MINNESOTA CORRECTIONAL FACILITY - ST. CLOUD
FINANCIAL AND COMPLIANCE AUDIT
FOR THE FOUR FISCAL YEARS ENDED JUNE 30, 1987

JULY 1988

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

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STATE OF MINNESOTA
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Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Orville B. Pung, Commissioner
Department of Corrections

Mr. William F. McRae, Superintendent
Minnesota Correctional Facility - St. Cloud

Audit Scope

We have completed a financial and compliance audit of the Minnesota Correctional Facility - St. Cloud (MCF-St. Cloud) for the four fiscal years ended June 30, 1987. Section I provides a brief description of the MCF-St. Cloud's activities and finances. Our audit was made in accordance with generally accepted auditing standards and the standards for financial and compliance audits contained in the U.S. General Accounting Office Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, and accordingly, included such audit procedures as we considered necessary in the circumstances. Field work was completed on March 4, 1988.

The objectives of the audit were to:

- study and evaluate MCF-St. Cloud internal control systems, including revenues, expenses, liabilities, payroll, (employee and inmate), industries and social welfare accounts;
- verify that financial transactions were properly recorded on the statewide accounting (SWA) system;
- verify that financial transactions were made in accordance with applicable laws, regulations, and policies, including Minn. Stat. Chapters 241 to 244, and other finance-related laws and regulations; and
- determine the status of prior audit recommendations included in our audit report for the year ended June 30, 1983.

Management Responsibilities

The management of the MCF-St. Cloud is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures.

The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

The management of MCF-St. Cloud is also responsible for the facility's compliance with laws and regulations. In connection with our audit, we selected and tested transactions and records from the programs administered by MCF-St. Cloud. The purpose of our testing of transactions was to obtain reasonable assurance that management had, in all material respects, administered its programs in compliance with applicable laws and regulations.

Audit Techniques

During our audit, we employed a variety of audit techniques. These included, but were not limited to auditor observation, interviews with MCF-St. Cloud staff, analytical reviews to identify unusual transactions or trends, and the examination of documentation supporting a representative number of transactions. Statistical sampling techniques were used to assure that representative samples of transactions were chosen. However, the use of statistical sampling did not prohibit us from reviewing additional transactions which may have come to our attention during the audit.

Conclusions

In our opinion, except for the issues discussed in Section II, findings #1-6, and #8-10, the system of internal accounting control at MCF-St. Cloud in effect as of March 4, 1988, taken as a whole, was sufficient to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly.

In our opinion, for the period July 1, 1983 to June 30, 1987, MCF-St. Cloud properly recorded, in all material respects, its financial transactions on the statewide accounting system.

In our opinion, except for the issue addressed in Section II, finding #7, for the period July 1, 1983 to June 30,1987, MCF-St. Cloud administered its programs in compliance, in all material respects, with applicable finance-related laws and regulations.

Section II of this report contains the findings we developed during this audit. The recommendations are presented to assist you in resolving the audit findings and in improving accounting procedures and controls. We will be monitoring and reviewing the MCF-St. Cloud's progress on resolving these findings as identified in the response to this report. Section III entitled "Status of Prior Audit Recommendations and Progress Toward Implementation" includes a summary of the progress on all recommendations developed during our audit of MCF-St. Cloud for the fiscal year ending June 30, 1983, report dated June 1984.

We would like to thank the staff of the Minnesota Correctional Facility - St. Cloud for their cooperation during this audit.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

June 15, 1988

MINNESOTA CORRECTIONAL FACILITY - ST. CLOUD

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AUDIT PARTICIPATION

The following staff from the Office of the Legislative Auditor prepared this report:

John Asmussen, CPA	Deputy Legislative Auditor
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Judy Jensen, CPA	Staff Auditor
Mary Lentsch	Staff Auditor

EXIT CONFERENCE

The findings and recommendations in this report were discussed with the following people on Tuesday, March 29, 1988:

<u>MCF- St. Cloud</u>

William F. McRae, Superintendent
David Ek, Business Manager
Nick Heltemes, Accounting Officer
Clint Moran, Accounting Officer
Glen Bartel, Custody Lieutenant
Colonel Nemec, Personnel Director
Kathy Schumacker, Payroll Clerk
Jerry Pierzina, Industries Supervisor
Roy Swanson, Factory Manager
Gib Koopmeiners, Industries Accountant

<u>Department of Corrections</u>

Shirley Flekke, Fiscal Services Director
Peter Maurer, Accounting Director - Facilities

I. INTRODUCTON

Minnesota Correctional Facility - St. Cloud (MCF-St. Cloud), which opened in 1889, is one of five state facilities for adult male offenders. The facility houses young adult males, primarily between the ages of 18 and 24, in a maximum security environment. The facility consists of 55 acres surrounded by a 22 foot granite wall, and includes five separate cell houses, a recreation area, a dining room, a gymnasium, industrial and academic facilities, and an administrative section. The facility has a capacity of 700, with a current population of approximately 710. The facility employs approximately 350 staff to meet the necessary security, educational, and administrative needs of its population. MCF-St. Cloud is under the general management and control of the Commissioner of Corrections and the immediate supervision of a superintendent appointed by the commissioner. William F. McRae has served as superintendent since April 1968.

MCF-St. Cloud offers a wide variety of treatment programs including individual counseling, group counseling, job counseling, drug treatment, and recreational therapy. A number of programs incorporate both local and Twin Cities community resources, including college and vocational schools, halfway houses, and nonresidential ethnic culture programs. The facility's education department provides academic instruction and vocational training.

The industry program at the facility is designed to provide vocational learning experiences to inmates. Inmates are notified of job openings, apply for jobs and once hired, are subject to the same hire/fire policies outside workers encounter. Industries consist of furniture manufacturing, upholstery, metal working, printing, and mattress making. The facility also manufactures the state's license plates and tabs.

MCF-St. Cloud operations are financed primarily through General Fund appropriations made directly to the Department of Corrections, which is responsible for maintaining, controlling, and transferring the necessary funds to the appropriate facility accounts. Other funding sources include federal grants, outstate inmate contracts, social welfare receipts and industries' earnings. Expenditures for fiscal years 1985-1987 are shown below:

General Fund:	1987	1986	1985
Salaries	$11,440,914	$10,890,953	$10,381,405
Contract services	173,481	130,911	113,498
Travel	12,244	10,165	14,561
Supplies	1,344,011	1,303,081	1,292,088
Equipment	85,446	30,476	37,491
Other administrative expenditures	427,358	386,040	311,142
Expenditures from other sources	1,829,919	2,109 527	1,976,072
Total Expenditures	$15,306,373	$14,861,148	$14,126,257

II. CURRENT FINDINGS AND RECOMMENDATIONS

1. PRIOR AUDIT FINDING NOT RESOLVED: Accounting functions for the social welfare account, the canteen account, and the current expense account are not adequately separated, and reconciliations are not completed on a timely basis.

In the design of an accounting system a necessary consideration is the need for certain duties to be performed by different people. This separation of duties provides a check on the work of one individual by others and insures that errors, either intentional or otherwise, are detected during the business cycle.

Our prior audit report for the fiscal year ended June 30, 1983 noted that social welfare accounting functions at MCF-St. Cloud were not adequately separated. As of March 4, 1988, this situation remains unchanged. The same employee has responsibility for receiving cash, making the deposits, reconciling bank accounts, and reconciling receipts to SWA reports. In addition, a similar situation exists for both the canteen and the current expense imprest cash accounts. The ability by one employee to complete and reconcile these transactions make it possible for errors or irregularities to occur and remain undetected. Someone independent of the receipt process could complete the reconciliations or review the completed reconciliations.

Social welfare and canteen imprest cash accounts are not reconciled to SWA records on a timely basis. The most recent reconciliations completed for the social welfare account and the canteen account were for the months of October 1987 and February 1987, respectively. As of March 1988, a delay of between three and eleven months existed for the reconciliations of these accounts. The delay may cause problems, such as an input error which resulted in an overpayment of $2,670 to an inmate. Since the reconciliation was not completed until approximately one year after the input error was made, the inmate had spent the $2,670 and was transferred to another correctional facility. If the reconciliation had been performed timely, this error would have been detected and corrected before the money was spent and the inmate transferred. The staff tried to recover the amount, but thus far have not been successful.

RECOMMENDATIONS

- The reconciliations of the social welfare account, the canteen account, and the current expense account should be completed or reviewed by someone independent of other duties associated with these accounts.

- MCF-St. Cloud should reconcile both the social welfare account and the canteen account on a regular and timely basis.

- MCF-St. Cloud should continue attempts to collect the $2,670 erroneously credited to a former inmate.

2. <u>PRIOR AUDIT FINDING NOT RESOLVED: Electronic data processing controls over the MCF-St. Cloud social welfare account need to be strengthened</u>.

In accordance with Minn. Stat. Section 241.08, MCF-St. Cloud has established social welfare subaccounts for each inmate. The inmates are not allowed to carry cash in the facility. They are, however, permitted to purchase goods and services through a system that operates much like a checking account. This system, called "Inmate Social Welfare", is maintained on the MCF-St. Cloud computer system. All money the inmate receives from outside sources and inmate work programs increases the inmate's social welfare subaccount. Funds spent at the main canteen, the hobbycraft shop, or money sent to outside sources decreases the inmate's subaccount.

The computer system for the MCF-St. Cloud social welfare account generates a monthly statement for the inmates that summarizes their subaccount activity. The beginning and ending balances as well as each receipt and disbursement made by an inmate during the month are recorded on the statement. The computer is programmed to automatically calculate the inmate balance at month-end. We noted in our previous audit report for the fiscal year ended June 30, 1983, that it was possible for someone with system access to override this process and manually insert a balance at month-end. If this was done after the inmate statements had been run, but before the trial balance was generated, the balance in the social welfare account could be manipulated. The ability to manipulate account balances without entering transactions greatly decreases the reliability of computer generated balances. Only two or three employees work with the transactions, but no password is needed to access the system.

In addition, the computer system does not provide a postprocessing control for automatic verification of input corrections. After a batch of either receipts or disbursements has been entered into the computer system, the system displays an initial batch total. However, if a correction to a batch is entered onto the system, it does not display an adjusted total. As a result, the only method to verify the accuracy of the corrected transaction is for the input operator to pull up the transaction manually on the system. Currently, the input operator is not performing this verification. As discussed in finding #1, a posting error resulted in an overstatement of an inmate's account balance by $2,670. Had the operator called up the transaction to verify the input amount, the posting error would have been detected. Postprocessing controls are important to ensure that all transactions are properly entered.

We were told that the central office is considering the potential of acquiring a new computerized social welfare system. Such a system would provide better complementary controls.

RECOMMENDATIONS

- MCF-St. Cloud should consult with the central office staff or other knowledgable sources and devise computer controls to ensure the integrity of inmate subaccount balances. If costs of acquiring a new system are prohibitive, they should consider revising or adding manual controls to compensate for weaknesses in the computerized system.

- MCF-St. Cloud should add controls to automatically generate adjusted totals for batches with corrected entries or require the input operator to manually check the correction on the system immediately after inputting the transaction.

3. <u>The Honor Unit canteen is not operated through the statewide accounting (SWA) system and does not comply with Department of Correction (DOC) policies</u>.

MCF-St. Cloud has one canteen available for the use of all inmates. In addition, it has operated a canteen for the past ten years for inmates who reside in the Honor Unit, which is the most favorable living unit at MCF-St. Cloud. To be eligible an inmate must pass a special screening process and maintain certain behavioral standards. The daily operations of the canteen are handled by one inmate who is selected and supervised by an Honor Unit correctional counselor and the living unit director. Inmates make purchases with vending machine "coins" and are not allowed to purchase goods on credit. These purchases are not posted to the inmate accounts. The correctional counselor takes the "coins" to the business office, where the total is credited to the Honor Unit account. Additional goods for resale are purchased through the social welfare imprest cash account. MCF-St. Cloud estimated the Honor Unit canteen sales in fiscal year 1987 to be approximately $40,000.

The Honor Unit canteen expenditures are not directly processed through the SWA system. Minn. Stat. Section 16A.055, Subd. 2 requires all agencies to use the uniform accounting system prescribed by the Commissioner of Finance. Without a waiver from the Department of Finance, the Honor Unit canteen expenditures are to be processed through the SWA system. Inherent controls within the SWA system would provide assurance that the transactions comply with related rules and regulations and are accurately reported.

The Department of Corrections (DOC) has policies which govern the canteen operations at all correctional facilities. The policies detail both the general administrative and the records maintenance aspects of operating a canteen and include:

-- the develpment of specific policies and procedures, including written guidelines for the daily operations of the canteen;

-- periodic review of the canteen operations by the superintendent;

-- adequate records for all financial transactions; and

-- financial statements prepared for canteen operations at least quarterly.

MCF-St. Cloud's operation of the Honor Unit canteen does not comply with DOC policies. Specific policies and procedures have not been established, and a review of the operation has been limited to supervision by the living unit director. The business office has not supervised the accounting of financial transactions of the canteen and has not assisted in the development of financial statements. Without the proper monitoring of the canteen's financial activity and accurate financial statements, MCF-St. Cloud cannot be assured of the accuracy and propriety of the canteen's activity.

RECOMMENDATIONS

- MCF-St. Cloud should process all expenditure transactions on the SWA system for both canteens.

- MCF-St. Cloud should comply with the policies established by DOC for the operation of a canteen.

4. <u>Significant weaknesses exist in the internal controls over consumable inventory at MCF-St.Cloud</u>.

MCF-St. Cloud has a consumable inventory valued at approximately $450,000 as of June 1987. The inventory consists of food, clothing, drugs, automobile parts, and other supplies. MCF-St. Cloud assigns to each unit the responsibility for maintaining their own inventory and inventory records. The units having an inventory include plant operations, warehouse, pharmacy, health services, industry, food services, auto mechanics, tailor shop, and the canteen operation.

Elements of a strong internal control system for consumable inventory include:

-- an adequate separation of duties to ensure that the same individual cannot commit errors or irregularities that could not be prevented or detected;

-- physical security over the assets; and

-- an accurate recordkeeping system which can be relied on for detecting loss or theft.

The internal control systems over consumable inventory at MCF-ST. Cloud do not contain all of the elements described above. As a result, significant weaknesses exist in internal controls and are described below.

<u>Duties over consumable inventory are not separated</u>. The unit supervisors of food services, industry, plant operations, the tailor shop and the warehouse dispense inventory items, maintain the inventory records, and complete the physical inventory.

Effective internal controls provide that individuals other than those in custody of the inventory and inventory records should participate in the inventory counts and verify the counts to inventory records. Under the present system, it would be possible for intentional or unintentional errors to be concealed, since those in charge of inventory and records are also conducting the physical counts. The prevention or detection of errors or irregularities would be improved if someone independent of the inventory function verified the accuracy of the physical inventory records.

Adjustments of inventory records are not approved. During a physical inventory, differences between the inventory count and accounting records may be identified. Inventory supervisors for food services, industry, warehouse, the tailor shop, and plant operations resolve these differences by manually adjusting their inventory records downward to match the inventory count. We did not discover any significant reductions, but the potential exists.

The "Consumable Inventory Management Program Manual" issued by the Department of Administration requires that records of the inventory count be retained and a thorough effort be made to determine the cause for the differences. Most inventory supervisors do not maintain records of the physical count or obtain approval to adjust inventory records. Since the inventory supervisor has custody over the inventory records and completes the physical inventory, the prevention or detection of errors or irregularities would be improved if the unit supervisor would authorize the adjustment of inventory records. Inventory reports need to be completed by the inventory supervisor and signed by the unit supervisor prior to adjusting inventory records. These reports could then be used to investigate the cause of inventory differences.

Some units have insufficient inventory records. In our audit report issued April 1984, we recommended that MCF-St. Cloud establish a perpetual inventory system for the pharmacy. A perpetual inventory system has not been established. Also, health services, auto mechanics and the canteen do not maintain a perpetual inventory system. A perpetual inventory system normally is used to record all purchases and issuances of inventory. The balance in these records then can be compared to actual physical counts to detect loss or theft of inventory, and can also be used to determine the need to purchase additional inventory. A perpetual inventory system is important, because one individual has complete control and inventory balances are not independently verified, and because the unit supervisors cannot determine if a loss or theft of inventory occurred. We acknowledge that a perpetual system would be more costly to maintain, but it would be merited at least for sensitive items.

Because of the weaknesses described above, MCF-St. Cloud cannot rely on the accuracy of the inventory or the inventory records. In order to provide adequate internal controls over consumable inventory, MCF-St. Cloud needs to ensure that internal controls over every consumable inventory have all the elements of a strong internal control system described above.

RECOMMENDATION

- MCF-St. Cloud should review their internal controls over the consumable inventory at every location to ensure that:

  -- a separation of duties over consumable inventory exists;

  -- inventory records are maintained and inventory adjustments are properly approved; and

  -- those units without inventory procedures establish a perpetual inventory system for all sensitive items and others where justified.

5. MCF-St. Cloud has not complied with Department of Administration guidelines for completing physical inventories and spot-checks of fixed assets.

MCF-St. Cloud has a fixed asset inventory recorded at a cost of $1.4 million as of March 1, 1988. The inventory consists of 1,271 items and includes equipment, vehicles, machinery, and tools. MCF-St. Cloud has internally separated the fixed asset inventory function between industries and the custody office. Each unit has responsibility over the fixed assets under its authority and maintains its own inventory records.

Minn. Stat. Section 16B.04 authorizes the Department of Administration (DOA) to provide direction to all state agencies for the management and control of fixed assets. In 1985 DOA issued to state agencies the "Fixed Asset Records Management System (FARMS) Users Manual" providing information and instructions on the proper management of state owned fixed assets. This manual includes the requirement that every state agency complete a physical inventory of their fixed assets at least once every two years. However, the custody section at MCF-St. Cloud has not completed a physical inventory in over two years, and industries has not completed a physical inventory since 1980.

The FARMS manual also requires that as part of the management of fixed assets state agencies complete spot-checks of the fixed asset inventory. The spot-checks are to be completed in the interim period between physical inventories. The procedures for the spot-checks include:

-- establishing a schedule to insure that each area of each building is spot-checked;

-- preparing a report stating the accuracy level and discrepancies discovered at each area; and

-- completing a physical inventory for those areas that fall below the 92 percent minimum accuracy level.

MCF-St. Cloud did not have a schedule for the spot-checks and completed them only as time permitted. In addition, MCF-St. Cloud did not keep records of the spot-checks and did not utilize results to identify which areas should have a complete physical inventory.

A physical inventory serves to verify the existence of the fixed assets and determine the accuracy of the inventory records. Spot-checks serve as a means of maintaining the minimum accuracy levels of the fixed assets inventory between the completion of the physical inventories. We did not have problems finding any assets in our testing. Because MCF-St. Cloud has not taken a complete physical inventory in over two years and did not maintain records or utilize the results of the spot-checks as required by DOA, we are uncertain of the accuracy or reliability of the fixed asset records.

RECOMMENDATION

- MCF-St. Cloud should comply with Department of Administration requirements and complete a physical inventory as a minumum every two years. Spot-checks should be completed according to the procedures described in the FARMS manual issued by DOA.

6. <u>PRIOR AUDIT FINDING PARTIALLY RESOLVED: Procedural controls over the procurement of services and the processing of contract disbursements need to be strengthened</u>.

MCF-St. Cloud expended approximately $196,000 for professional and technical services in fiscal year 1987. The following areas of noncompliance with state administrative policies governing contracted services were identified:

<u>Contractual services were rendered and liabilities were incurred by MCF-St. Cloud before the written agreements were finalized</u>.

Minn. Stat. Section 16A. 15, Subd. 3 requires that payments may not be made prior to incurring an obligation. Subdivision 3 also provides that "a claim presented against an appropriation without prior encumbrance may be made valid on investigation, review and approval by the Commissioner of Finance, if the services, materials, or supplies to be paid for were actually furnished in good faith without collusion and without intent to defraud."

Finance Procedure 06:04:18 and Minn. Stat. Section 16A.15, Subd. 3 require state agencies to submit letters of explanation for incurring contractual service and other obligations prior to the encumbrance of funds. These letters must be authorized by the Department of Finance prior to the payment of services or employees may be held liable for incurring these obligations. Finance Operating Procedure 06:04:05 provides that contracts are to be signed prior to their effective date.

Four out of the ten contracts we tested were signed and encumbered after the contractual services had begun. Three of the four were with health service providers. MCF-St. Cloud did not send letters of explanation to the Department of Finance as required by Minn. Stat. Section 16A.15, Subd. 3. Failure to comply with state contract policies increases the risk that MCF-St. Cloud may incur unauthorized obligations.

Contracts were not developed for professional/technical services exceeding $2,000.

All state contracts, including professional/technical service agreements are subject to review and approval by the Department of Administration, Contract Management Division, and must be approved as to form and execution by the Office of the Attorney General. Agencies may request advance approval of Contract Management for professional/technical services expenditures under $500 with an annual plan instead of by separate contracts. This plan must include the total dollar amount of services to be used, the dollar amounts for each category in the plan, and the methods used for calculating the rates. The maximum amount that may be paid to any one firm or individual during a fiscal year is $500, although this limit may be raised to $2,000 if approved in the annual plan. MCF-St. Cloud received approval for the $2,000 limit for health care facilities.

Four vendors received payments, ranging from $2,966 to $15,862, for which contracts were not established. The Department of Administration Policy and Procedure Manual ADM-188 requires that a contractual services agreement must be processed if payments to the vendor will be $2,000 or more. In addition to noncompliance with ADM-188, the critical effect of not negotiating a legal, written document binding the parties could result in future litigation or claims against MCF-St. Cloud. Areas such as financial and payment terms, conditions, duties and responsibilities, liabilities and effective time periods need to be defined in a written contractual services agreement.

In addition to noncompliance with state administrative policies, MCF-St. Cloud did not maintain documentation supporting the contractual agreements. Contracts with three hospitals provide for a price list of services used for billing their charges to the facility. MCF-St. Cloud did not request these price lists and without these lists, they could not verify the costs charged against the contract. We could not determine whether the amounts paid to these hospitals were correct.

RECOMMENDATIONS

- Contracts should be developed for professional/technical services which are estimated to exceed over $2000 per year.

- Contract agreements should be processed prior to the start of services. If necessary, MCF-St. Cloud should send letters of explanation to the Department of Finance as required by Minn. Stat. Section 16A.15 when obligations have been incurred before funds have been encumbered.

- Price lists should be obtained for all contracts to verify charges against the contract.

7. <u>The Industries Services Plan improperly allows for sales to state employees and discounts on industry services to employees of MCF-St. Cloud</u>.

The industry program at MCF-ST. Cloud is designed to employ inmates in a work setting, provide exposure to realistic work habits, and develop marketable occupational skills. Industries at the facility consists of furniture manufacturing, upholstery, metal working, printing, and mattress manufacturing. Sales of services and products at the facility amounted to over $530,000 for fiscal year 1987.

The Industries Business Plans states that industries services and products are available to state and local government units, colleges, nonprofit organizations, selected private sector businesses, and state employees. This provision potentially may be in conflict with the provisions of Minn. Stat. Section 15.054, which allows public employees to purchase materials produced by the state only if they are available to the general public.

Many employees of the MCF-St. Cloud purchase products or services through the industries program, and are currently receiving a 25 percent discount on materials on upholstery services not available to other customers. Minn. Stat. Section 43A.38, Subd. 5 prohibits use of employee's official position to secure benefits or advantages not available to the general public. These discounts are not available to other customers of the industries' program.

RECOMMENDATIONS

- Minnesota Correctional Industries - St. Cloud should revise their marketing plan to make all services available to the general public or eliminate sales to state employees.

- Industries should eliminate the policy of providing discounts on upholstery services to MCF-St. Cloud employees.

8. <u>MCF-St. Cloud has not established an agreement with the Department of Public Safety for the production of license plates and tabs</u>.

Industries at MCF-St. Cloud produces automobile, truck and other vehicle license plates and tabs for the Department of Public Safety (DPS). In 1987 industries produced 4.4 million tabs and 700,000 license plates. Industries billed DPS approximately $44,000 for utilities, administrative expenditures, and inmate wages, and $76,000 for electricity charges. Materials are provided by DPS.

No specific statute gives MCF-St. Cloud the responsibility to produce license plates. There also is no agreement between DPS and industries at MCF-St. Cloud for the production of license plates and tabs, and the billing of related costs. Because there is no agreement, questions or disputes over costs and responsibilities may arise. For instance, MCF-St. Cloud currently charges DPS 40 percent of the electric bill received by the facility each month. This rate is based on a usage study completed by MCF-St. Cloud in 1968. It is possible that because of the length of time since the date of the study, and due to changes in production, the allocation of electricity costs could have changed. An agreement would help to resolve this issue. Minn. Stat. Section 471.59 provides the statutory authority for agreements between agencies. The statute requires each agreement to state its purpose and requires strict accountability for all funds and a report of all receipts and disbursements. An agreement would identify specific responsibilities and provide a means for determining the basis for reimbursement of costs. It would also provide a process for avoiding future problems by allowing for the negotiation of contract elements. Good business practice requires periodic renegotiation.

RECOMMENDATION

- MCF-St. Cloud should negotiate an agreement with the Department of Public Safety for the production of license plates and tabs. This agreement should include the responsibilities of both parties under the contract, and identify the method for determining costs and the reimbursement process.

9. <u>Controls over the calculation of workers' compensation benefits and leave restoration are inadequate</u>.

During fiscal years 1986 and 1987, MCF-St. Cloud had 15 work-related injuries which resulted in employees missing time from work. An employee may elect to use accumulated vacation or sick leave, or both, during an absence resulting from injury or illness for which a claim for workers' compensation is made or while an award of benefits is pending. Minn. Stat. Section 176.021, Subd. 5 provides that the payment of workers' compensation and vacation or sick leave benefits shall not result in the payment of a total weekly rate of compensation that exceeds the weekly wage of the employee. If a state employee is receiving workers' compensation payments, the employing agency must not pay more than the difference between the workers' compensation payment and the employee's normal salary.

One employee of MCF-St. Cloud received an overpayment of $137 of workers' compensation benefits during fiscal year 1986. The MCF-St. Cloud personnel office receives the "Notice of Discontinuance of Workers' Compensation Benefits" report from the Department of Employee Relations, Workers' Compensation Division. This report summarizes the workers' compensation benefits awarded by the Workers' Compensation Division and is sent to all agencies when workers' compensaton benefits have been discontinued for an employee. The report of July 24, 1986, showed an overpayment of $137 of workers' compensation for one employee, requiring an adjustment by the personnel office at MCF-St. Cloud. The MCF-St. Cloud personnel office did not adequately review this report and as a result, did not make the required adjustment.

When a workers' compensation award has been made, the agency must restore a portion of the leave taken during the period in which the benefits were received, not to exceed two-thirds of the employee's normal salary. The hours of leave restored are calculated by dividing the workers' compensation benefits received by the employee's normal hourly rate. These steps are included in Department of Finance Operating Policy and Procedure 07:04:31.

MCF-St. Cloud does not maintain adequate documentation supporting their workers' compensation leave restoration calculations. We tested a sample of five employees who received workers' compensation benefits during fiscal years 1986 and 1987. We had to contact the Workers' Compensation Division to obtain support for the amount of benefits paid to three of the employees. With this documentation we were able to reconstruct the calculation for determining the amount of leave restored by MCF-St. Cloud for four of the five employees. However, because of inadequate documentation, we could not reconstruct the leave restoration calculation for the fifth employee. Without sufficient documentation, inadequate support exists for responses to inquires from the employee or other sources.

RECOMMENDATIONS

- MCF-St. Cloud should correct the leave balance for the employee who received $137 in excess workers' compensation benefits,

- MCF-St. Cloud should maintain adequate documentation supporting the leave restoration calculation for employees receiving workers' compensation benefits.

10. <u>PRIOR AUDIT FINDING NOT RESOLVED: Receipts totaling over $250 are not deposited promptly</u>.

Minn. Stat. Section 16A.275 requires that all receipts be deposited daily into the state treasury or a depository bank if total receipts exceed $250. In our prior audit report for fiscal year 1983, we noted that receipts were not deposited daily and in some instances were accumulated and not deposited until the end of the week. While MCF-St. Cloud has improved their deposit procedures since 1984, receipts are still not being deposited promptly. Procedures for the deposit of receipts are as follows:

-- Day One - Money is received at the information desk and "cage one" (reception area) and is stored overnight.

-- Day Two - Money is brought over to the business office, combined with the business office receipts, and a deposit form is prepared.

-- Day Three - Money is deposited into a state depository.

The current procedures result in a deposit of funds from the information desk and cage one at a minimum of two days after receipt. This procedural delay does not comply with statutory requirements.

RECOMMENDATION

- MCF-St. Cloud should comply with Minn. Stat. Section 16A.275 and deposit receipts promptly when the total daily receipts exceed $250.

III. STATUS OF PRIOR AUDIT RECOMMENDATIONS AND PROGRESS TOWARD IMPLEMENTATION

Minnesota Correctional Facility-St. Cloud (MCF-St. Cloud) Diversified Industries has not developed an effective cost accounting system.

1. MCF-St. Cloud Diversified Industries should work with the DOC central office staff to develop an effective cost accounting system to accumulate and assign all costs of production for goods and services produced.

RECOMMENDATION IMPLEMENTED. In fiscal year 1985, MCF Diversified Industries developed a manual cost accounting system which accumulates direct labor costs, materials and factory overhead costs in order to determine the total costs of goods and services provided.

Inventory records maintained at MCF Diversified Industries need to be improved.

2. MCF-St. Cloud Diversified Industries should develop perpetual records for all raw materials inventory items.

RECOMMENDATION IMPLEMENTED. MCF-St. Cloud developed a perpetual inventory system in fiscal year 1985 for raw material inventory items. Inventory cards are maintained for each inventoried item. All purchases, issuances or inventory adjustments are recorded timely on the inventory cards.

The accounts receivable policy for MCF-St. Cloud Diversified Industries needs to be reviewed.

3. MCF-St. Cloud Diversified Industries should work with DOC central office to develop an accounts receivable policy which would include 30 days as the normal payment period and an interest or penalty charge on balances older that 30 days.

RECOMMENDATION WITHDRAWN. An opinion issued by the Office of the Attorney General on June 5, 1980, disallowed the charging of interest on industries overdue accounts. This opinion states that Minn. Stat. Section 334.16 does not provide for charging of interest on open end credit sales. While this opinion addressed overdue accounts at Lino Lakes, overdue accounts at MCF-St. Cloud are also the result of open end credit sales. Consequently, MCF-ST. Cloud cannot charge interest on the overdue accounts resulting from industries sales.

MCF-St. Cloud Diversified Industries does not periodically reconcile expenditures to the statewide accounting (SWA) system records.

4. MCF-St. Cloud Diversified Industries should establish procedures to periodically reconcile industries expenditures to SWA records to ensure the accuracy of payments.

RECOMMENDATION IMPLEMENTED. An employee at MCF-St. Cloud Diversified Industries has reconciled the manual expenditure records to SWA reports on a monthly basis since fiscal year 1985.

The documentation supporting payroll transactions is not processed in a consistent manner and is not always retained for subsequent verification.

5. Written procedures describing payroll reporting requirements including the types of documentation and signatures needed to support payroll transactions should be developed and distributed to timekeepers and other staff members. All documentation should be retained for subsequent verification.

RECOMMENDATION IMPLEMENTED. In April 1986, MCF-St. Cloud developed new institutional policies containing detail reporting requirements for payroll. Documentation supporting payroll transactions was maintained by MCF-St. Cloud.

Duties for processing payroll and other disbursements are not segregated.

6. The duties of maintaining personnel records and entering payroll data into the computer should be assigned to separate individuals.

RECOMMENDATION IMPLEMENTED. In fiscal year 1985, MCF separated the duties for processing payroll by assigning to one employee the responsibility for maintaining the personnel records, while another employee enters the payroll data.

7. The payment of invoices should be approved by someone independent of the other duties in the purchasing process.

RECOMMENDATION IMPLEMENTED. Since fiscal year 1984, responsibility for the payment of disbursements has been assigned to separate individuals. The budget accountant approves the purchases orders, an account clerk prepares the orders, and the business manager authorizes the payment.

Procedural controls over procurement and the processing of disbursements need to be strengthened.

8. Expenditures shall not be authorized for payment unless all supporting documentation is properly prepared and completed.

RECOMMENDATION PARTIALLY IMPLEMENTED. Beginning in fiscal year 1984, MCF developed procedures for the processing of payments in compliance with Department of Finance requirements. However, MCF-St. Cloud did not resolve the problems relating to payments to certain vendors exceeding $2,000 without establishing contracts. See current finding #6.

Internal controls over the pharmacy inventory need to be strengthened.

9. MCF-St. Cloud should establish and maintain perpetual inventory records using either manual or computerized methods.

RECOMMENDATION NOT IMPLEMENTED. See current finding #4.

10. The periodic physical inventory and verification of pharmaceuticals received should be completed by another employee from the pharmacy or the business office in the presence of the pharmacist.

RECOMMENDATION IMPLEMENTED. Since fiscal year 1984, a health service employee and warehouse employee have compared the pharmaceuticals received to the shipping order, and a health services employee has accompanied the pharmacist when completing the physical inventory.

The controls over gasoline inventories are inadequate.

11. MCF-St. Cloud administration should improve controls over the gasoline inventory as follows:

    -- physical inventories of gasoline should be taken by someone independent of the receiving and disbursing function;

    -- written procedures for completing physical inventories should be developed and distributed;

    -- the "outside patrolman" should sign the gas usage/fill ticket for each vehicle serviced; and

    -- the gasoline records should be expanded to include vehicle odometer readings, date filled and the name of the outside patrolman filling the vehicle.

RECOMMENDATION IMPLEMENTED. On February 6, 1985, MCF-St. Cloud revised the procedures over the gasoline inventory by providing for separation of duties and maintaining improved inventory records. Procedures now call for the outside patrolman to sign the gas ticket and note the required information on the ticket. The lawn crew completes the physical inventory, and the budget accountant reconciles the gas usage to inventory records.

Electronic data processing controls over MCF-St. Cloud inmate social welfare account need to be strengthened.

12. MCf-St. Cloud should consult with the central office staff and devise computer controls to insure the integrity of inmate balances.

RECOMMENDATION NOT IMPLEMENTED. See current finding #2.

Social welfare accounting functions at MCF-St. Cloud are not adequately separated.

13. The reconciliation of the social welfare account should be completed by someone independent of other duties associated with the account.

RECOMMENDATION NOT IMPLEMENTED See current finding #1.

Receipts totaling over $250 were not always deposited on a daily basis.

14. MCF staff should comply with Minn. Stat. Section 16A.275 by making daily deposits of receipts when the total exceeds $250.

RECOMMENDATION NOT IMPLEMENTED. See current finding #10.

MCF-St. Cloud does not have a written policy regarding the providing of complementary meals, but some employees are receiving free meals on a regular basis.

15. MCF-St. Cloud should work with the central office staff to develop a written policy governing the providing of complimentary meals to employees and others.

RECOMMENDATION IMPLEMENTED. A policy was issued effective February 4, 1986, requiring all staff to purchase meal tickets.

DEPARTMENT: MCF-St. Cloud

STATE OF MINNESOTA
Office Memorandum

TO: Warren Bartz
Audit Manager

DATE: 6-15-88

FROM: David Ek
Business Manager

PHONE: 255-5072
N.S. 256-5072

SUBJECT: Response to Audit of March, 1988

Please consider the following responses to the recommendations included in the draft report dated June 2, 1988.

1. Prior audit finding not resolved: accounting functions for the Social Welfare Account, the Canteen Account and the Current Expense Account are not adequately separated and reconciliations are not completed on a timely basis.

   There is a separation between the Social Welfare Account and the Current Expense Imprest Cash account. The institution budget accountant reconciles the C.E. account and processes the reimbursement thru the SWA. Other than that, as the report states, there is no separation of deposits and cash reconciliation except the reconciling of receipted cash coming in for the S.W. inmate/group accounts. This situation stems from the limited staffing of the business office and the current split in job responsibilities between the two accounting officers.

   Effective immediately, every effort will be made to reconcile both the Social Welfare Account and the Canteen Account on a regular and timely basis. Regarding the collection of the money erroneously credited to the incorrect inmate account, arrangements have been made with the Alaska Dept. of Corrections to recoup the money via the oil revenue distribution paid to all citizens of Alaska. As of this date, the first monthly payment has been received.

2. Electronic data processing controls over the MCF-SCL Social Welfare Account need to be strengthened.

   This is a prior audit finding which remains unresolved at this writing. However, the DOC Central Office has developed a year-long schedule for computer programing and the current plan is to completely overhaul the Social Welfare Accounting program in F.Y. 1989. The plan is to use FOCUS, a 4th generation language, which should facilitate the design and use of the new program. The intent is to have the program written by DOC staff.

   It should be noted that we have requested various changes in the program for a number of years because of changes in the law, changes in administrative policy, etc. (This is in addition to the previous auditor's report recommending that the program shortcomings be corrected.)

3. The Honor Unit Canteen is not operated through the Statewide Accounting System (SWA) and does not comply with Department of Corrections Policies.

Effective July 1, 1988, the Honor Unit canteen will establish procedures which will enable the Business Office to develop and publish quarterly statements, similar to those it develops and publishes for Hobbycraft and the Barber Shop program. This will entail the establishment of a beginning inventory, accounting for all purchases and all sales during the accounting period.

Likewise, we are currently reviewing the DOC and MCF-St. Cloud policy governing the operation of the canteen to assure that those portions of the policy that apply to the Honor-Canteen are being adhered to. The Honor Unit is in the process of developing operating policy and procedures also.

Essentially, the same purchasing procedures will be used for the Honor Canteen as is used for the Institution Canteen: about 80 percent of the purchases are made via DPO with the disbursement coming from SWA; the balance of purchases are made with local 'special orders', paid for via contingency check with the checking account being reimbursed via SWA.

4. Significant weakness exist in the internal controls over consumable inventory at MCF-SCL.

Pharmacy- considerable discussion has taken place regarding this single activity currently lacking a perpetual inventory system. Contact has been made to several pharmacist-in-charge at State hospitals who maintain larger inventories than is kept at St. Cloud. None of the pharmacies maintained a perpetual inventory. The State Board of Pharmacy, the licensing agency, likewise does not require nor recommend a perpetual inventory in a pharmacy setting. (Please refer to the letter of 4/18/88, Dave Holmstrom, Exec. Director, Board of Pharmacy attached.)

We are of the opinion that installing a perpetual inventory would require more man hours than it would benefit us, particularly in view of our extremely limited use of controlled substances.

Inventories in the warehouse, laundry/tailorshop, food service and plant operation will continue to be audited quarterly in-house. Corrections and adjustments will be made with the supervisor's approval and signature. Follow-up on shortages will be documented and filed.

5. MCF/St. Cloud has not complied with Dept. of Administration guidelines for completing physical inventories and spot-checks of fixed assets.

Every six months, an in-house audit will be conducted by our Fixed Assets Managers (Budget Managers and Area/Shop Supervisors) and will be followed up by our Asset Coordinator, who will make the necessary corrections and/or assist in problem solving. All audits will be recorded and filed for future reference and verification.

6. Procedural controls over the procurement of services and the processing of contract disbursements need to be strengthened.

We make every attempt to have contracts fully executed and encumbered prior to any obligation. Occasionally there are instances where, even though contracts are initiated far in advance to anticipated need, the contracts are not fully executed/encumbered. In the case of medical contracts, normally they are encumbered prior to obligation, but medical situations sometimes require immediate action. This is the case of the Ramsey Hospital/Ramsey Clinic contracts where considerable delay was encountered.

Contracts were not developed for professional/technical service agreements exceeding $2,000.

Since the beginning of the audit period, there have been two major medical contracts developed including a contract with the St. Cloud Hospital for out-patient services and a contract with the St. Cloud Orthopedic Assoc. Both of these represent large annual expenditures previously paid via blanket Expenditure Authorization. The intent is to review the yearly total payments to the various medical providers and develop contracts where the anticipated annual expenditures is certain to exceed $2,000.

A review of the medical expenditures for the first eleven months of F.Y. '88 showed thirteen medical providers who either have exceeded the $2,000 limit or are expected to by June 30th. Of the thirteen, eight are under contract now and will, in all probability, remain on contract ad infinitum. The problem with some of the providers on contract is that we are not assured that we will spend $2,000 in any one year, thus tying up the money. For example, we use a local source for plastic & reconstructive surgery, but primarily for injuries requiring emergency medical attention or for other unanticipated medical procedures. Generally, there is no way of determining the annual need for such services.

While we agree with the principles involved in the auditors recommendation, from a management point of view, it does present a problem.

7. Industries Services Plan improperly allows for sales to state employees and discounts on industry services to employees of MCF/St. Cloud.

The Industries Department at St. Cloud intends to revise their Business Plan, part III, "Business Definition", to read "Our present market is geographically limited to the State of Minnesota with which sales are made to state and local government units; colleges - public and private, nonprofit organizations; selected private sector businesses and others.

The Industries program will discontinue the practice of giving discounts on upholstery material to all individuals including MCF/SCL employees, all state employees, and all other individual customers. This change will become effective July 1, 1988.

8. MCF/St. Cloud has not established an agreement with the Department of Public Safety for the production of license plates and tabs.

This item has been forwarded to the DOC Industries Coordinator (Mr. D. G. Tomsche) who will work with appropriated Public Safety staff in regard to this issue.

9. Controls over the calculation of Worker's Compensation benefits and Leave restoration are inadequate.

Subsequent to the audit, the report of July 24, 1986 referred to above, showing an overpayment of $137 was discovered to be an interim in the audit report. The final report of this particular case showed that there was no overpayment in the final analysis. The problem evolved around the fact that biweekly Worker's Compensation reports are first mailed to our Central Office and not all of the reports find their way to MCF/St. Cloud on a timely basis. Consequently, at any single time, the file may not be up to date. This situation has since been addressed but needs continual monitoring.

10. Prior audit finding not resolved: receipts totaling over $250 are not deposited promptly.

The audit report noted that the deposit procedure has improved since 1984 (the last audit) but are still not being deposited promptly. The report depicts a situation where money received could possibly be held 3 days before deposit in a bank (State Depository). The problem is that money is received at the institution during the normal business hours and during the business week, plus money is received after hours and weekends and holidays. We lack the staffing wherewithal to meet every situation that could be interpreted as a requirement of the Statute. We are, with great consistency, making deposits every bank business day and at a time during the business day falling within the limitations of our staffing pattern. We see little opportunity to change our ability to meet the recommendation of the audit report.

DE:vd
Attachment: letter D. Holmstrom
e-audit