior periods, and even if it was less than the actual fee paid, based upon Finding # 4, it is unlikely that PRIDE would be able to collect on the over payments.

<u>Finding # 7</u>: PRIDE has loaned/advanced funds to ITC and its affiliates interest-free, without any stated terms of repayment. Also, amounts recorded in PRIDE's financial records as due from ITC and ITC affiliates have been reduced by significant amounts for reasons that were sometimes questionable.

Recommendation: We recommend that the PRIDE Board determine whether either of the explanations for the 2002 accounts receivable reduction (i.e. assumption of initiatives or adjustment for overvaluation of assets) is valid. In addition, for the 2003 write-down, the appropriate PRIDE staff should monitor the proposed accounting entry to ensure that it is properly recorded at fiscal year end.

Discussion: The 2002 accounts receivable adjustment to PRIDE's account was based upon the premise of an assumption of ongoing functions by PRIDE. The nature and the extent of those assumptions appear to have been unclear when presented to the Board of Directors. In an effort to clarify the issue, Cherry, Bekaert & Holland, the CPA firm that conducted the annual audit, was contacted for comment. Their review of this transaction noted that both organizations mutually agreed to reallocate these costs and the accounting entries were made accordingly. It was their understanding that the adjustment was a result of management's and Board's analysis of the activities. They could not address the accuracy of the analysis. Further research will be necessary to resolve questions as to the 2002 accounts receivable adjustment.

Response: The PRIDE Board will engage a CPA firm to review the validity of the 2002 reduction in PRIDE's accounts receivable account for ITC. The findings will be forwarded to the Inspector General when completed. The PRIDE Controller will ensure that the appropriate accounting entries are made for the 2003 pension write-down and will ensure that they are included in the accounting records and financial statements for the fiscal year ended 12-31-04.

<u>Finding # 8</u>: Management had not established a policy of setting limits on the amount of funds that can be used to support ITC and its affiliates. The lack of such a policy has resulted in significant advances being made to ITC and its affiliates at the expense of PRIDE's financial welfare.

Recommendation: PRIDE should establish a financially sound policy for evaluating all investments. Future investment decisions should be firmly grounded in a plan geared to attaining the projected return on the investment.

Discussion: Agree with the findings. Management did not provide the Board with realistic business plans that contained critical performance metrics. Businesses that were unable to achieve their plan goals repeatedly were not submitted to the Board for review and for corrective action. Budgeted capital expenditure plans were not closely monitored and prioritized based upon projected ROI's.

Response: As discussed in Finding #3, a process currently exists to evaluate new business ventures. This process will be updated to include guidelines for minimum profitability and ROI objectives, consideration of the capital requirements and the resultant impact upon cash flow, and guidelines for the number of inmate workers utilized, the training relevance and the potential security impact of the project.
Again, as discussed in Finding # 3, a process also exists to monitor the performance of existing businesses to make sure that they are performing to acceptable levels.

Finding # 9: The amounts paid to PRIDE and ITC executives were not reasonable considering the companies' financial condition.

Recommendation: We recommend that the PRIDE Board revisit their policies for calculating salary increases and bonuses. Not only should the attainment of operational goals be considered but goals related to the financial growth of the company should also be included. The attainment of those goals and the company's ability to pay should be the basis for determining the amount of salary increases given. Justification for the supplemental executive retirement plan should be documented.

Discussion: All salary grade levels within PRIDE are based upon a wage & salary survey that was conducted by a consulting firm (Mercer) in October 2000. The comparison group used in the study was private sector companies that were in comparable industry sectors and with approximately the same annual sales value. The comparison to private sector companies was considered to be more appropriate since PRIDE employees are not entitled to state employee benefits or retirement.
In addition to established pay grades, there is also a policy in place for salary increases and bonuses, which has been reviewed and approved by our labor attorneys.

Response: The current PRIDE policy for administering salary increases and bonuses is consistent with the audit recommendation conceptually. The PRIDE Board agrees to revisit the salary and bonus policy to make sure that procedures are in place to ensure compliance with current policy guidelines and the recommendations of this audit.

The justification for the PRIDE supplemental executive retirement plan will be documented. Presently, there is no one in PRIDE who qualifies for this plan.

ITC

RECEIVED
JAN 26 2005
Governor's Office
Inspector General

January 26, 2005

Ms. Kim B. Mills, Director of Audit
Office of the Inspector General
The Capitol, Room 2103
Tallahassee, FL 32399-0001

VIA FACSIMILE

Dear Ms. Mills:

The Inspector General's staff has requested that the Industries Training Corporation's Board of Directors respond to the report issued on December 17, 2004 as a result of a review of the records and activities at PRIDE Enterprises.

The following is a summary:

- PRIDE has historically relied on State Government spending as the basis for its business. PRIDE's growth was dependent on growth of government. Since the early 1990's, PRIDE made various attempts to diversify it's market to insulate it from changes in State Government spending. The company consistently migrated back to dependency on State Government. As a result, the PRIDE Board of Directors met in August 1997 at a Strategic Planning Workshop. The goal was to develop a model for how PRIDE could expand its reach, diversify its markets and increase inmate jobs. With the aid of professional business consultants and corporate counsel, PRIDE developed the business model that became ITC and Related Affiliates. ITC was established as the administrative branch of the company. Global Outsourcing performed marketing, research and development and New Business Development in non-government markets. Labor Line performed inmate support services and job placement. PRIDE performed all of these functions internally prior to the establishment of the Related Companies.

- At inception, PRIDE and ITC had identical Boards of Directors to insure congruency of mission and strategic plans. Common Board memberships continued through November 2004 to enable the sharing of objectives, information and results.

- A letter of agreement between ITC and PRIDE was created on June 30,1999, which outlines the various services ITC would perform for PRIDE, and how fees for services ITC performed for PRIDE would be charged. Payments made by PRIDE to

ITC for all the services contemplated in the agreement were in accordance with the agreement. They were based on PRIDE's estimated budget and ITC's estimated costs to provide the services. The estimates were approved as part of the budget process each year. ITC does not believe there have been past overpayments. There still remains a disagreement in amounts due for services for the 4th quarter of 2004.

- PRIDE and ITC have discontinued its organizational and contractual relationship as of December 31, 2004. There are no duel management positions or common Board members. All administrative functions have been transferred to PRIDE. New business Development and PIE Program Development have been curtailed. Inmate Transition Services has also been re-assumed by PRIDE.

- All salary grade levels for ITC were based upon a survey conduced by Mercer Human Resource Consultants, a professional consulting firm that specializes in that business. The comparison groups used were private sector companies that were in comparable industry sectors with comparable sales volume.

Sincerely,

Randall L. May
Chairman

RLM/cb