



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Department of Corrections
Special Review: MINNCOR Industries and
Minnesota Correctional Education Foundation



Financial Audit Division

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- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

Senator Ann H. Rest, Chair
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Members of the Legislative Audit Commission

Ms. Joan Fabian, Commissioner
Department of Corrections

We have conducted a special review of MINNCOR Industries, the correctional industry program for the Department of Corrections for the period July 1, 2003, through March 31, 2006. We conducted the special review after receiving allegations about certain MINNCOR business practices. The allegations included potential conflicts of interest, the improper disposition of surplus property, and questionable contracting practices. In addition, it was alleged that MINNCOR had inappropriately made donations to certain nonprofit organizations, including the Minnesota Correctional Education Foundation. Based on our initial assessment, we decided to conduct a special review and issue this report.

The enclosed Report Summary highlights our overall conclusions. We discuss the issues more fully in Chapter 2 and Chapter 3 of the report, which contains 8 findings and 16 recommendations.

We would like to thank the staff at the Department of Corrections for their cooperation during this special review.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

Report Signed On: July 21, 2006

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- MINNCOR Industries
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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Cecile Ferkul, CPA, CISA	Deputy Legislative Auditor
Marla Conroy, CPA, CISA	Director of Investigations
Sonya Johnson, CPA	Investigator
Laura Peterson, CPA	Audit Director

Exit Conference

The following representatives from the Department of Corrections participated in the exit conference held on July 10, 2006:

Joan Fabian	Commissioner
Dennis Benson	Deputy Commissioner
Lisa Cornelius	Assistant Commissioner
Rich Schoenthaler	Chief Financial Officer, MINNCOR
Chris Pizinger	Chief Executive Officer, MINNCOR
Marcie Koetke	Director of Education
Chris Dodge	Financial Management Director

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Report Summary

Key Findings:

- The Department of Corrections did not adequately resolve a conflict of interest involving three MINNCOR employees who attended a National Football League game as guests of a vendor. (Finding 1, page 7)
- MINNCOR Industries did not comply with state statutes or department policies when it disposed of surplus property. (Finding 2, page 9)
- The Department of Corrections did not have statutory authority to establish the Minnesota Correctional Education Foundation. (Finding 4, page 13)
- Conflicts of interest from having public officials serving on the foundation board have not been appropriately addressed. (Finding 5, page 14)
- The Department of Corrections may not have complied with federal grant requirements. (Finding 6, page 16)
- The Department of Corrections inappropriately transferred \$60,500 from MINNCOR to the Minnesota Correctional Education Foundation. (Findings 7 and 8, pages 17 and 18)

Audit Scope:

In response to allegations, we conducted a special review of MINNCOR Industries, the correctional industry program for the Department of Corrections for the period July 1, 2003, through March 31, 2006. Our review included the Minnesota Correctional Education Foundation.

Background:

MINNCOR Industries provides inmates an opportunity to acquire certain knowledge and skills prior to release. MINNCOR operates in eight correctional facilities and produces various products and services, which it sells to state agencies, local units of government, and businesses.

In 2004, the Department of Corrections established the Minnesota Correctional Education Foundation, a nonprofit organization that supports the department's postsecondary education program for inmates.

<p>The audit report contained a total of eight findings - three relating to MINNCOR business practices and five relating to the department's relationship with the Minnesota Correctional Education Foundation.</p>

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Chapter 1. Introduction

Background

We conducted a special review of MINNCOR Industries, the correctional industry program for the Department of Corrections for the period July 1, 2003, through March 31, 2006. We conducted the special review after receiving allegations about certain MINNCOR business practices. The allegations included potential conflicts of interest, the improper disposition of surplus property, and questionable contracting practices. In addition, it was alleged that MINNCOR had inappropriately made donations to certain nonprofit organizations, including the Minnesota Correctional Education Foundation. Based on our initial assessment, we decided to conduct a special review and issue this report.

We also issued a performance audit of the Department of Corrections for the period July 1, 2003, through June 30, 2005 (Report #06-20), which was released as a public document on July 27, 2006. The audit scope included personnel and payroll controls and governmental grants and subsidies.

MINNCOR Industries

MINNCOR Industries provides inmates an opportunity to work and acquire certain knowledge and skills prior to release. MINNCOR operates in eight state correctional facilities and provides various products and services that are sold to state agencies, local units of government, and businesses. Some of the products produced and services provided by MINNCOR include custodial supplies, park and patio accessories, and office, library, and residential furniture, data entry, market research, laundry, and sewing services. MINNCOR Industries also enters into partnerships with private and public sector businesses, where MINNCOR provides inmate labor and on-site production facilities, and the business provides product specifications, raw materials, and equipment.

MINNCOR's financial activity is recorded on the state's accounting system in the Minnesota Industries Revolving Fund, a fund that allows income to be used to finance continuing operations. Table 1-1 summarizes MINNCOR's Revenues and Expenditures for fiscal years 2004 and 2005.

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Table 1-1
MINNCOR Revenue and Expenditures
Fiscal Years 2004-2005

	<u>2004</u>	<u>2005</u>
Sales	\$29,906,078	\$32,326,875
Cost of Goods Sold	<u>(14,606,788)</u>	<u>(16,591,775)</u>
Gross Margin	\$15,299,290	\$15,735,100
Manufacturing Costs ^(Note 1)	<u>(\$9,269,866)</u>	<u>(\$8,884,064)</u>
Operating Income	6,029,424	6,851,036
General and Administrative Costs	<u>(3,555,198)</u>	<u>(5,526,536)</u>
Net Income	<u>\$2,474,226</u>	<u>\$1,324,500</u>

Note 1: The manufacturing costs are those costs incurred at the state correctional facilities.

Source: MINNCOR's 2005 Annual Report-Comparative Income Statement (unaudited).

Minnesota Correctional Education Foundation

The Minnesota Correctional Education Foundation is a nonprofit organization whose mission is to provide eligible inmates with appropriate academic and vocational opportunities to prepare them for release as productive and contributing citizens. The foundation, established in July 2004, held its first board of directors' meeting in March 2005. Mr. Curt Peterson was the foundation's first executive director until he resigned in November 2005. Ms. Liz Evensen has served as the foundation's executive director since December 2005.

The foundation partners with the Department of Corrections and a consortium of higher education institutions to provide postsecondary education to inmates. Since its establishment, the foundation's role has been promoting postsecondary education in the correctional facilities and raising funds. The department contracted with Inver Hills Community College to provide, in part, educational planning and assessments at certain correctional facilities. The educational assessments determine the inmates' academic ability and eligibility for the program. The department used a federal grant from the U.S. Department of Education, *Grants to States for Workplace and Community Transition Training for Incarcerated Youth Offenders* (CFDA #84.331), to pay Inver Hills Community College for these services.

From December 2004 through March 2006, the foundation had approximately \$200,000 in revenues and \$51,000 in expenditures. The department provided office space and general administrative support to the foundation. The department also paid the salary of the foundation's executive director from the *Grants to States for Workplace and Community Transition Training for Incarcerated Youth Offenders*. Table 1-2 summarizes the foundation's financial activity.

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Table 1-2
Minnesota Correctional Education Foundation
Receipts and Disbursements
December 2004 through March 31, 2006

<u>Receipts</u>	
Corporate and Individual Donations	\$139,021
MINNCOR ^(Note 2)	60,500
Interest Revenue	488
Total Receipts ^(Note 1)	<u>\$200,009</u>
<u>Disbursements</u>	
Vocational Training ^(Note 3)	\$ 35,500
Golf Tournament ^(Note 4)	10,204
Insurance	1,800
Supplies and Postage	1,004
Application for Nonprofit Status and Other Services	989
Other	1,112
Total Disbursements ^(Note 1)	<u>\$ 50,609</u>
Ending Cash at March 31, 2006	<u>\$149,400</u>

Notes:

1. The Minnesota Correctional Education Foundation stated that it received administrative support from the Department of Corrections valued at approximately \$75,000 for the executive director's salary, office space, equipment, and supplies. The receipts and disbursements in this table do not reflect this amount.
2. MINNCOR payments included \$10,000 to sponsor the foundation's golf tournament, \$15,000 for general support, and \$35,500 for vocational training.
3. MINNCOR paid the foundation for vocational training. The foundation then paid a private vocational/technical college for conducting the training.
4. The amount includes \$9,954 expenditures for the first golf tournament held July 28, 2005, and a \$250 deposit related to the 2006 golf tournament.

Source: Auditor prepared from the Minnesota Correctional Education Foundation's bank statements and other supporting documentation.

Objective and Methodology

Our objective in conducting this special review was to answer the following questions:

- Did a conflict of interest result when three MINNCOR employees attended a National Football League game as guests of a business partner?
- Did MINNCOR comply with applicable state statutes and department policies and procedures when it disposed of certain surplus property?
- Did MINNCOR comply with applicable department policies and procedures when developing certain business partnership agreements and related pricing for goods produced?

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- Did the Department of Corrections have authority to establish and financially support the Minnesota Correctional Education Foundation?
 - Have potential conflicts of interest related to the foundation been appropriately addressed?

We reviewed relevant documents, including selected MINNCOR business partnership agreements and financial records. We reviewed applicable state statutes and Department of Corrections' policies and procedures. We also examined the accounting records of the Minnesota Correctional Education Foundation. We interviewed staff from the departments of Corrections and Administration and the Minnesota Correctional Education Foundation. We also obtained information from one of MINNCOR's business partners. Our review was not a full audit of MINNCOR Industries, the Minnesota Correctional Education Foundation or the federal *Grants to States for Workplace and Community Transition Training for Incarcerated Youth Offenders*.

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Chapter 2. MINNCOR Industries

Chapter Conclusions

The Department of Corrections did not adequately resolve a conflict of interest involving three MINNCOR employees who attended a National Football League game as guests of a vendor. In addition, MINNCOR did not comply with state statutes and department policies and procedures when disposing of surplus property, executing business partnership agreements, establishing sales prices, and paying vendor invoices.

In response to allegations, we conducted a review of certain MINNCOR transactions that occurred during fiscal years 2004 through 2006. The allegations included potential conflicts of interest, the improper disposition of surplus property, and questionable contracting practices. In addition, it was alleged that MINNCOR had inappropriately made donations to certain nonprofit organizations, including the Minnesota Correctional Education Foundation.

During our review, we found that MINNCOR had internal policies and procedures specific to particular operations; however, the policies were either not followed or did not reflect current MINNCOR practices. The following findings relating to surplus property, pricing, and contracts are examples of this situation. As a part of its policy, the department scheduled periodic reviews and updates of its policies and procedures. MINNCOR did not follow this schedule in 2005.

Current Findings and Recommendations

1. The Department of Corrections did not adequately resolve a conflict of interest.

The Department of Corrections did not adequately resolve a conflict of interest involving three MINNCOR employees who had influence over business partnership agreements. On November 21, 2005, the employees traveled to Green Bay, Wisconsin to discuss manufacturing processes and contract terms with a business partner. The company offered the MINNCOR employees tickets to the Monday night football game between the Green Bay Packers and the Minnesota Vikings. The tickets were for the company's private box. The employees said they each reimbursed the company \$67, which was the face value of the ticket. Although the employees reimbursed the company the face value of the tickets, that did not reflect the full value of attending the game, which included use of the private box, food, and beverages. We determined the total value of attending the

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game was approximately \$400 per person. In addition, the company also paid for the MINNCOR employees' meals and hotel accommodations.

Minnesota Statutes 2005, 15.43, prohibits state employees who may influence a purchasing decision from accepting anything of value from a company to which a contract or purchase order has been awarded. In addition, *Minnesota Statutes 2005*, 43A.38, subd. 2 states:

Employees in the executive branch in the course of or in relation to their official duties shall not directly or indirectly receive or agree to receive any payment of expense, compensation, gift, reward, gratuity, favor, service or promise of future employment or other future benefit from any source, except the state for any activity related to the duties of the employee...

A conflict of interest occurred when the company paid the MINNCOR employees' meals and hotel expenses and when the employees accepted tickets to the game. A conflict also existed because these tickets were not available to the general public, but only to the company and its guests.¹ MINNCOR's chief executive officer was aware of the employees' attendance at the football game, but did not consider it a problem since the game occurred outside of work hours and the employees paid the company the face value of the tickets.

A MINNCOR employee indicated the company had paid for their hotel accommodations pursuant to the department's contract with the company. The department's contract required the company to, "...provide initial and ongoing product training as may be required by STATE to effectively sell and manufacture products covered under this agreement..." The contract did not require the company to pay state employee meals and hotel accommodations. The Department of Corrections is responsible for employees' travel expenses while conducting state business. Allowing a company or vendor to pay these expenses violates statutory provisions designed to ensure fair contracting practices.

Recommendations

- *The Department of Corrections should ensure the three MINNCOR employees reimburse the company the full value of attending the football game.*

¹ *Minnesota Statutes 2005*, 43A.38, subd. 5, provides that certain actions by an employee shall be deemed a conflict of interest including "... use or attempted use of an employee's official position to secure benefits, privileges, exemptions or advantages for the employee or the employee's immediate family, or an organization with which the employee is associated, which are different from those available to the general public;..."

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- *The department should reimburse the company for any travel costs paid on behalf of its employees.*
- *The department should ensure its employees are aware of and comply with legal provisions regarding conflicts of interest.*

2. MINNCOR did not comply with state statutes and department policies and procedures when disposing of surplus property.

Department officials incorrectly believed that items produced by MINNCOR for resale were exempt from state statutes governing surplus property. The statutes do not exempt these resale items from surplus property requirements. *Minnesota Statutes 2005, 16C.23* gives the Department of Administration authority to dispose of surplus property for the state. The statute defines surplus property as:

...state or federal commodities, equipment, materials, supplies, books, printed matter, buildings, and other personal or real property that is obsolete, unused, not needed for a public purpose, or ineffective for current use.

There were several instances where MINNCOR did not comply with statutory requirements or department policies when disposing of surplus items:

- In January 2006, MINNCOR discontinued its Minnesota Line of farm equipment. MINNCOR sent out flyers to farm implement customers and posted the flyer on its website announcing that “The Minnesota Line Farm Equipment will be discontinued January 1, 2006,” and that “all wagons and gravity boxes will be sold.” MINNCOR sold the farm implement equipment at discounted prices. MINNCOR also sold the remaining farm implement service parts in lots after obtaining two verbal bids.

MINNCOR did not contact the Department of Administration before selling the equipment or service parts. In addition, MINNCOR did not comply with its own policies and procedures regarding the sale of the parts. The department’s policies and procedures required MINNCOR to advertise the sale to the general public and sell the items either by pre-pricing or making them available through sealed bids; however, MINNCOR accepted verbal bids. Some customers, who had purchased wagons or gravity boxes at discounted prices, said they were unaware the service parts were available for sale and were angry that they were not given an opportunity to bid on the items.

MINNCOR sold the parts based on a \$10,000 verbal bid when its inventory records reflected the items originally cost over \$400,000. MINNCOR’s chief financial officer explained the inventory records were not accurate, indicating that

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some of the parts were nearly 30 years old, and MINNCOR should have written down the inventory value to zero several years ago.

- MINNCOR did not contact the Department of Administration before donating 52 wooden cabinets to a local nonprofit organization. The Department of Administration's User Guide to State Property Management states that a nonprofit organization "must be certified eligible by the [Department of Administration's] Surplus Services in order to receive surplus property from any state agency." MINNCOR did not contact the Department of Administration's Surplus Services when it donated these items, nor was the nonprofit certified to receive surplus property from the state.
- In October 2005, MINNCOR held a garage sale to dispose of water damaged furniture. MINNCOR did not contact the Department of Administration to determine the most appropriate method of handling the disposal of these items.

The department's policies made a distinction between "surplus product" and "surplus property." The policy defined surplus product as customer returns, damaged products, product prototypes, obsolete products, or any MINNCOR product that could not be marketed and sold as new. The policy required MINNCOR to advertise the sale of surplus products to the general public and sell the items either by prepricing or making them available through sealed bids. In contrast, MINNCOR defined surplus property as surplus fixed assets and equipment previously used by MINNCOR for manufacturing or delivery purposes. Department policy stated surplus property would not be sold unless approved by the Department of Administration's Surplus Property Division. Although the department made this distinction between surplus product and surplus property, it is not reflected in statute.

Recommendations

- *The Department of Corrections should ensure MINNCOR complies with Minnesota Statutes regarding the disposition of surplus property.*
- *The department should ensure its policies coincide with statutory requirements concerning surplus property and that MINNCOR follows these policies.*
- *The department should ensure MINNCOR's inventory records are accurately maintained.*

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3. MINNCOR did not comply with department policies with regard to contracts and pricing and state statutes with regard to prompt payment of invoices.

MINNCOR did not comply with department policies and procedures when executing business partnership agreements and establishing sales prices. In addition, MINNCOR did not follow state statutes regarding prompt payment of invoices. Several of the business partnership agreements had no evidence of an approval by MINNCOR's executive team before being sent to the business partner for signature. Members of MINNCOR's executive team include its chief executive officer, chief financial officer, director of administration, and the vice presidents of sales, business development, and operations.

Department policy 403.080 requires proposed contracts be submitted to the executive team for final approval before contracts go to the customer for signature. MINNCOR officials said the executive team reviews and approves these contracts; however, there was no evidence in executive team meeting minutes or other documentation to support the review and approval of contracts. Documentation of the executive team's discussion and approval of a contract would be helpful if questions arise regarding the contract's terms and conditions.

MINNCOR did not adequately document how it established product and service sale prices. Department of Corrections policy 405.020 requires MINNCOR to use a pricing sheet for all products and services. The policy requires that the cost of raw materials, overhead, general and administrative expenses, and any other expenses be included when determining product and labor service costs. The cost is to be increased by a minimum of ten percent for profit. Although MINNCOR tracks these costs, the department did not sufficiently document how it arrived at the sale prices. Documentation may include analysis of market conditions, profit margins, or other factors considered when setting the sale prices.

MINNCOR did not comply with statutory requirements concerning timely payment of vendor invoices. MINNCOR did not pay four of nine invoices tested in a timely manner. The department paid the four invoices during the period of August 2004 through September 2005. According to *Minnesota Statutes* 2005, 16A.124, subd. 3, state agencies generally must pay vendors within 30 days following the receipt of the invoice for the delivery of the product or service. Nontimely payment of invoices subjects the department to additional and unnecessary costs.

Recommendations

- *The Department of Corrections should ensure MINNCOR complies with its policies and procedures concerning the approval of business partnership agreements and pricing of products and services.*
- *The Department of Corrections should ensure all invoices are paid in accordance with the statutory prompt payment requirement.*

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Chapter 3. Minnesota Correctional Education Foundation

Chapter Conclusions

The Department of Corrections created and financially supported the Minnesota Correctional Education Foundation without statutory authority. Conflicts of interest from public officials serving on the foundation board have not been adequately addressed. In addition, the department may have inappropriately used a federal grant to pay the entire salary of the foundation's executive director. It also inappropriately transferred MINNCOR money to the Minnesota Correctional Education Foundation.

During our review of MINNCOR, we found that officials at the Department of Corrections had transferred money from MINNCOR to the Minnesota Correctional Education Foundation. We questioned the department's authority to make the transfer and decided to expand our review to include the foundation.

Current Findings and Recommendations

4. The Department of Corrections created and financially supports the Minnesota Correctional Education Foundation without statutory authority.

State law did not authorize the department to establish and financially support the Minnesota Correctional Education Foundation. The department created the foundation as a private, nonprofit organization, transferred money to the foundation, and provided it with office space and other administrative support. Department of Corrections' officials stated that the foundation's purpose is to support the department's postsecondary education program for inmates.

State agencies operate under explicit and detailed statutory authority and restrictions, particularly in their use of money appropriated by the Legislature. Absent specific authority, state agencies cannot create separate legal entities (such as a nonprofit organization), transfer money, and provide administrative support to those entities. In this case, the department's unauthorized actions create concerns about accountability and conflicts of interest.

When the Legislature authorizes the creation of a nonprofit organization, it typically defines the entity's purpose and obligations, as well as how the entity will interact with state agencies. The authorizing legislation also normally defines the composition of the governing body and identifies the laws with which it must comply, such as the state's

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Open Meetings Law, the Government Data Practices Act, Code of Ethics, and other laws that set standards for how state business must be conducted. Since the Department of Corrections created the Minnesota Correctional Education Foundation without authorizing legislation, neither the Legislature nor the Governor (who is part of the lawmaking process through the power to sign or veto legislation) were able to set standards or expectations for the foundation's operations. Essentially, the foundation is operated at the discretion of officials in the Department of Corrections. For example:

- The department's director of education is the immediate supervisor of the foundation's executive director.
- The Department of Corrections provided administrative support, including office space, supplies, and equipment to the foundation estimated to be worth nearly \$24,000.
- The department "donated" \$25,000 to the foundation. (Finding 7 further discusses this concern.)
- The commissioner of the Department of Corrections, MINNCOR's chief executive officer, and the department's director of education are among the ten voting members on the foundation's board of directors.

In addition to the fact that state law did not authorize creation of the foundation or define its relationship with the Department of Corrections, no agreement exists between the department and the foundation to define their respective roles, responsibilities, and liabilities. State agencies should not operate or use public money in such an informal and unauthorized way.

Recommendation

- *The Department of Corrections should obtain statutory authority during the 2007 Legislature to provide administrative or financial support to the Minnesota Correctional Education Foundation. If the authority is obtained, the department should enter into a detailed agreement with the foundation that clearly defines their respective roles, responsibilities, and liabilities. If the statutory authority is not obtained, the department should stop providing administrative and financial support to the foundation.*

5. Conflicts of interest from public officials serving on the foundation board have not been appropriately addressed.

Conflicts of interest resulted when department officials served on the Minnesota Correctional Education Foundation's board. Department officials who served on the

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foundation's board did not comply with the state's code of ethics statutes and department conflict of interest policies. *Minnesota Statutes 2005*, 43A.38, subd. 5, provides that certain actions by an employee shall be deemed a conflict of interest and subject to procedures regarding resolution of conflicts.

These actions include:

...use or attempted use of an employee's official position to secure benefits, privileges, exemptions or advantages for . . . an organization with which the employee is associated, which are different from those available to the general public.

In addition to the financial support discussed in Finding 4, the department issued three payments to the foundation totaling \$60,500 from the Minnesota Industries Revolving Fund.

- MINNCOR's chief executive officer, who is also a member of the foundation's board of directors, authorized two payments totaling \$25,000 to the foundation.
- Another MINNCOR employee, who reported to MINNCOR's chief executive officer, authorized a third payment for \$35,500.

Department employees authorized the use of state funds to the benefit of the foundation, an organization they were associated with as board members. These funds may not have been as available to other organizations as they were to the foundation because of this association.

In addition to conflicts related to department officials serving on the board, conflicts arise from the fact that the president of Inver Hills Community College is also a member of the foundation's board. The Department of Corrections entered into an interagency agreement with Inver Hills Community College in which the college agreed to provide a full time executive director for the foundation. The department agreed to provide Inver Hills Community College up to \$55,000 in salary, benefits, and travel expenses for the foundation's executive director. The department used money from the federal *Grants to States for Incarcerated Youth Offenders* (CFDA #84.331) for these costs. (The use of these federal grant funds is further discussed in Finding 6.)

Inver Hills Community College paid the foundation's first executive director under a consulting contract and received reimbursement from the Department of Corrections. In December 2005, an employee of Inver Hills Community College became the foundation's executive director. She remained on the college's payroll, and the college obtained reimbursement from the Department of Corrections.

When a person holds positions in two or more organizations, there is a potential conflict of interest if the person can use one position to influence decisions that benefit another

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organization with which he or she is associated. State law contains procedures to avoid having these potential conflicts become actual conflicts. Given the potential for conflicts by having public employees serve on the foundation's board, these employees should comply with *Minnesota Statutes* 2005, 43A.38, subd. 6, which requires employees avoid situations where they believe a potential conflict exists.

Recommendation

- *If the foundation continues, the Department of Corrections should ensure that public employees serving on the foundation board comply with the Minnesota Statutes 2005, 43A.38.*

6. The Department of Corrections may not have complied with federal grant requirements.

The department may have inappropriately used federal grant funds from the U. S. Department of Education to reimburse Inver Hills Community College for the salary, benefits, and travel costs of the Minnesota Correctional Education Foundation's executive director. *Grants to States for Workplace and Community Transition Training for Incarcerated Youth Offenders* (CFDA #84.331), restricts the use of funds to benefit inmates who are 25 years old or younger and who are eligible for parole or release within five years.² The foundation's mission does not limit its support or efforts to inmates who meet the federal grant eligibility requirements.

To comply with federal grant provisions, the department should only use the federal grant for the portion of the executive director's salary, benefits, and travel costs that relates to the foundation's support of eligible inmates. The remaining costs would need to be funded from a source other than this federal grant. Since the foundation has not used its resources for the direct benefit of any inmates as of March 31, 2006, the use of these federal grant funds for the executive director's salary may not be allowable.

Recommendations

- *The Department of Corrections should work with the U.S. Department of Education to determine whether the use of federal grant funds to pay the executive director's salary, benefits, and travel costs is allowable.*

² The federal grant's guidelines allow the use of funds to pay the costs of administering the federal grant program. The guidelines state the administrative costs must be necessary and reasonable and may include costs of coordinating and collaborating with public and private agencies, institutions, and organizations in order to identify resources that can be used to supplement the federal grant program.

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- *The department should only charge the federal grant for the portion of the executive director's salary, benefits, and travel costs that relates to its support of eligible inmates.*

7. The Department of Corrections inappropriately transferred \$25,000 from MINNCOR to the Minnesota Correctional Education Foundation to sponsor the foundation's golf tournament and provide a general donation.

The Department of Corrections inappropriately transferred \$25,000 from MINNCOR's Minnesota Industries Fund to the foundation. In January 2005, MINNCOR paid the foundation \$10,000 to sponsor the foundation's first annual golf tournament. In March 2005, MINNCOR paid the foundation an additional \$15,000 "as a supporter of the work of the Minnesota Correctional Education Foundation." These payments did not comply with *Minnesota Statutes* 2005, 241.27, subd. 2, concerning the appropriate use of the Minnesota Industries Fund. The statute states:

...The revolving fund established shall be used for the conduct of the industrial and commercial activities now or hereafter established at any state correctional facility, included but not limited to the purchase of equipment, raw materials, the payment of salaries, wages and other expenses necessary and incident thereto...Additionally, the expenses of inmate vocational training . . . may be financed from the correctional industries revolving fund

The foundation deposited the \$10,000 golf sponsorship and the \$15,000 donation in its savings account. As of March 31, 2006, the foundation had not expended these funds. MINNCOR no longer had direct control over how these funds were used. While state statutes provide that Industries Fund monies can be used for the payment of inmate vocational training, the department no longer controls these funds and cannot assure that the monies are used for their intended purpose.

Recommendations

- *The Department of Corrections should obtain repayment of \$25,000 from the Minnesota Correctional Education Foundation.*
- *The department should ensure Minnesota Correctional Industries funds are expended in compliance with statutory requirements.*

Special Review - Department of Corrections

- **MINNCOR Industries**
- **Minnesota Correctional Education Foundation**

8. The Department of Corrections inappropriately transferred \$35,500 from MINNCOR to the foundation to pay for services contracted for by the department.

In February 2006, MINNCOR paid the foundation \$35,500 for it to pay a private college for vocational training the college provided to inmates. Department of Corrections had negotiated a contract with a private college to provide this training. Although the department negotiated the fee with the college, the contract did not specify the fee nor did it require that the department pay the college. While the money was used for an authorized purpose, MINNCOR inappropriately paid the foundation rather than paying the private college directly for the vocational training. The department should not send state funds to the foundation to make payments on its contracts.

Recommendation

- *The department should directly pay vendors for contracted services.*



OFFICE OF THE COMMISSIONER
Contributing to a Safer Minnesota

July 19, 2006

James R. Nobles, Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St. Paul, MN 55155-1603

Dear Mr. Nobles:

Thank you for the opportunity to discuss and comment on the recommendations arising from the special review of MINNCOR Industries. The efforts of your office are appreciated in conjunction with completing this special review. Below please find a response for each finding in the report.

Recommendation

The DOC should ensure the three MINNCOR employees reimburse the company the full value of attending the football game.

Response

The Department of Corrections attempted to adequately resolve the conflict of interest allegation through investigation, follow-up action, and training. MINNCOR believed staff paying for the face value of the ticket was adequate. The Department will comply with the Auditor's recommendation and the employees will reimburse the company for the full value of attending the football game.

Person Responsible:
Chris Pizinger

Estimated Completion Date:
August 2006

Recommendation

The DOC should reimburse the company for any travel costs paid on behalf of its employees.



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Response

The Department of Corrections will comply with this recommendation. MINNCOR understood that travel costs were to be paid by the company as part of the training agreed upon in contractual agreement absent of language specifying otherwise. MINNCOR will reimburse the vendor for the travel costs as recommended.

Person Responsible:
Chris Pizinger

Estimated Completion Date:
August 2006

Recommendation

The DOC should ensure its employees are aware of and comply with legal provisions regarding conflicts of interest.

Response

The Department of Corrections agrees with this recommendation. An agency-wide code of conduct training, developed by the Department of Finance, will be mandatory for all managers. This training will be delivered this fiscal year and annual refresher courses will be provided thereafter.

Person Responsible:
Lisa Cornelius

Estimated Completion Date:
July 2007

Recommendation

The DOC should ensure MINNCOR complies with Minnesota statutes regarding the disposition of surplus property.

Response

The Department of Corrections agrees with this recommendation. As highlighted in the Auditor's report, an ambiguity exists in the definition of state surplus property and its application to MINNCOR. MINNCOR believes products and material used in, and held for resale, in the normal course of business do not fall under the definition of state surplus property. MINNCOR defines the material it uses and products derived from such material as surplus *product* – not surplus *property*. MINNCOR has never produced products to be sold by the Department of Administration. Statutory language will be drafted to clarify the definition of surplus property and surplus product for MINNCOR. This change will be presented to the Legislature for consideration during the next legislative session.

Person Responsible:
Rich Schoenthaler

Estimated Completion Date:
June 2007

Recommendation

The DOC should ensure its policies coincide with statutory requirements concerning surplus property and that MINNCOR follows these policies.

Response

The Department of Corrections agrees with this recommendation. Policies will be reviewed annually to ensure compliance with statutory language.

Person Responsible:
Rich Schoenthaler

Estimated Completion Date:
Completed

Recommendation

The DOC should ensure MINNCOR inventory records are accurately maintained.

Response

The Department of Corrections agrees with this recommendation. Two years ago, MINNCOR began an extensive physical audit of fixed assets and inventory at each facility. Inventory procedures, methods, and training were redesigned and are being completed monthly and annually. Adjustments to reflect the true inventory and assets of MINNCOR were completed and written to the books as each facility's inventory and fixed assets were counted and reconciled. In addition, procedures were put in place in fiscal year 2006 to write off the cost of non-moving inventory, in excess of four years, on the MINNCOR books.

These procedures resulted in the write-off of the farm machinery inventory, which had an average life with no turns on the books of greater than 25 years. These types of adjustments and procedures would be in accordance with sound business practices and generally accepted accounting principles.

Person Responsible:
Rich Schoenthaler

Estimated Completion Date:
Completed

Recommendation

The DOC should ensure MINNCOR complies with its policies and procedures concerning the approval of business partnership agreements and pricing of products and services.

Response

The Department of Corrections agrees with this recommendation. Policies and procedures for MINNCOR will be revised to reflect current practice in regards to the approval of business partnership agreements and pricing of products and services. These practices will be in accordance with generally accepted accounting principles. Contract training will also be required for appropriate MINNCOR staff by the agency contract coordinator during the current fiscal year.

Person Responsible:
Rich Schoenthaler

Estimated Completion Date:
December 2006

Recommendation

The DOC should ensure all invoices are paid in accordance with statutory prompt payment requirements.

Response

The Department of Corrections agrees with this recommendation. Corrective action was taken immediately when the Department received the monthly prompt payment report reflecting non-compliance in this area. The Department will make every effort to pay all invoices within 30 days.

Person Responsible:
Lisa Cornelius

Estimated Completion Date:
Completed

Recommendation

The Department of corrections should obtain statutory authority during the 2007 Legislature to provide administrative or financial support to the Minnesota Correctional Education Foundation. If the authority is obtained, the department should enter into a detailed agreement with the foundation that clearly defines their respective roles, responsibilities, and liabilities. If the statutory authority is not obtained, the department should stop providing administrative and financial support to the foundation.

Response

Research has shown that offenders earning higher education degrees are significantly less likely to re-offend and create new victims. The Minnesota Correctional Education Foundation (MCEF) is a private, non-profit organization developed as an innovative, cost effective way for offenders to continue their education without using taxpayer funds. Outside legal counsel was involved in researching the authority to establish a foundation and referenced Minnesota Statute 465.717 for guidance. This statute does not specify state agencies are required to have statutory authority to create a corporation. Thus, the Department did not realize that legislative authority was needed. Presentations were made to the legislature in 2006 informing members of the new foundation but no authority was requested.

The Department of Corrections will comply with this finding. Statutory language will be developed to bring forward during the 2007 legislative session to obtain authority for the department to provide administrative and financial support to the MCEF. If approval is received the Department will enter into a detailed agreement with MCEF to make more clearly define roles, responsibilities, and liabilities.

Person Responsible:
Marcie Koetke

Estimated Completion Date:
June 2007

Response

If the foundation continues, the Department of Corrections should ensure that public employees serving on the foundation board comply with the Minnesota Statutes 2005, 43A.38.

Response

The Department of Corrections staff serving on the MCEF Board immediately resigned when informed that the auditor viewed their participation as a possible conflict of interest. Foundation Board members requested Department representatives maintain an ex-officio status with no voting rights. The foundation believes it is critical to have the expertise of the department and strong support of the MCEF mission. This mission is to provide eligible offenders with appropriate academic and vocational opportunities to prepare them for release as productive and contributing citizens. The Board is also expecting Department representatives to identify and ensure that best correctional practices are maintained as the board makes decisions regarding educational offerings.

The president of Inver Hills Community College was actively recruited to serve on the MCEF Board because of her valuable expertise in higher education and experience with successful foundations. Neither she nor other state employees realized voluntary service on the board could be perceived as a conflict of interest. She was advised on July 13, 2006 of the conflict of interest concerns raised by the legislative auditor and immediately submitted her resignation from the board.

Person Responsible:
Marcie Koetke

Estimated Completion Date:
Completed

Recommendation

The Department of Corrections should work with the U.S. Department of Education to determine whether the use of federal grant funds to pay the executive director's salary, benefits, and travel costs is allowable.

The department should only charge the federal grant for the portion if the executive director's salary, benefits and travel costs that relates to its support of eligible inmates.

Response

The Department of Corrections requested and received approval from the U.S. Department of Education for the use of federal grant dollars prior to entering into an agreement with Inver Hills Community College to establish a position to research and establish a foundation. There was no limitation set on the percent of federal funds that could be used to apply towards the director's salary, benefits, and travel. The department will work with the US Department of Education to obtain a more clearly stated approval.

Person Responsible:
Marcie Koetke

Estimated Completion Date:
September 2006

Recommendation

The Department of Corrections should obtain repayment of \$25,000 from the Minnesota Correctional Education foundation.

The department should ensure Minnesota Correctional Industries funds are expended in compliance with statutory requirements.

Response

In the past, prison industries operated with full state funding. The legislature eliminated this funding and required MINNCOR to become self-sufficient. The Department is relatively new at operating a business-like program and believed it was appropriate to market MINNCOR at this event as an opportunity to attract new business.

The Department of Corrections will comply with this finding and repayment of \$25,000 will be made from MCEF to MINNCOR. Contracts will be developed between the Department of Corrections and vendors directly when MINNCOR funds educational expenses. The practice of routing this funding through MCEF will discontinue. The Department will seek statutory language next legislative session to allow MINNCOR to fund educational activities other than direct vocational education expenses.

Person Responsible:
Marcie Koetke

Estimated Completion Date:
June 2007

It is the goal of the department to have corrected all of the report findings no later than June 2007. Thank you again for the efforts of your staff.

Sincerely,



Joan Fabian
Commissioner

Copy: Dennis Benson, Deputy Commissioner
Harley Nelson, Deputy Commissioner
Lisa Cornelius, Assistant Commissioner/Agency Chief Financial Officer