

MARYLAND CORRECTIONAL ENTERPRISES
(An Enterprise Fund of the State of Maryland)

Financial Statements Together with
Report of Independent Public Accountants

For the Years Ended June 30, 2018 and 2017



S B & COMPANY, LLC
KNOWLEDGE • QUALITY • CLIENT SERVICE

JUNE 30, 2018 AND 2017

CONTENTS

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS	1
MANAGEMENT’S DISCUSSION AND ANALYSIS	4
FINANCIAL STATEMENTS	
Statements of Net Position	10
Statements of Revenue, Expenses, and Change in Net Position	11
Statements of Cash Flows	12
Notes to the Financial Statements	13
SUPPLEMENTAL SCHEDULES	
Schedules of Cost of Sales and Services	25
REQUIRED SUPPLEMENTAL INFORMATION	
Schedule of Proportionate Share of Net Pension Liability	28
Schedule of Contributions	29



S B & COMPANY, LLC
KNOWLEDGE • QUALITY • CLIENT SERVICE

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of
Maryland Correctional Enterprises

Report on the Financial Statements

We have audited the accompanying statements of financial position of Maryland Correctional Enterprises (MCE), an enterprise fund of the State of Maryland, as of June 30, 2018 and 2017, and the related statements of revenue, expenses, and change in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of entity's internal controls. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.



S B & COMPANY, LLC
KNOWLEDGE • QUALITY • CLIENT SERVICE

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Maryland Correctional Enterprises, as of June 30, 2018 and 2017, and the respective changes in its financial position and, its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis, schedule of proportionate share of net pension liability, and schedule of contributions as listed on the table of contents be presented to supplement the basic financial statements. Such information, although not a required part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise MCE's basic financial statements. The accompanying schedules of cost of sales and services are presented for purposes of additional analysis and are not a required part of the basic financial statements.



S B & COMPANY, LLC
KNOWLEDGE • QUALITY • CLIENT SERVICE

The schedules of cost of sales and services are the responsibility of management and were derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedules of cost of sales and services are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Hunt Valley, Maryland
September 28, 2018

S B & Company, LLC

MARYLAND CORRECTIONAL ENTERPRISES

Management's Discussion and Analysis June 30, 2018 and 2017

General

The following information is presented as a preface to the audited financial statements of Maryland Correctional Enterprises (MCE) for the fiscal years ended June 30, 2018, 2017 and June 30, 2016. The notes to the financial statements found later in this report will provide additional information, essential to a full understanding of the statements.

FINANCIAL HIGHLIGHTS

Total revenues for fiscal year 2018, were \$55.0 Million. This is a decrease of \$4.1 million or 6.9%, from the previous year is total revenues of \$59.1 million.

Net Operating Income (NOI) for the year ended June 30, 2018 was \$3.8 million, an increase of \$2.2 Million over the previous fiscal year's net operating income of \$1.6 million.

Overall financial results, reflects a more conservative operating economic climate within the State of Maryland's government where reduced demands for MCE's goods and services parallels the objectives of reduced governmental spending. Despite such constraints, MCE was able to exceed the previous year's NOI by reducing inventory usage as well as reducing operating expenses.

FINANCIAL STATEMENTS OVERVIEW

An analysis of the financial statements is presented below in the order of Statement of Net Position, Statement of Revenues, Expenses, and Change in Net Position, and a Statement of Cash Flows.

The statement of net position, along with the statement of revenues, expenses, and changes in net position presents the results of the current fiscal year's financial operations. The financial statements for the prior fiscal years, 2017 and 2016, are also included for purposes of comparison.

NET POSITION & CHANGES IN NET POSITION

For the fiscal year 2018, total net position increased \$3.8 million from the prior year. Net position was \$30.2 million, \$26.4 and \$ 27.3 million for the end of fiscal years 2018, 2017 and 2016, respectively.

MARYLAND CORRECTIONAL ENTERPRISES

Management's Discussion and Analysis June 30, 2018 and 2017

NET POSITION & CHANGES IN NET POSITION

The changes in assets are a primary measure of an entities financial health. A comparison of the change in the cumulative net asset balances at the end of each fiscal year is an indicator of whether such overall financial position is achieving the desired result of perpetual growth or decline. Key components of an analysis of an entities financial position however, includes non-financial factors, such as the periods political and fiscal policies, appeal of product lines and the anticipated demand for products and services are all relative to a forecast of the long term viability of positive operations and financial growth.

The statement of cash flows is presented using the direct cash flow method. This statement provides useful information regarding the sources and uses of cash, reserves and the resulting increase or decrease in accumulated balances.

For the fiscal year ended June 30, 2018, current assets amounting to \$37.4 million; or 82% of total assets. Details of the total current assets balance at fiscal year-end in order of liquidity are as follows:

Details of the current assets balance at fiscal year-end in order of liquidity are as follows:

Cash	\$ 19,716,260
Trade receivables	7,140,609
Inventories	10,487,989
Other	31,735
Total	<u><u>\$ 37,376,593</u></u>

Management has internally restricted \$9.4 million of the 2018 year-end cash balance for designated uses as follows:

Vehicles and Equipment	\$ 1,012,390
Expansion Projects	1,930,440
ERP System	3,000,000
Working Capital	3,500,000
Total	<u><u>\$ 9,442,830</u></u>

MARYLAND CORRECTIONAL ENTERPRISES

Management's Discussion and Analysis June 30, 2018 and 2017

NET POSITION & CHANGES IN NET POSITION (continued)

The following presents details of the net position as of June 30, 2018, 2017, and 2016.

	Net Position		
	As of June 30,		
	2018	2017	2016
Current assets	\$ 37,376,593	\$ 32,609,225	\$ 34,074,809
Capital assets, net	8,364,885	7,393,387	5,600,356
Total Assets	<u>45,741,478</u>	<u>40,002,612</u>	<u>39,675,165</u>
Deferred Financing Outflows Related to Pensions	<u>2,534,760</u>	<u>8,135,404</u>	<u>3,163,940</u>
Current liabilities	2,964,923	2,362,156	3,196,409
Noncurrent liabilities	14,136,434	18,508,042	11,374,373
Total Liabilities	<u>17,101,357</u>	<u>20,870,198</u>	<u>14,570,782</u>
Deferred Financing Inflows Related to Pensions	<u>936,410</u>	<u>874,554</u>	<u>975,215</u>
Net Assets:			
Invested in capital assets	8,364,885	7,393,387	5,600,356
Unrestricted	21,873,586	18,999,877	21,692,752
Total Net Assets	<u>\$ 30,238,471</u>	<u>\$ 26,393,264</u>	<u>\$ 27,293,108</u>

The following presents details of the changes in net position for the fiscal years ended June 30, 2018, 2017 and 2016.

	Change in Net Position		
	For the Years Ended June 30,		
	2018	2017	2016
Operating Revenue	\$ 55,003,182	\$ 59,067,623	\$ 61,440,235
Operating Expenses	(51,150,018)	(57,467,549)	(58,189,802)
Operating Income	<u>3,853,164</u>	<u>1,600,074</u>	<u>3,250,433</u>
Non-operating Expense, net	(7,957)	82	3,705
Income (Loss) Before Transfers	<u>3,845,207</u>	<u>1,600,156</u>	<u>3,254,138</u>
Transfer to State of Maryland	<u>-</u>	<u>(2,500,000)</u>	<u>-</u>
Change in Net Position	3,845,207	(899,844)	3,254,138
Net Position, Beginning	26,393,264	27,293,108	24,038,970
Net Position, Ending	<u>\$ 30,238,471</u>	<u>\$ 26,393,264</u>	<u>\$ 27,293,108</u>

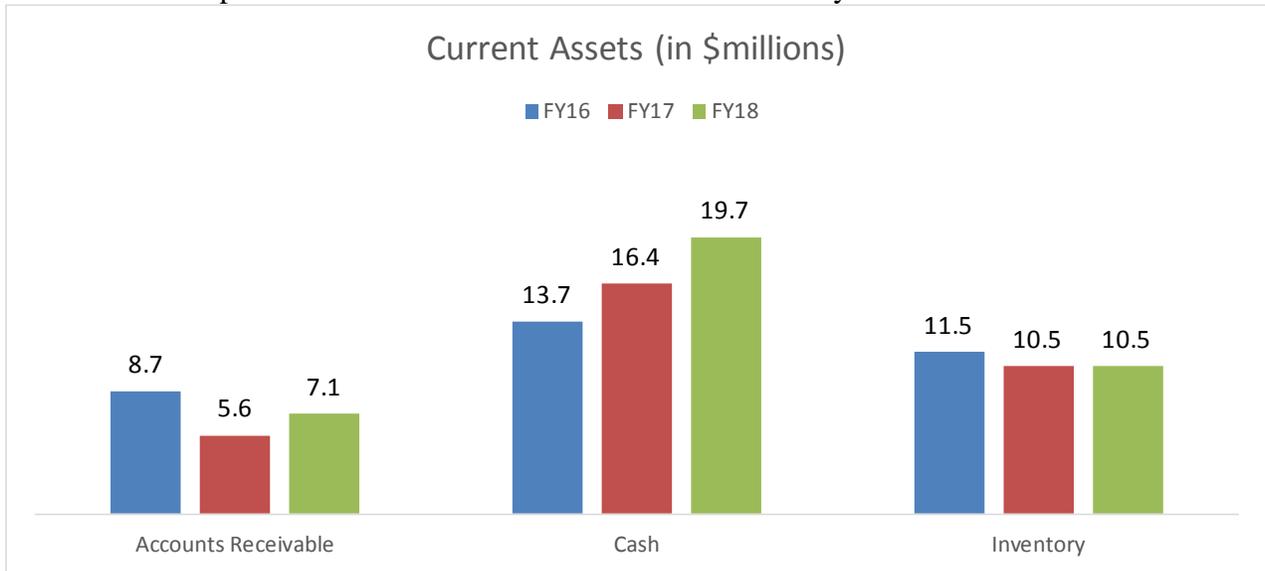
MARYLAND CORRECTIONAL ENTERPRISES

Management's Discussion and Analysis June 30, 2018 and 2017

CURRENT ASSETS

For the fiscal year, ended June 30, 2018, current assets were \$37.4 million, or 82% of total assets. This is an increase of \$4.8 million from \$32.6 million in 2017. This change was primarily a result of a \$3.4 million increase in cash and a \$ 1.5 million increase in accounts receivable.

The chart below presents the current asset balances for the fiscal years 2016-2018:



CAPITAL ASSETS

The capital asset balance at the end of fiscal year 2018 amounted to \$8.4 million, an increase of \$1.0 million from the prior year's balance of \$7.4 million. This increase is attributable to the replacement of production equipment during the year and an increase in Structures and Improvements.

The capital asset balance at the end of fiscal year 2017 was \$7.4 million, an increase of \$1.8 million from the prior year's balance of \$5.6 million. That increase was primarily attributable to investments in construction and purchases of production equipment during the year.

MARYLAND CORRECTIONAL ENTERPRISES

Management's Discussion and Analysis June 30, 2018 and 2017

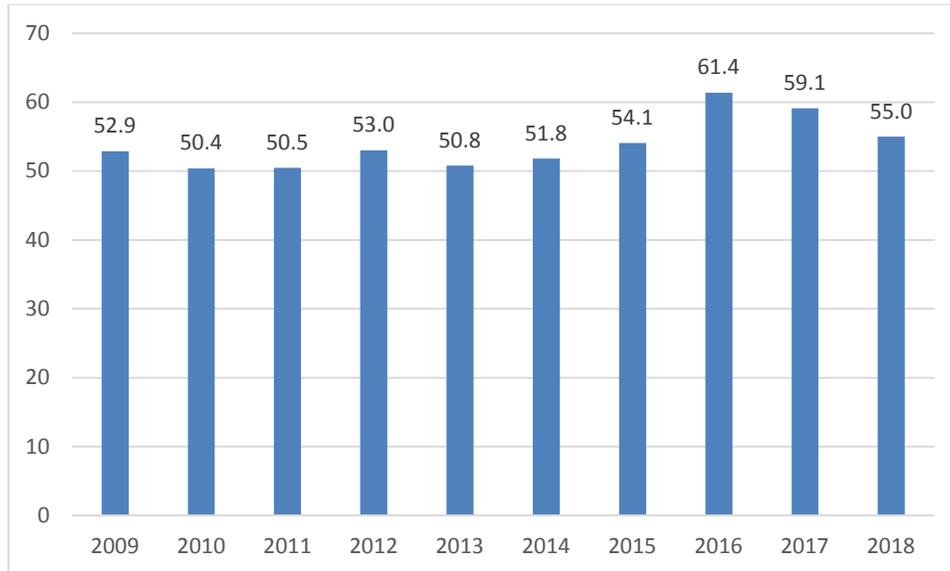
LIABILITIES

Total liabilities at the end of fiscal year end 2018 amounted to \$17.1 million, a decrease of \$3.8 million from the prior year's balance of \$20.9 million. This reflects a \$4.5 million reduction in the pension liability from \$17.9 million at the end of fiscal year 2017 to \$13.4 million at the end of fiscal 2018. For fiscal year ended 2016, the pension liability was reported at \$14.6 million. These estimates reflect MCE's proportional share of the State of Maryland's overall net liability.

OPERATING INCOME

The net operating income for fiscal year 2018 was \$3.8 million, a \$2.2 million increase over fiscal year 2017's \$1.6 million and a \$0.6 million increase over 2016's \$3.2 million.

Revenues for each of the last ten years are presented below:

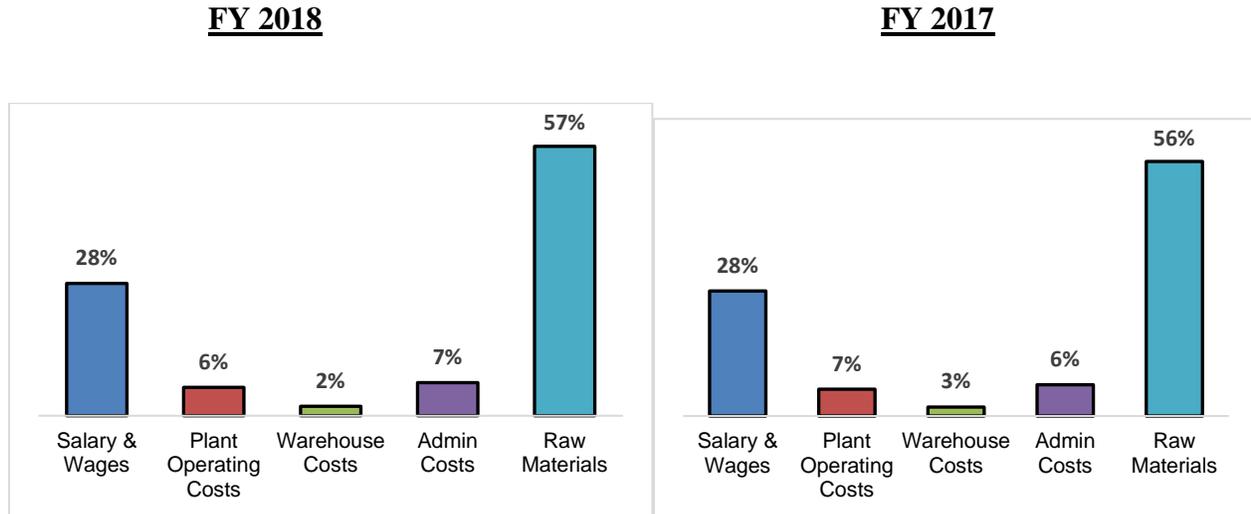


MARYLAND CORRECTIONAL ENTERPRISES

Management's Discussion and Analysis June 30, 2018 and 2017

EXPENDITURES

Presented below is a breakdown of the major categories of expenditures for the fiscal years 2018 and 2017:



FINANCIAL OUTLOOK

Revenue is mainly derived from governmental agencies within the State of Maryland. Management estimates that revenues in the current year and beyond will slightly decline due to the projected reduction in the inmate population and anticipated State budget cuts and expenditure reductions.

In fiscal year 2018, MCE completed the renovation of the warehouse on Brock Bridge Road in Jessup. The warehouse will be in full operation in the Spring of 2019, providing office space, sales offices, and a product showroom.

MCE is continuing to pursue the acquisition of a new Enterprise Resource Planning (ERP) information system. A revised strategic plan is being developed to address the complications encountered in this major undertaking. It is anticipated that a contract for the new system will be issued in fiscal year 2019. Management has committed \$ 3.0 million to this major information development program.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of MCE's finances. Questions concerning the information provided in this report or requests for additional financial information should be addressed to Maryland Correctional Enterprises, 7275 Waterloo Road, Jessup, Maryland 20794.

MARYLAND CORRECTIONAL ENTERPRISES

Statements of Net Position As of June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
ASSETS		
Current Assets:		
Cash	\$ 19,716,260	\$ 16,364,411
Accounts Receivable	7,140,609	5,594,751
Inventories	10,487,989	10,534,798
Other Assets	31,735	115,265
Total Current Assets	<u>37,376,593</u>	<u>32,609,225</u>
Capital Assets, Net of Accumulated Depreciation:		
Construction in progress	-	1,928,386
Equipment	3,232,128	3,092,929
Structures and improvements	5,132,757	2,372,072
Total capital assets, net	<u>8,364,885</u>	<u>7,393,387</u>
Total Assets	<u>45,741,478</u>	<u>40,002,612</u>
Deferred Outflows Related to Pensions	<u>2,534,760</u>	<u>7,631,986</u>
LIABILITIES AND NET POSITION		
Liabilities:		
Current Liabilities:		
Accounts payable and accrued liabilities	\$ 1,985,294	\$ 1,545,722
Accrued vacation and workers compensation costs	806,378	733,358
Unearned revenue	173,251	83,076
Total Current Liabilities	<u>2,964,923</u>	<u>2,362,156</u>
Noncurrent Liabilities:		
Net pension liability	13,430,842	17,910,789
Accrued vacation and workers compensation costs	705,592	597,253
Total Liabilities	<u>17,101,357</u>	<u>20,870,198</u>
Deferred Inflows Related to Pensions	936,410	371,136
Net Position:		
Invested in Capital Assets	8,364,885	7,393,387
Unrestricted	21,873,586	18,999,877
Total Net Position	<u>\$ 30,238,471</u>	<u>\$ 26,393,264</u>

The accompanying notes are an integral part of these financial statements.

MARYLAND CORRECTIONAL ENTERPRISES

Statements of Revenue, Expenses, and Change in Net Position For the Years Ended June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Operating Revenue:		
Sales and services	\$ 55,003,182	\$ 59,067,623
Operating Expenses:		
Cost of sales and services	41,922,598	45,940,308
Selling, general, and administrative expenses	5,506,421	5,814,082
Other selling, general, and administrative expenses	2,848,629	4,770,654
Depreciation	872,370	942,505
Total Operating Expenses	<u>51,150,018</u>	<u>57,467,549</u>
Operating Income	<u>3,853,164</u>	<u>1,600,074</u>
Nonoperating Revenue and Expense:		
Miscellaneous income	614	(488)
Loss on disposal of assets	(8,571)	570
Nonoperating Expenses, net	<u>(7,957)</u>	<u>82</u>
Income Before Transfers and contributed capital	<u>3,845,207</u>	<u>1,600,156</u>
Transfer to State of Maryland General Fund	<u>-</u>	<u>(2,500,000)</u>
Change in Net Position	3,845,207	(899,844)
Net Position, Beginning	<u>26,393,264</u>	<u>27,293,108</u>
Net Position, Ending	<u>\$ 30,238,471</u>	<u>\$ 26,393,264</u>

The accompanying notes are an integral part of these financial statements.

MARYLAND CORRECTIONAL ENTERPRISES

Statements of Cash Flows For the Years Ended June 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash Flows from Operating Activities:		
Receipts from customers	\$ 53,548,073	\$ 61,463,547
Payments to suppliers of goods or services	(34,205,709)	(38,103,118)
Payments to employees	(14,138,120)	(15,410,595)
Net Cash From Operating Activities	<u>5,204,245</u>	<u>7,949,834</u>
Cash Flows from Noncapital Financing Activities:		
Transfers out	-	(2,500,000)
Cash Flows from Capital and Related Financing Activities:		
Acquisitions and construction of plant and equipment	(1,852,396)	(2,790,863)
Increase in Cash	3,351,849	2,658,971
Cash, Beginning of Year	16,364,411	13,705,440
Cash, End of Year	<u>\$ 19,716,260</u>	<u>\$ 16,364,411</u>
Reconciliation of Operating Income to Net Cash		
From Operating Activities:		
Operating income	\$ 3,853,164	\$ 1,600,074
Adjustments to Reconcile Operating Income to		
Net cash From operating activities:		
Depreciation	872,370	942,505
Deferred outflows and inflows related to pensions	5,662,500	(5,072,125)
Effect of Changes in Non-Cash Operating Assets and Liabilities:		
Accounts receivable	(1,545,858)	3,141,032
Inventories	46,809	924,615
Other assets	83,530	58,908
Accounts payable and accrued liabilities	439,572	97,592
Accrued vacation and workers compensation costs	181,930	(161,503)
Pension and related items	(4,479,947)	7,163,845
Unearned revenue	90,175	(745,109)
Total Adjustments	<u>1,351,081</u>	<u>6,349,760</u>
Net Cash From Operating Activities	<u>\$ 5,204,245</u>	<u>\$ 7,949,834</u>

The accompanying notes are an integral part of these financial statements.

MARYLAND CORRECTIONAL ENTERPRISES

Notes to the Financial Statements June 30, 2018 and 2017

1. ORGANIZATION AND PURPOSE

Maryland Correctional Enterprises (MCE) is organized under the State of Maryland's Department of Public Safety and Correctional Services (DPSCS) and operates under the provisions of the Correctional Services Article, Section 3-501 through 3-528 of the Annotated Code of Maryland (hereinafter referred to as the Code). The Code provides, in part, that MCE develop programs that provide work experience or rehabilitation for eligible inmates incarcerated within the DPSCS and further requires that MCE operate the correctional industries in an environment that closely resembles that of a private sector business operations and be financially self-supporting

MCE headquarters is located at 7275 Waterloo Road, Jessup, MD 20794. The products and services offered by MCE are available for purchase by State of Maryland and Federal agencies, political subdivisions, and any charitable, civic, educational, fraternal, or religious association, institution, or agency for its own use; not for resale to others or as otherwise provided for under the law. MCE is included in the State's basic financial statements, as an enterprise fund.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying financial statements were prepared on the accrual basis of accounting. Under this method, revenue is recorded when earned and expenses are recorded when incurred.

Accounts Receivable

MCE's sales are made primarily to agencies of the State of Maryland, as such; it is estimated that all outstanding accounts receivable will be collected, and therefore, an allowance for doubtful accounts has not been established for the fiscal years ended June 30, 2018 and 2017.

Inventories

Inventories are stated at the lower of cost or market. Raw materials inventory is valued on an average cost basis and work in process and finished goods inventories are valued on a first in, first out basis. MCE's inventories were as follows:

	As of June 30,	
	2018	2017
Raw materials	\$ 5,015,476	\$ 4,954,032
Work in process	455,430	379,194
Finished goods	5,017,083	5,201,573
Total inventories	\$ 10,487,989	\$ 10,534,799

MARYLAND CORRECTIONAL ENTERPRISES

Notes to the Financial Statements June 30, 2018 and 2017

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Capital Assets

Capital assets are recorded at cost. Depreciation expense is calculated using the straight-line method over the estimated useful lives of the assets and for leasehold improvements, over the remaining term of the lease, whichever is shorter. Estimated useful lives of capital assets are as follows:

<u>Classification</u>	<u>Estimated Useful Life</u>
Equipment	2 – 10 years
Structures and improvements	5 – 15 years
Buildings	30 years

Operating and Non-operating Revenue and Expenses

Operating revenue and expenses are generated primarily from providing and delivering goods and services in connection with MCE's ongoing principal operations. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenue and expenses outside of these categories are reported as non-operating revenues and expenses.

3. CASH

As of June 30, 2018 and 2017, the amount of cash on deposit with the State Treasurer was \$19,716,260 and \$16,364,411 respectively.

All interest earned on MCE's cash deposits reverts to Maryland's General Fund. The State Treasurer has statutory responsibility for all statewide cash management activities, as such; the amount on deposit with the State Treasurer is part of the State's internal investment pool and is not separately identified as to specific types of securities for individual agencies within the State. The State Treasurer maintains these and other State agency funds on a pooled basis in accordance with State statutes. For additional information on investments and the risk of cash, see the State of Maryland Comprehensive Annual Financial Report.

MARYLAND CORRECTIONAL ENTERPRISES

Notes to the Financial Statements June 30, 2018 and 2017

3. CASH (continued)

Investment Rate Risk

The State Treasurer's investment policy states that to the extent possible, it will attempt to match its investments with anticipated cash flow requirements. Unless matched to a specific cash flow, the State Treasurer will not directly invest in securities maturing more than five years from the date of purchase.

Credit Risk

State law requires that the State Treasurer's investments in repurchase agreements be collateralized by United States Treasury and agency obligations. In addition, investments may be made directly in United States agency obligations. These agency obligations are rated Aaa by Moody's and AAA by Standard and Poor's. State law also requires that money market mutual funds contain only United States Treasuries or agencies or repurchase agreements secured by these. The money market mutual funds are rated Aaa/AAA. The Local Government Investment Pool is rated AAA by Standard and Poor's.

Concentration of Credit Risks

The State Treasurer's investment policy limits the amount of repurchase agreements invested with a particular institution to 30% of the portfolio. There is no other limit on the amount that may be invested in any one issuer. As of the fiscal years ended June 30, 2018 and 2017, the State Treasurer had more than 5% of its investments in the; Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Federal Home Loan Bank. These investments are 42%, 43%, and 5% of the State Treasurer's total investments, respectively.

MARYLAND CORRECTIONAL ENTERPRISES

Notes to the Financial Statements June 30, 2018 and 2017

4. CAPITAL ASSETS

Capital asset activity by classification, for the fiscal years ended June 30, 2018 and 2017 were as follows:

	2018			
	Beginning Balance	Additions	Deletions	Ending Balance
Construction in Progress	\$ 1,928,386	\$ -	\$ 1,928,386	\$ -
Equipment	22,218,119	3,791,339	421,890	25,587,568
Structures and Improvements	4,319,963	-	-	4,319,963
	<u>28,466,468</u>	<u>3,791,339</u>	<u>2,350,276</u>	<u>29,907,531</u>
Less Accumulated Depreciation for:				
Equipment	19,125,191	746,685	402,805	19,469,071
Structures and Improvements	1,947,890	125,685	-	2,073,575
	<u>21,073,081</u>	<u>872,370</u>	<u>402,805</u>	<u>21,542,646</u>
	<u>\$ 7,393,387</u>	<u>\$ 2,918,969</u>	<u>\$ 1,947,471</u>	<u>\$ 8,364,885</u>

	2017			
	Beginning Balance	Additions	Deletions	Ending Balance
Construction in Progress	\$ -	\$ 1,928,386	\$ -	\$ 1,928,386
Equipment	21,882,732	809,534	474,147	22,218,119
Structures and Improvements	4,319,963	-	-	4,319,963
	<u>26,202,695</u>	<u>2,737,920</u>	<u>474,147</u>	<u>28,466,468</u>
Less Accumulated Depreciation for:				
Equipment	18,780,077	819,663	474,549	19,125,191
Structures and Improvements	1,822,262	125,628	-	1,947,890
	<u>20,602,339</u>	<u>945,291</u>	<u>474,549</u>	<u>21,073,081</u>
	<u>\$ 5,600,356</u>	<u>\$ 1,792,629</u>	<u>\$ (402)</u>	<u>\$ 7,393,387</u>

For the fiscal year ended June 30, 2018 and 2017, total depreciation expense was \$872,370 and \$942,205 respectively.

MARYLAND CORRECTIONAL ENTERPRISES

Notes to the Financial Statements June 30, 2018 and 2017

5. ACCOUNTS PAYABLE AND OTHER ACCRUED LIABILITIES

Accounts Payable and other Accrued Liabilities consisted of the following major categories:

	As of June 30,	
	2018	2017
Payable to vendors	\$ 1,233,932	\$ 795,625
Accrued payroll expenses	601,365	600,100
Payable to Federal government (see note 12)	150,000	150,000
Total Accounts Payable and Accrued Expenses	\$ 1,985,297	\$ 1,545,725

6. RETIREMENT COSTS

Plan Descriptions

Certain employees of MCE are provided with pensions through the Employees Retirement System of the State of Maryland (ERS) or the Correctional Officers Retirement System (CORS), both of which are cost-sharing multiple-employer defined benefit pension plan administered by the Maryland State Retirement and Pension System (MSRPS). The State Personnel and Pensions Article of the Annotated Code of Maryland (the Article) grant the authority to establish and amend the benefit terms of ERS to the MSRPS Board of Trustees. MSRPS issues a publicly available financial report that can be obtained at www.sra.state.md.us/Agency/Downloads/CAFR/.

Benefits provided.

A member of the Employees' Retirement System is generally eligible for full retirement benefits upon the earlier of attaining age 60 or accumulating 30 years of creditable service regardless of age. The annual retirement allowance equals 1/55 (1.81%) of the member's AFC multiplied by the number of years of accumulated creditable service.

An individual who is a member of the Employees' Pension System on or before June 30, 2011, is eligible for full retirement benefits upon the earlier of attaining age 62, with specified years of eligibility service, or accumulating 30 years of eligibility service regardless of age. An individual who becomes a member of the Employees' Pension System on or after July 1, 2011, is eligible for full retirement benefits if the member's combined age and eligibility service equals at least 90 years or if the member is at least age 65 and has accrued at least 10 years of eligibility service.

MARYLAND CORRECTIONAL ENTERPRISES

Notes to the Financial Statements June 30, 2018 and 2017

6. RETIREMENT COSTS (continued)

For most individuals who retired from the Employees' Pension System on or before June 30, 2006, the annual pension allowance equals 1.2% of the member's AFC, multiplied by the number of years of creditable service accumulated prior to July 1, 1998, plus 1.4% of the member's AFC, multiplied by the number of years of creditable service accumulated subsequent to June 30, 1998.

With certain exceptions, for individuals who are members of the Employees' Pension System on or after July 1, 2006, the annual pension allowance equals 1.2% of the member's AFC, multiplied by the number of years of creditable service accumulated prior to July 1, 1998, plus 1.8% of the member's AFC, multiplied by the number of years of creditable service accumulated subsequent to June 30, 1998. Beginning July 1, 2011, any new member of the Employees' Pension System shall earn an annual pension allowance equal to 1.5% of the member's AFC multiplied by the number of years of creditable service accumulated as a member of the Employees' Pension System.

Exceptions to these benefit formulas apply to members of the Employees' Pension System, who are employed by a participating governmental unit that does not provide the 1998 or 2006 enhanced pension benefits or the 2011 reformed pension benefits. The pension allowance for these members equals 0.8% of the member's AFC up to the social security integration level (SSIL), plus 1.5% of the member's AFC in excess of the SSIL, multiplied by the number of years of accumulated creditable service. For the purpose of computing pension allowances, the SSIL is the average of the social security wage bases for the past 35 calendar years ending with the year the retiree separated from service.

Early Service Retirement

A member of the Employees' Retirement System may retire with reduced benefits after completing 25 years of eligibility service. Benefits are reduced by 0.5% per month for each month remaining until the retiree either attains age 60 or would have accumulated 30 years of creditable service, whichever is less. The maximum reduction for the Employees' Retirement System member is 30%. An individual who is a member of either the Employees' Pension System on or before June 30, 2011, may retire with reduced benefits upon attaining age 55 with at least 15 years of eligibility service. Benefits are reduced by 0.5% per month for each month remaining until the retiree attains age 62. The maximum reduction for these members of the Employees' Pension System is 42%. An individual who becomes a member of the Employees' Pension System on or after July 1, 2011, may retire with reduced benefits upon attaining age 60 with at least 15 years of eligibility service. Benefits are reduced by 0.5% per month for each month remaining until the retiree attains age 65. The maximum reduction for these members of the Employees' Pension System is 30%.

MARYLAND CORRECTIONAL ENTERPRISES

Notes to the Financial Statements June 30, 2018 and 2017

6. RETIREMENT COSTS (continued)

Disability and Death Benefits

Generally, a member covered under retirement plan provisions who is permanently disabled after 5 years of service receives a service allowance based on a minimum percentage (usually 25%) of the member's AFC. A member covered under pension plan provisions who is permanently disabled after accumulating 5 years of eligibility service receives a service allowance computed as if service had continued with no change in salary until the retiree attained age 62. Death benefits are equal to a member's annual salary as of the date of death plus all member contributions and interest.

Contributions

The Article sets contribution requirements of the active employees and the participating governmental units are established and may be amended by the MSRPS Board. Employees are required to contribute 7% of their annual pay. MCE's contractually required contribution rate for ERS for the year ended June 30, 2018 and 2017, was approximately \$1.6 and \$1.2 million, respectively, actuarially determined as an amount that, when combined with employee contributions, is expected to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. Contributions to ERS from MCE were approximately \$1.6 and \$1.2 million for the years ended June 30, 2018 and 2017, respectively.

As of June 30, 2018, and 2017, MCE reported a liability of approximately \$13.4 and \$17.9 million for its proportionate share of the ERS net pension liability. (NPL). This NPL, measured as of June 30, 2015, was determined by an actuarial valuation and MCE's proportion was based on a projection of MCE's long-term share of contributions to the pension plan relative to the projected contributions of all participating government units, actuarially determined. As of June 30, 2018, and 2017, MCE's proportion of the ERS was 0.057 and 0.082 percent, respectively.

MARYLAND CORRECTIONAL ENTERPRISES

Notes to the Financial Statements June 30, 2018 and 2017

6. RETIREMENT COSTS (continued)

For the year ended June 30, 2018 and 2017, MCE recognized pension expense for ERS of approximately \$1.0 and \$2.1 million respectfully. As of June 30, 2018 and 2017, MCE reported the following for deferred outflows and deferred inflows:

	June 30, 2018		June 30, 2017	
	Deferred Outflow	Deferred Inflow	Deferred Outflow	Deferred Inflow
Contributions Subsequent to Measurement Date	\$ 935,304	\$ -	\$ 1,513,464	\$ -
Change in Proportional Share	164,834	-	3,641,343	-
Net Difference in Investment Earnings	1,017,456	-	1,983,144	-
Change in Assumptions	417,166	-	494,035	-
Actual and Expected Experience		936,410	-	371,136
Totals	\$ 2,534,760	\$ 936,410	\$ 7,631,986	\$ 371,136

Approximately \$0.9 million reported as deferred outflows of resources related to ERS resulting from MCE contributions subsequent to the measurement date will be recognized as a reduction of the ERS net pension liability in the year ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to ERS will be recognized in pension expense as follows:

<u>Year End June 30,</u>	
2019	\$ 420,670
2020	639,113
2021	393,983
2022	(198,924)
2023	(591,797)
Total	\$ 663,045

Actuarial assumptions, long-term expected rate of return on pension plan investments, discount rate, and pension plan fiduciary net position are available at www.sra.state.md.us/Agency/Downloads/CAFR/.

Sensitivity of MCE's proportionate share of the NPL to changes in the discount rate

MCE's proportionate share of the ERS net pension liability, (NPL), calculated using a discount rate of 7.55 percent is \$13,430,842. Additionally, MCE's proportionate share of the NPL calculated using a discount rate of 1-percentage-point lower (6.55 percent) is \$23,783,090 or at 1-percentage-point higher (8.55 percent) amounts to \$10,972,650.

MARYLAND CORRECTIONAL ENTERPRISES

Notes to the Financial Statements

June 30, 2018 and 2017

7. POST EMPLOYMENT BENEFITS OTHER THAN PENSION (OPEB)

In addition to the pension benefits described in Note 6, the State provides post-employment health care benefits to retired employees and their dependents. These benefits vary depending upon the employee's year of hire. The State subsidizes a portion of the covered medical, dental, prescription, and hospitalization costs, depending on the type of insurance plan. Costs for postretirement benefits are for State retirees and primarily funded by the State. The State does not distinguish employees by employer/State agency. For the years ended June 30, 2018, 2017, and 2016, the State did not allocate postemployment health care costs to participating employers and as a result did not require a contribution from MCE. As such, the State has elected to maintain the entire Net OPEB Liability as a liability of the general fund of the State and has not allocated any balances to State entities including MCE.

8. LEASE COMMITMENTS

Effective January 1, 1991, MCE entered into a cancelable, open-ended operating lease with DGS for warehouse space. Warehouse rental expenditures are currently \$200,000 per year.

Effective April 19, 1999, MCE entered into another cancelable operating lease also with DGS, for office space. The initial annual rents were \$107,814, subject to periodic adjustments. Total rent expenditures for fiscal years 2018 and 2017 were \$181,112 and \$175,806 respectively.

9. RISK MANAGEMENT

MCE's insurance for general liability, property and casualty, tort liability, workers' compensation coverage, and certain employee health benefits are provided by the State under its self-insurance program. The program charges MCE for the costs of servicing and paying claims based upon its percentage of estimated current-year payroll or on its average loss experience. In determining the charges to be allocated, consideration is given to trends in the actual claims experience of the State as a whole and provisions for catastrophic losses.

Workers' compensation insurance coverage is provided by the Chesapeake Employers Insurance Company (Formerly IWIF). This is a self-insurance program against claims brought under the State Workers' Compensation Law. The State of Maryland records a liability in its financial statements for accrued workers' compensation coverage for State employees. This liability is valued at its present value applying a 4% discount rate. MCE's portion of the State's liability for accrued workers' compensation costs is recognized in MCE's financial statements.

MARYLAND CORRECTIONAL ENTERPRISES

Notes to the Financial Statements June 30, 2018 and 2017

9. RISK MANAGEMENT (continued)

The following is the detail of MCE's activity for workers' compensation liability for the fiscal years ended June 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Beginning of year liability	\$ 441,000	\$ 424,000
Claims and changes in estimates	225,965	97,614
Claim payments	<u>(120,965)</u>	<u>(80,614)</u>
End of year liability	<u>\$ 546,000</u>	<u>\$ 441,000</u>

10. NONCURRENT LIABILITIES

MCE's noncurrent liabilities consist of accrued vacation leave and accrued workers' compensation costs. The account activity during fiscal years ended June 30, 2018 and 2017 were as follows:

	<u>2018</u>				
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>	<u>Current Portion</u>
Accrued vacation leave	\$ 889,611	\$ 258,054	\$ 181,695	\$ 965,970	\$ 724,478
Accrued worker's compensation costs	<u>441,000</u>	<u>225,965</u>	<u>120,965</u>	<u>546,000</u>	<u>81,900</u>
Total	<u>\$ 1,330,611</u>	<u>\$ 484,019</u>	<u>\$ 302,660</u>	<u>\$ 1,511,970</u>	<u>\$ 806,378</u>

	<u>2017</u>				
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>	<u>Current Portion</u>
Accrued vacation leave	\$ 1,068,115	\$ 535,352	\$ 713,856	\$ 889,611	\$ 667,208
Accrued worker's compensation costs	<u>424,000</u>	<u>97,614</u>	<u>80,614</u>	<u>441,000</u>	<u>66,150</u>
Total	<u>\$ 1,492,115</u>	<u>\$ 632,966</u>	<u>\$ 794,470</u>	<u>\$ 1,330,611</u>	<u>\$ 733,358</u>

MARYLAND CORRECTIONAL ENTERPRISES

Notes to the Financial Statements June 30, 2018 and 2017

11. RELATED PARTY TRANSACTIONS

MCE utilizes low cost inmate labor to generate its operating revenues at facilities within various correctional institutions. MCE also reimburses the various institutions for fuel and other utility costs related to the generation of such revenues, accordingly, such costs are recorded in the financial statements as a charge against income. Capital Improvements to the institutions facilities used by MCE are capitalized and amortized as described in Note 2.

DPSCS does not charge MCE rent for the occupied space, or for certain other administrative costs incurred by the Department, conversely, MCE does not charge the Department for the costs to rehabilitate and train inmates, therefore, such costs are not recognized in the accompanying financial statements.

12. TRANSFERS TO THE FEDERAL GOVERNMENT

According to the Federal OMB Circular A-87, the revenues generated by MCE for the sale of its products and services to Maryland's State agencies contain Federal funds. Each fiscal year MCE is required by the Department of Health and Human Services, a Federal agency, to conduct an analysis to determine if the retained earnings are in excess of stated guidelines. The analysis conducted for fiscal years 2010 through 2016 revealed no excess retained earnings. To provide for future liabilities, resulting from the continuing compliance with Uniform Grant Guidance, MCE financial statements include a liability of \$150,000 for fiscal years 2018 and 2017 respectively.

13. TRANSFERS TO THE STATE'S GENERAL FUND

No transfer was required during fiscal year 2018. In accordance with the State legislative mandates, MCE transferred \$ 2,500,000 to the General Fund during the fiscal year 2017. Transfers to the General Fund are recorded as a charge against net assets.

14. NEW ACCOUNTING PRONOUNCEMENTS

MCE adopted Governmental Accounting Standard Board (GASB) Statement No. 75, entitled Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions; and GASB Statement No. 76 entitled, The Hierachy of Generally Accepted Accounting Principles for State and Local Governments. Adoption of these statements did not have a material effect on MCE's financial statements.

GASB issued Statement No. 83, "Certain Asset Retirement Obligations;" Statement No. 84, "Fiduciary Activities;" Statement No. 87, "Leases;" Statement No. 88, "Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements;" and Statement No. 89, "Accounting for Interest Cost Incurred before the End of a Construction Period." MCE will be analyzing the effects of these pronouncements and plans to adopt them applicable by their effective date.

SUPPLEMENTAL SCHEDULES

MARYLAND CORRECTIONAL ENTERPRISES

Schedule of Cost of Sales and Services For the Year Ended June 30, 2018

Cost of Sales:

Beginning Inventory:

Finished Goods, July 1		\$ 5,201,572
Work in Process, July 1	\$ 379,194	

Raw Materials:

Inventory, July 1	\$4,954,032	
Purchases	27,370,011	
Total Goods Available	<u>\$32,324,043</u>	
Inventory, June 30	<u>(5,015,476)</u>	
Raw Materials Used		\$27,308,567

Manufacturing Expenses:

Direct Labor:

Inmates	\$864,239	
Incentive Pay to Inmates	<u>950,363</u>	
Total Direct Labor		\$1,814,602

Other Manufacturing Expenses:

Indirect Labor	\$6,785,237	
Operating Expenses	2,285,758	
Miscellaneous	<u>582,239</u>	
Total Other Manufacturing Expenses		<u>\$9,653,234</u>
Total Manufacturing Expenses		\$39,155,597

Ending Inventory:

Work in Process, June 30	<u>(455,430)</u>	
Cost of Goods Manufactured		\$38,700,167
Finished Goods, June 30		<u>(5,017,083)</u>
Total Cost of Sales		<u>38,884,656</u>

Cost of Services:

Direct Labor - Inmates	\$339,275	
Indirect Labor	875,133	
Operating Expenses	1,430,088	
Miscellaneous	<u>393,446</u>	
Total Services Expenses		<u>\$3,037,942</u>
Total Cost of Services		<u>\$3,037,942</u>

Cost of Sales and Services

\$41,922,598

MARYLAND CORRECTIONAL ENTERPRISES

Schedule of Cost of Sales and Services For the Year Ended June 30, 2017

Cost of Sales:

Beginning Inventory:

Finished Goods, July 1		\$ 6,153,698
Work in Process, July 1	\$ 301,642	

Raw Materials:

Inventory, July 1	\$5,004,073	
Purchases	30,903,821	
Total Goods Available	<u>\$35,907,894</u>	
Inventory, June 30	<u>(4,954,032)</u>	
Raw Materials Used		\$30,953,862

Manufacturing Expenses:

Direct Labor:

Inmates	\$900,410	
Incentive Pay to Inmates	<u>1,022,289</u>	
Total Direct Labor		\$1,922,699

Other Manufacturing Expenses:

Indirect Labor	\$6,254,181	
Operating Expenses	2,325,571	
Miscellaneous	<u>587,784</u>	
Total Other Manufacturing Expenses		<u>\$9,167,536</u>
Total Manufacturing Expenses		\$42,345,739

Ending Inventory:

Work in Process, June 30	<u>(379,194)</u>	
Cost of Goods Manufactured		\$41,966,545
Finished Goods, June 30		<u>(5,201,572)</u>
Total Cost of Sales		<u>42,918,671</u>

Cost of Services:

Direct Labor - Inmates	\$345,321	
Indirect Labor	912,808	
Operating Expenses	1,338,224	
Miscellaneous	<u>425,284</u>	
Total Services Expenses		<u>\$3,021,637</u>
Total Cost of Services		<u>\$3,021,637</u>

Cost of Sales and Services

\$45,940,308

REQUIRED SUPPLEMENTAL INFORMATION

MARYLAND CORRECTIONAL ENTERPRISES

Schedule of Proportionate Share of Net Pension Liability For the Year Ended June 30, 2018, 2017, 2016, and 2015

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
MCE's proportion of the ERS net pension liability (asset)	0.066%	0.082%	0.057%	0.052%
MCE's proportionate share of the ERS net pension liability (asset)	<u>\$ 13,430,838</u>	<u>\$ 17,910,789</u>	<u>\$ 10,746,941</u>	<u>\$ 91,989,488</u>
MCE's covered-employee payroll	\$ 11,692,152	\$ 12,809,943	\$ 13,559,521	\$ 13,446,740
MCE's proportionate share of the net pension liability (asset) as a percentage of its covered-employee payroll	114.87%	139.82%	79.26%	684.10%
Plan fiduciary net position as a percentage of the total pension liability	69.38%	65.79%	68.78%	71.87%

This schedule is presented to illustrate the requirement to show information for 10 years. However, information prior to June 30, 2015 is not available.

MARYLAND CORRECTIONAL ENTERPRISES

Schedule of Contributions For the Year Ended June 30, 2018, 2017, 2016, and 2015

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Contractually required contribution (ERS)	\$ 935,304	\$ 1,513,464	\$ 1,579,592	\$ 1,207,873
Contributions in relation to the contractually required contribution	<u>(935,304)</u>	<u>(1,513,464)</u>	<u>(1,579,592)</u>	<u>(1,207,873)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
MCE's covered-employee payroll	\$ 11,692,152	\$ 12,809,943	\$ 13,559,521	\$ 13,446,740
Contributions as a percentage of covered-employee payroll	8.00%	11.81%	11.65%	8.98%

This schedule is presented to illustrate the requirement to show information for 10 years. However, information prior to June 30, 2015 is not available.