

**MINNESOTA CORRECTIONAL FACILITY -  
LINO LAKES  
FINANCIAL AND COMPLIANCE AUDIT  
FOR THE FOUR YEARS ENDED JUNE 30, 1987**

**AUGUST 1988**

Financial Audit Division  
Office of the Legislative Auditor  
State of Minnesota



# NOTICE

State of Minnesota  
Office of the Legislative Auditor  
Veterans Service Building • St. Paul, MN 55155  
612/296-4708

## MINNESOTA CORRECTIONAL FACILITY - LINO LAKES

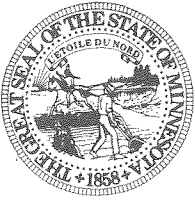
### REPORT SUMMARY AUGUST 1988

The Office of the Legislative Auditor has issued an audit report on the Minnesota Correctional Facility - Lino Lakes for the four years ended June 30, 1987. The report contains eight findings relating to improved procedures and controls.

The first finding outlined improved controls over receipts. The second finding related to documentation and controls over local checking accounts. One finding dealt with reducing payroll adjustments. One finding related to properly authorizing the meal ticket change fund. Another finding dealt with improper staff purchases of Industries raw materials, and two findings outlined improved procedures and controls for MCF-LL Industries. The last finding dealt with controlling inmate payroll.

In his response the superintendent concurred with our recommendations and sent copies of some new procedures relating to purchases by employees of MCF-LL Industries.





STATE OF MINNESOTA

**OFFICE OF THE LEGISLATIVE AUDITOR**

VETERANS SERVICE BUILDING, ST. PAUL, MN 55155 • 612/296-4708

JAMES R. NOBLES, LEGISLATIVE AUDITOR

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Representative Phillip J. Riveness, Chair  
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Orville B. Pung, Commissioner  
Department of Corrections

Mr. Frederic A. Holbeck, Superintendent  
Minnesota Correctional Facility - Lino Lakes

**Audit Scope**

We have completed a financial and compliance audit of the Minnesota Correctional Facility - Lino Lakes (MCF-LL) for the four fiscal years ended June 30, 1987. Section I provides a brief description of MCF-LL'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 Government Auditing Standards, and accordingly, included such audit procedures as we considered necessary in the circumstances. Field work was completed on March 18, 1988.

The objectives of the audit were to:

- study and evaluate MCF-LL internal controls systems, including revenues, expenses, assets, liabilities, payroll (employee and inmate), industries and social welfare accounts;
- verify that financial transactions were properly recorded on the statewide accounting 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.

**Management Responsibilities**

The management of MCF-LL 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

Representative Phillip J. Riveness, Chair  
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system are to provide management with a 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 the 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 the changes in conditions, or that the degree of compliance with the procedures may deteriorate.

The management of MCF-LL is also responsible for compliance with laws and regulations. In connection with our audit, we selected and tested transactions and records from the programs administered by MCF-LL. The purpose of our testing transactions was to obtain reasonable assurances 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-LL staff, analytical review to identify unusual transactions or trends, and the examination of documentation supporting a representative number of transactions. Random sampling techniques were used to assure that representative samples of transactions were chosen. However, the use of random 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 1-4 and 6-8, the MCF-LL system of internal accounting control in effect on January 31, 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 four years ended June 30, 1987, the MCF-LL properly recorded, in all material respects, its financial transactions on the statewide accounting system.

In our opinion, except for issues discussed in Section II, finding 5, for the four years ended June 30, 1987, MCF-LL administered its programs in compliance, in all material respects, with applicable finance-related laws and regulations.


Representative Phillip J. Riveness, Chair  
Members of the Legislative Audit Commission  
Mr. Orville B. Pung, Commissioner  
Mr. Frederic A. Holbeck, Superintendent  
Minnesota Correctional Facility - Lino Lakes  
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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 your progress on resolving these findings after the dates projected for completion as identified in the response to this report. Section III includes a summary of the progress on all recommendations developed during our audit of MCF-LL for the period July 1, 1982 to June 30, 1983 (report dated June 1984).

We would like to thank the Minnesota Correctional Facility - Lino Lakes staff for their cooperation during this audit.



James R. Nobles  
Legislative Auditor



John Asmussen, CPA  
Deputy Legislative Auditor

July 21, 1988





# MINNESOTA CORRECTIONAL FACILITY - LINO LAKES

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## AUDIT PARTICIPATION

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

John Asmussen, CPA	Deputy Legislative Auditor
Warren Bartz, CPA	Audit Manager
Brad White, CPA	Auditor-in-Charge
Mary Annala	Staff Auditor
Leslie Dosh	Staff Auditor

## EXIT CONFERENCE

The findings and recommendations in this report were discussed with the following staff on April 8, 1988:

### MCF-Lino Lakes:

Frédéric Holbeck, Superintendent  
William McGrath, Assistant Superintendent of Administration  
Bert Mohs, Assistant Superintendent  
James Chappuis, Industry Director  
Dennis Anderson, Finance Director  
Kenneth Schoenrock, Accounting Supervisor  
Chuck Jakway, Support Services  
Mary Ann Beckman, Industry Accounting Supervisor

### Department of Corrections:

Peter Maurer, Internal Audit Director, Central Office



# MINNESOTA CORRECTIONAL FACILITY - LINO LAKES

## I. INTRODUCTION

The Minnesota Correctional Facility - Lino Lakes (MCF-LL) is one of nine correctional institutions operated by the Department of Corrections. Superintendent Frederic Holbeck was appointed by the Commissioner of Corrections and is responsible for the operations of the prison.

The MCF-LL medium/minimum security facility houses adult male inmates transferred in from the state's maximum security institutions. These inmates are generally serving the last remaining months of their sentence at MCF-LL before release. Prior to transfer the inmates are screened for stable work and discipline records. Programs at Lino Lakes are designed to control the inmate's behavior and assist him in returning to the community as a law-abiding citizen. The current average daily population at MCF-LL is 203 while authorized staff complement is 134.5 positions. Payroll expenses for fiscal year 1987 were \$4,981,385 or 57 percent of the total MCF-LL operating expenses of \$8,729,631 from state support, industries, and social welfare funds.

A variety of work, vocational, educational, and treatment programs are offered at Lino Lakes. Educational services include adult basic education, remedial classes, and college courses available to medium security inmates. Treatment programs include therapy for sex offenders and inmates with antisocial or character disorders. Industry work programs are a primary focus at MCF-LL, providing realistic work experience to aid inmates in successfully returning to the community. Shops include printing, assembly, metal fabrication, upholstery, and wood fabrication, with emphasis on job relationships and skill-building techniques. During fiscal year 1987, cash basis industry receipts and disbursements totaled \$1,882,306 and \$2,186,162, respectively.

MCF-LL is responsible for the care and custody of all money belonging to inmates of the facility. The transactions involving the inmates' money are processed through the social welfare accounts. During fiscal year 1987, \$560,760 was collected and \$575,008 was disbursed on behalf of the inmates.

In January 1988, MCF-LL sold two adjacent cottages and 10 acres of land to Anoka County for \$970,000. These dedicated funds will be utilized by MCF-LL to expand buildings and services to house an additional 90 inmates at this facility. With the completion date for this expansion set for September 1988, commensurate increases in appropriated funding and operating costs are anticipated for upcoming fiscal years.

## MINNESOTA CORRECTIONAL FACILITY - LINO LAKES

### II. CURRENT FINDINGS AND RECOMMENDATIONS

#### 1. PRIOR FINDING NOT RESOLVED. Internal controls over receipts require improvement.

Most receipts at the Minnesota Correctional Facility - Lino Lakes (MCF-LL) come through the mail. The receipts include checks and money orders sent to inmates from relatives or friends and receipts for industry sales. Cash receipts are also collected and are supported by cashier tapes or cash receipt slips.

Minn. Stat. Section 16A.275 requires that all receipts be deposited daily with the state treasurer or a depository bank if the total exceeds \$250. Our testing determined that deposits were not being made on a daily basis. Five current deposits examined showed accumulated receipts from the previous three to five days. During fiscal year 1987 only 110 deposits had been made by MCF-LL during the period July 1, 1986 to June 30, 1987, although dedicated receipts totaled approximately \$1.4 million. Daily depositing of receipts is primarily important for the interest benefit to the state and as the preferred internal control practice. Prior audits from our office and also from the Department of Corrections internal auditor in April 1987, reported delays in depositing; however, no improvements have been made.

Currently, a manual listing of receipts is prepared in the mail room before transfer to the superintendent's secretary for preparation of the deposit. The business office staff attempt to trace the individual checks on this listing to the deposit slip. However, when a receipt cannot be traced, no further investigation is completed. Effective follow-up must be completed to ensure that all receipts are properly deposited.

Other problems make it impossible for the business office to compare total receipts with the total deposits. Money received from inmate admissions and receipts from industry cash sales are not logged on any listing before being sent to the business office. A separate listing could be developed for these locations and used for comparison to the deposit. Also, if a check must be signed by an inmate it is not submitted for deposit but rather taken to the duty officer who arranges for the inmate's signature. All incoming receipts must be logged, and the disposition of receipts not deposited must be identified, to make it possible for a comparison of the total amount received with the total amount deposited for the facility.

#### RECOMMENDATIONS

- MCF-LL business office should deposit all receipts aggregating \$250 or more on a daily basis.
- Internal controls over receipts should be improved by:
  - recording all incoming receipts on a receipt listing;

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- noting disposition of receipts withheld from deposit;
- reconciling each deposit to the mail listings, cash receipt slips, and cashier tapes showing the original receipt; and
- investigating any receipts listed but not deposited.

2. Local checking account payment documentation and industry checking account controls are inadequate

The authority and purpose for correctional facility contingent accounts is Minn. Stat. 241.13, Subd. 1. MCF-LL has two separate checking accounts for the current expense and industries contingent accounts, established at \$1,000 and \$800, respectively. They are replenished periodically through the statewide accounting system. The purpose for the contingent accounts is to issue checks to vendors requiring immediate payment. Concerns were identified with the controls and payment support for these local checking accounts.

Adequate vendor invoices were not found for both checking accounts to support the payments made. From fiscal year 1986 to 1988, 53 of 88 (60%) payments from the current expense account did not have a vendor invoice. Likewise, the industry contingent checking account did not have invoices for 95 of 252 (38%) payments. Some of these payments, however, were supported by a MCF-LL purchase requisition, special expense form, or departmental purchase order. Effective control over the contingent accounts would include vendor invoices to substantiate the payments made. Goods and services internally procured and approved may require additional supporting documentation such as purchase orders or special expense forms to provide the necessary authorization for purchase. Vendor invoices decrease the potential for impropriety and also provide an independent assurance that payments have been prepared at the correct amount.

Other internal controls over the industry contingent checking account also are weak. No running balance is maintained in the check register, bank statements are not always reconciled, and individual checks being replenished are not itemized. Since no check register balance is determined until reconciliation to the bank statement, negative balances are not known until a bank overdraft occurs. Three overdrafts were noted in fiscal year 1984. Maintaining the check register balance would also improve comparability to the monthly bank statement. The bank statements were not reconciled to the check register for 20 of the past 55 months. Monthly reconciliations would provide for timely detection of errors on the bank statement or check register and allow for possible recourse with the bank. A weakness exists in the replenishment process since individual checks being replenished are not listed or itemized, but rather are grouped and summarized for convenient coding. Minn. Stat. Section 241.13, Subd. 1 requires an itemized statement of every expense made from the

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contingent account. Itemizing individual checks would reduce the risk of unreplenished or duplicate reimbursement of checks. The checking account records need to be improved and maintained timely to permit effective internal controls.

### RECOMMENDATIONS

- Current expense and industry contingent checking account payments should be supported by vendor invoices.
- Internal controls over the industry checking account should be improved by:
  - maintaining a running check register balance,
  - reconciling the bank statements to the check register balance monthly, and
  - itemizing individual checks being replenished.

### 3. Late time reports and leave requests have caused the need for recurring retroactive adjustments to correct time reported.

The biweekly payroll data must be entered into the state central payroll system by an established deadline each pay period. Regular and overtime hours worked, paid leave hours, and compensatory hours earned must be reported by employees, reviewed by supervisors, and summarized by the MCF-LL business office payroll unit prior to input. Problems with late staff time sheets and leave slips has created the need to routinely process retroactive adjustments to correct payroll hours. For the current fiscal year, 15 of 17 pay periods so far have needed retroactive adjustments while during fiscal year 1987, 21 of 26 pay periods required adjustments.

Frequently, time sheets are not submitted by staff and the business office processes regular hours for the full pay period. When the time sheets are subsequently received, a retroactive adjustment transaction is processed to correct for any leave taken. Department of Finance Operating Policy and Procedure No. 07:04:09 requires the payroll unit to enter hours from the time report. If any time reports are missing or if any employee is on approved leave, the employee's supervisor is to complete a time report for the hours worked and appropriate number of paid leave hours.

Certain retroactive adjustments were also caused by employees submitting late leave requests. These employees reported regular hours worked on the time reports for the leave hours taken and the supervisor approved the time report without verifying the accuracy of hours worked. Subsequently the leave request was turned in by the employee or supervisor and a retroactive adjustment was processed to adjust for leave taken. Department of

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Finance Operating Policy and Procedure No. 07:04:23 requires that supervisors compare approved leave requests against the biweekly time report for accuracy. This procedure is apparently not always completed by supervisors.

Retroactive adjustments are intended for correction of input errors in earnings types and for rate adjustments. These transactions are not meant for routine usage but rather on an exception basis as errors occur and adjustments are necessary. Allowing staff to submit time sheets and leave requests late increases the potential risk for unreported leave and places an additional administrative burden on the business office for preparing and processing retroactive adjustments.

### RECOMMENDATION

- MCF-LL supervisors should ensure that time reports are submitted promptly by employees and that leave taken is properly reported on their time reports.

#### 4. The meal ticket change fund at MCF-LL was not properly authorized.

A \$50 meal ticket change fund was established at MCF-LL several years ago. This petty cash fund was not created through the Department of Finance and is not included on the department's listing of authorized imprest cash accounts. MCF-LL staff indicated this change fund was established out of a private employee fund, but no evidence can be located substantiating this source.

Department of Finance Operating Policy and Procedure No. 06:06:04 sets forth the requirements for establishing an imprest cash fund. The agency is to submit a request identifying purpose, amount to be retained in petty cash or checking accounts, and appropriation account from which the fund will be established. The Department of Finance will approve or deny the agency request in writing.

### RECOMMENDATIONS

- MCF-LL staff should seek authorization for the meal ticket change fund in accordance with Department of Finance procedures.
- The meal ticket change fund should be promptly deposited as miscellaneous revenue to the General Fund unless evidence can be provided on the original source of funds.

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### 5. Staff purchases of Industries raw materials are improper.

Two Industry managerial staff have purchased substantial amounts of lumber from the Industry raw materials inventory. This practice is questionable under the current state statutes which disallow employee purchasing of merchandise from governmental agencies. Minn. Stat. Section 15.054 prohibits public employees from purchasing property and materials from state agencies unless this merchandise is for sale to the general public in the ordinary course of business.

Five current purchases totaling \$1,731 were made by staff primarily for lumber which was cut to specific sizes. This wood was purchased in bulk at a savings; however, a materials markup and handling charge of 10 percent was added back to materials cost when pricing these staff purchases. Also, a burden or overhead rate was applied to recover storage and scrap costs which were indirectly incurred. Efforts to identify similar sales made to the general public disclosed four other invoices for lumber sales to individuals, however, these individuals were found to be friends or relatives of the two industry staff. No evidence of independent lumber sales to the general public could be provided, and it is unlikely that management desires to venture into public sales of this nature.

The MCF-LL business office investigated these and other staff sales. They have identified concerns with the quantities and prices billed and have developed improved controls over allowable staff sales. The proposed controls could prevent errors or irregularities and provide consistent and equitable charges.

### RECOMMENDATIONS

- Staff purchases of Industries raw materials should be discontinued unless similar sales are made available to the general public in the ordinary course of business.
- MCF-LL should improve controls over allowable sales to staff to ensure that the proper quantities and prices are billed.

### 6. PRIOR FINDING NOT RESOLVED. Improvements in the cost accounting system and billing procedures are needed for MCF-LL Industries.

MCF-LL Industries provides a number of products and services for the state and private organizations and individuals. The production costs and overhead rate applied are summarized and billed to the customers. Testing of the cost accounting system and billing procedures revealed that improvements are necessary to provide effective production control and accurate customer invoices.

The Industries job cost system is a manual comparison of standard or estimated costs to actual costs for each production order. The system provides management with the ability to effectively control actual production



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costs. Currently, standard costs are not detailed on a job-by-job basis to provide effective comparison to actual material and labor costs. Actual materials costs are not accurately tracked from raw materials inventory as explained in finding 7. Actual labor hours contain errors and problems as indicated in finding 8. The accumulation of accurate actual cost data is critical for effective production control.

MCF-LL Industries billing procedures contained additional weaknesses. Several delivery tickets were not on file, not signed, or contained different quantities than shown on the invoice. Three invoice prices did not agree with the catalogue price list and the job files contained no indication of alteration or additional work performed. Supporting accounts receivable subsidiary ledgers could not be located for six invoices tested. Credit invoices issued by MCF-LL are also not effectively controlled. The invoices are not prenumbered and do not go through the proper authorization process prior to issuance. Such weaknesses increase the potential for errors or irregularities to occur and go undetected in the billing process.

MCF-LL Industries staff have indicated they are in the process of obtaining an upgraded computer system which should address many of the concerns identified. This system may provide better interface between inventory, payroll, and billing functions, in addition to improved detail for standard and actual production costs and financial statement balances.

### RECOMMENDATIONS

- MCF-LL Industries should continue its efforts to computerize the cost accounting system and develop procedures to improve the accuracy and detail of standard and actual production costs.
- MCF-LL Industries should improve billing procedures and controls by:
  - ensuring that delivery tickets are on file, signed, and quantities agree;
  - noting when deviations from the standard price are made;
  - proper filing and retention of accounts receivable records; and
  - authorizing and controlling all credit invoices.

### 7. PRIOR FINDING PARTIALLY RESOLVED. Internal controls over raw materials inventories at MCF-LL Industries are inadequate.

The industries program at MCF-LL has production shops for printing, assembly, upholstery, and metal and wood fabrication. These shops maintain a

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large inventory of raw materials, valued at \$270,670 on December 31, 1987. Controls over raw materials inventory are weak and require improvements as follows:

- Effective perpetual inventory records are not maintained to properly record and control materials purchased or issued for production. Perpetual cards were developed and used for wood and printing inventories; however, these cards were discontinued in 1987 and not retained. A computerized inventory record was also developed but only provided the status of inventory on hand. This system did not provide a perpetual listing of inventory receipts and issuances and the source documentation entered was not retained.
- Complete physical inventory counts are taken quarterly, but without a perpetual record for comparison to recorded quantity, it is not possible to identify differences.
- No centralized or established receiving channels exist. Inventories are received at different and undesignated locations throughout the industry buildings. Because deliveries are received and not made known to the production supervisors, control and accounting is difficult for staff responsible for the materials.
- Receiving reports are not completed by the person actually receiving the items, but are subsequently filled out in the accounting unit based upon the packing slip.
- No economic order quantities have been established for determining when and how much inventory to purchase based upon production needs.

The Department of Administration, Consumable Inventory Section issued a report on April 24, 1987, citing similar deficiencies in inventory records and controls.

### RECOMMENDATION

- MCF-LL Industries should establish and improve internal controls over inventories by:
  - developing a perpetual inventory system documenting all purchases and issuances of raw materials;
  - comparing physical inventory counts to recorded balances;
  - developing a central receiving department or establishing receiving channels for each shop;

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- completing the receiving report at the time the goods are received, counted, and inspected; and
- establishing economic order quantities for materials.

8. Improved controls over time reporting and cost allocation for inmate payroll are needed.

MCF-LL was established to provide work programs for resident inmates. The facility set up two main work programs, support services and industries. Support service positions are funded from state appropriations and are established for the operational work within the facility. Industry positions are directly involved in the production of industry products and are paid from industry funds. Various weaknesses exist in time reporting for these programs.

Certain inmate payroll costs were not charged to the proper accounts for which actual work was performed. Inmates transferring between or working on both state support and industries activities were paid entirely from state appropriated funds. For current pay periods we identified three inmates who worked 156 hours on industry activities but were paid from state funds. State support positions can work on industry programs if the payroll costs and appropriate revenue from state appropriations is recognized in the financial statements to properly reflect all costs. These unallocated charges cause operating costs and state appropriated revenue to be understated on the industries financial statements.

Other problems concern the preparation, authorization, processing, and filing of inmate time cards:

- Industries' inmates are required to punch a time clock; however, the clock dates and times are frequently inaccurate. The time clock is continually broken from abuse by inmates and heavy use, causing inaccurate readings. Time card hours are manually altered without a supervisor's approval.
- Four minor discrepancies were detected between hours worked and actual hours paid. These errors were the result of the payroll clerk inaccurately determining hours worked from the time cards. The largest error resulted in overpayment of two hours for an industry inmate.
- Overtime was not properly authorized in three instances. Overtime is required to be documented and approved in advance. Without written approval, management cannot properly monitor payments for overtime hours.
- Support services time cards were not filed and organized effectively. Time cards could not be located for four of eight payroll items tested.

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Without proper documentation and effective time reporting controls there is an increased risk that errors or irregularities could occur in the payment of inmate payroll. Effective control over time reporting is essential for accurate and reliable reporting of payroll hours and for proper distributions between state support and Industries accounts.

### RECOMMENDATIONS

- Inmate payroll costs, and appropriate grant revenue from state support, should be allocated to the industry accounts for which the actual work was performed.
- MCF-LL should improve records and controls over inmate time reporting to ensure that payroll hours reported are accurate.

MINNESOTA CORRECTIONAL FACILITY - LINO LAKES

III. STATUS OF PRIOR AUDIT RECOMMENDATIONS  
AND  
PROGRESS TOWARD IMPLEMENTATION

Internal control over receipts needs strengthening.

1. MCF - Lino Lakes business office personnel should deposit all receipts aggregating \$250 or more on a daily basis.

RECOMMENDATION NOT IMPLEMENTED. See current finding #1.

2. All checks and money orders should be restrictively endorsed as soon as they are received.

RECOMMENDATION IMPLEMENTED. Effective July 1, 1984, restrictive endorsements are placed on all incoming receipts received at the MCF-LL business office.

3. Each deposit should be reconciled with the mail room listing of receipts. A notation of all checks and money orders withheld from deposit and their disposition should be shown on the reconciliation form.

RECOMMENDATION NOT IMPLEMENTED. See current finding #1.

4. MCF-LL business office personnel should notify the State Treasurer's Office by telephone when deposits exceed \$1,000.

RECOMMENDATION IMPLEMENTED. Effective July 1, 1984, the business office contacts the State Treasurer's Office regarding deposits exceeding \$1,000.

Internal controls over consumable raw materials inventories at MCF-LL Industries need to be strengthened.

5. MCF-LL Industries should establish an inventory recordkeeping system in compliance with criteria specified in the Department of Administration's Consumable Inventory Management Program Manual and should include the following:
  - a. Storage areas should be secured. Only authorized personnel should have access to the material.
  - b. A perpetual inventory system should be implemented. All receipt and issuance of materials should be documented in the perpetual records.
  - c. The perpetual system should be periodically compared to the results of a physical count taken by someone independent of the custodial and recordkeeping functions.

MINNESOTA CORRECTIONAL FACILITY - LINO LAKES

- d. A centralized receiving department or person should be established for the industry or for each shop. The receiving report should be filled out by this department or person and used to support the payments for materials received.
- e. Economic reorder quantities should be established for the consumable inventory.

RECOMMENDATION PARTIALLY IMPLEMENTED. Most raw material inventories have been segregated from the production centers. Complete physical inventories are taken to support financial statement valuation. Perpetual inventory control remains inadequate. See current finding #7.

A standardized cost accounting system is lacking at MCF-LL Industries.

- 6. MCF-LL should work with the DOC central office to develop an effective cost accounting system for all goods produced and services provided.

RECOMMENDATION PARTIALLY IMPLEMENTED. MCF-LL Industries has developed a manual cost accounting system for comparison of standard and actual costs for each job. The manual system does not provide sufficient detail on standard or actual costs. See current finding #6.

Internal control over local checking accounts needs strengthening.

- 7. Social welfare contingent fund checks should not be signed by authorized personnel until they are completely processed and ready for issuance.

RECOMMENDATION IMPLEMENTED. Beginning July 1, 1984, authorized staff no longer sign social welfare contingent fund checks in advance but rather sign when they are ready to be issued to the vendor.

- 8. A person without access to cash transactions and check signing should be responsible for doing the monthly bank reconciliations for the facility.

RECOMMENDATION IMPLEMENTED. Effective July 1984, MCF-LL separated duties for check preparation and bank reconciliation of the social welfare contingent checking account.

Food service employees receive free meals on a regular basis.

- 9. The current practice of providing free meals to food service employees should be discontinued. MCF-LL staff should work with the DOC central office staff to develop a consistent policy for food service and other employees at correctional facilities.

RECOMMENDATION WITHDRAWN. In January 1988, MCF-LL amended Procedure #2-304 to include food service staff as persons allowed to receive complementary meals. This policy is consistent with other correctional facilities.

July 21, 1988

Mr. James R. Nobles, Legislative Auditor  
Office of the Legislative Auditor  
Veterans Service Building  
St. Paul, Minnesota 55155

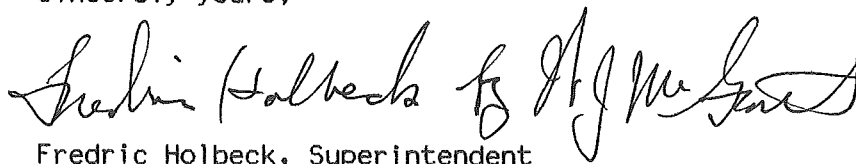
Dear Mr. Nobles:

Enclosed is our response to the audit report on MCF Lino Lakes covering the four years ended June 30, 1987. We have responded to each recommendation issued in your report with the actions we have or intend to implement, the estimated implementation or completion date, and staff designee responsible for effecting or monitoring implementation.

We appreciate the assistance your office has provided to the MCF-LL staff in maintaining and strengthening our system of internal accounting control, financial transaction processing, and compliance with finance related laws and regulations.

If you have any questions concerning our response, please do not hesitate to contact me or any of the appropriate staff.

Sincerely yours,

  
Fredric Holbeck, Superintendent

Enclosure

cc: Orville B. Pung, Commissioner of Corrections  
Howard Costello, Deputy Commissioner

DEPARTMENT OF CORRECTIONS

MCF Lino Lakes

Response to Audit Recommendations

**Finding #1:** Internal controls over receipts require improvement.

**Recommendation #1.A.:** MCF-LL Business Office should deposit all receipts aggregating \$250.00 or more on a daily basis.

**Response:** This is now being done whenever possible as permitted by staff scheduling and workload.

**Recommendation #1.B.:** Internal controls over receipts should be improved.

**Response:** Incoming receipts will be documented at the collection sites for use in verification of subsequent deposit, return, endorsement or other disposition. Monthly reconciliations of collection site listings, deposit records, and the Statewide Accounting reports will be performed. Receipts received but not deposited will be investigated and disposition duly noted.

**Person Responsible:** Dennis Anderson, Finance Director

**Date Implemented:** #1.A.: Already #1.B.: By the end of December 1988

**Finding #2:** Local checking account payment documentation and Industry checking account controls are inadequate.

**Recommendation #2.A.:** Current Expense and Industry Contingent checking account payments should be supported by vendor invoices.

**Response:** Documentation requirements for checking account payments will be the same as those for vendor payments made through the Statewide Accounting System, i.e., detailed vendor invoices or receipts.

**Recommendation #2.B.:** Internal controls over the Industry checking account should be improved.

**Response:** The maintenance of running balances, monthly reconciliations, and itemization of individual checks being replenished will be performed in a manner similar to that being done with the Current Expense and Social Welfare checking accounts.

**Person Responsible:** Dennis Anderson, Finance Director

**Date Implemented:** #2.A.: Already #2.B.: By the end of September 1988



**Finding #3:** Late time reports and leave requests have caused the need for recurring retroactive adjustments to correct time reported.

**Recommendation #3:** MCF-LL supervisors should ensure that time reports are submitted promptly by employees and that leave taken is properly reported on their time reports.

**Response:** Managers and supervisors will continue to be reminded (through means in addition to the notice in the Daily Memo) of the need for the prompt submission of time reports to the Business Office and of the responsibility they have in verifying the accuracy of time worked and of leave time. A request will also be made to the State Finance Central Payroll Unit to allow the input of MCF-LL payroll one day later so that payroll input need not be commenced while awaiting the receipt of all employee time reports. This would also aid in improving the accuracy of time reports as then 2nd and 3rd shift staff could submit their time reports on the day after the pay period ends rather than to 'forsee' their regular / overtime worked or leave taken the last day.

**Person Responsible:** William McGrath, Assistant Superintendent

**Date Implemented:** By the end of October 1988

**Finding #4:** Meal ticket change fund at MCF-LL was not properly authorized.

**Recommendation #4.A.:** MCF-LL staff should seek authorization for the meal ticket change fund in accordance with Department of Finance procedures.

**Response:** Authorization has been sought and received from State Finance for the creation of a \$50.00 petty cash fund. A copy of the approval letter was sent directly to the OLA on 07/12/88 from State Finance.

**Recommendation #4.B.:** The meal ticket change fund should be promptly deposited as miscellaneous revenue to the General Fund unless evidence can be provided on the original source of the funds.

**Response:** Investigation into the original source of the change fund is being conducted. Several long-time employees have indicated their understanding of the source as being the employee voluntarily funded 'Sunshine Fund' which bestows cards and flowers for long term illnesses or deaths. Appropriate disposition of the existing \$50.00 change will be made depending on the apparent validity of historical documentation or affidavit evidence.

**Person Responsible:** Dennis Anderson, Finance Director

**Date Implemented:** #4.A.: Already #4.B.: By the end of September 1988

**Finding #5:** Staff purchases of Industries raw materials are improper.

**Recommendation #5.A.:** Staff purchases of Industries raw materials should be discontinued unless similar sales are made available to the general public in the ordinary course of business.

**Response:** As a result of the comprehensive investigation by the MCF-LL Finance Director which complemented the OLA audit, four policy statements were developed and instituted which address the issues of 'Conflict of Interest' and 'Sales and Production Management'. One of these policy statements prohibits the purchase by DOC employees of raw materials or supplies from the MCF-LL Industry. The scope of this policy was determined so as to avoid the occurrence of any 'insider dealings' not available to the general public.

**Recommendation #5.B.:** MCF-LL should improve controls over allowable sales to staff to ensure that the proper quantities and prices are billed.

**Response:** A second policy statement within the 'Conflict of Interest' issue addresses the pricing of custom services and products purchased by DOC employees. This policy requires the independent estimation and verification of adequacy of work description, quantities, cost recovery, and pricing consistency by two knowledgeable staff (neither being the customer), the Industries Director, and Industries Accountant before the work is commenced. For standard catalog stock items, DOC employees have and will continue to pay the posted prices.

**Person Responsible:** Fred Holbeck, Superintendent

**Date Implemented:** Already      Policy statements were distributed to and discussed with all Industries staff on April 27, 1988.

**Finding #6:** Improvements in the cost accounting system and billing procedures are needed for MCF-LL Industries.

**Recommendation #6.A.:** MCF-LL Industries should continue its efforts to computerize the cost accounting system and develop procedures to improve the accuracy and detail of standard and actual production costs.

**Response:** The upgrade to the latest version of the Open Systems accounting software was completed this past June for those applications previously used by Industries -- payroll, job cost, and inventory. Installation of the general ledger application is pending the approval of the DOC user group. The utilization of the Lotus 123 spreadsheet by the Industry Accountant for job order monitoring and finished goods inventory valuation is a further enhancement to the automated capabilities being adopted by Industries. MCF-LL is following the schedule listed in the SPRING plan, which has been approved by the Commissioner of Corrections, for the installation of the various automated accounting applications. Adoption of the two recent policy statements concerning 'Sales and Production Management' which focus on cost analysis / recovery will also aid in this effort.

**Recommendation #6.B.:** MCF-LL Industries should improve billing procedures and controls.

**Response:** Improved procedures are being developed and implemented to aid in the control of product movements and the authorization, recording, and retention of critical financial information. Cross referencing of delivery tickets to invoices and to customer files will be performed and such records retained for audit verification. Deviations from that of standard pricing will be noted on applicable work orders, delivery tickets, and invoices. Credit invoices will be originated by the shop supervisors, approved by management, and issued by the accounting office. Again, the adoption of the policy statements on 'Sales and Production Management' will reinforce the efforts of production and administrative staff in strengthening billing procedures and controls.

**Person Responsible:** James Chappuis, Industry Director

**Date Implemented:** #6.A.: Accounts Receivable and Sales is the next Open Systems application scheduled for installation. It should be operational by the end of April 1989. The overall SPRING plan has scheduled installations of the various accounting applications to occur from 1988 through 1993.

#6.B.: By the end of September 1988.

**Finding #7:** Internal controls over raw materials inventories at MCF-LL Industries are inadequate.

**Recommendation #7:** MCF-LL Industries should establish and improve internal controls over inventories.

**Response:** Integral to the further automation and enhancement of the accounting and sales / production management information system used in Industries, the efforts of the SPRING project encompass the control and reporting of raw materials, work in process, and finished goods inventories. Industries is currently testing a perpetual inventory control system in furniture and printing, utilizing purchase and issuance information furnished by the Buyer and Shop Supervisors. As this trial effort continues, comparison of physical counts to perpetual records are being made and discrepancies noted for further examination. Improved receiving practices are being developed whereby each shop will have a designated receiving area supervised by the Shop Supervisor or designee who will have the responsibility for verifying and recording the raw materials or any other items received from an outside supplier. This effort will aid in the obtainment of accurate information for inventory control and accounts payable processing. The use of reorder points for the various raw materials and supplies items will be utilized where feasible, based upon production needs as forecast by the bills of materials prepared for the various jobs, storage capabilities, and supplier lead time requirements.

**Person Responsible:** James Chappuis, Industry Director

**Date Implemented:** We expect to be able to complete the testing of the perpetual inventory system by the end of June 1989 so that it may be fully implemented beginning with F.Y. 1990. For the remaining tasks commenced or contemplated, implementation should be possible by the end of October 1988.

**Finding #8:** Improved controls over time reporting and cost allocation for inmate payroll are needed.

**Recommendation #8.A.:** Inmate payroll costs, and appropriate grant revenue from State Support, should be allocated to the Industry accounts for which the actual work was performed.

**Response:** All reasonable efforts will be made to ensure that the appropriate and accurate charging of inmate payroll to Industries will be made, including the recognition of grant revenue from State Support. The conversion of the inmate payroll processing to the newer Open Systems package now requires the separation of State Support inmate payroll from that of Industries payroll by making State Support a distinct company (#9), not associated with MCF-LL Industries (company #1). Inmates who would be working in both Industries and State Support activities would actually submit two separate time reports, one for each activity.

**Recommendation #8.B.:** MCF-LL should improve records and controls over inmate time reporting to ensure that payroll hours reported are accurate.

**Response:** Industries production and institution custody staff will be instructed to verify and correct, if needed, each day the date and time recordings made by the time clocks. They will also be reminded to schedule their own work activities so that they can observe the inmates punching in and out of the shops so as to reduce the abuse given the time clocks. Production staff will also be reminded that any corrective alterations made to an inmate's time card, as well as the approval of overtime for inmate workers, must be documented and authorized as appropriate. Payroll staff will be reminded of the continual need for verification and balancing of hours worked against hours being paid, as well as the need to retain payroll records in a manner to enable future auditing.

**Person Responsible:** #8.A.: Mary Ann Beckman, Industries Accountant  
#8.B.: James Chappuis, Industry Director (Indus)  
Kenneth Schonrock, Accounting Supv (State)

**Date Implemented:** #8.A.: Already Industry inmate payroll paid from the State grant has been reported in the F.Y. 1988 financial statements.  
#8.B.: By the end of September 1988.

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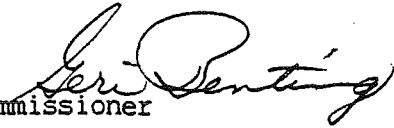
DEPARTMENT: of Finance

STATE OF MINNESOTA

OFFICE MEMORANDUM

DATE: July 12, 1988

TO: Dennis Anderson, Finance Director  
Department of Corrections MCF-LL

FROM: Geri Benting   
Assistant Commissioner

PHONE: 296-1699

SUBJECT: Imprest Cash

Under authority of Minnesota Statutes Section 15.191, your request to establish the Special Revenue Fund imprest cash account for \$50 is approved.

cc: Tom Casey  
Shirley Flekke  
John Heintz  
Legislative Auditor  
File

## MCF-LL / MCI-LL Policy Statement

Issue: Conflict of Interest

Topic: Purchases of Raw Materials or Supplies by DOC Employees Prohibited

Employees of the Minnesota State Department of Corrections and other individuals who may be deemed as 'insiders' by MCF-LL / MCI-LL officials are prohibited from purchasing raw materials and / or supplies -- in either the original state as is received by MCI-LL or as altered through cutting, milling, or assembling by MCI-LL -- from the Lino Lakes Industry Program where the subject items do not constitute a finished product completely built by MCI-LL.

Alterations of raw materials, such as the cutting of shelving, making of moldings or other pieces, cutting and/or assembly of drawers or other cabinetry items, or the cutting / milling of parts for unfinished products, etc. which are not made by MCI-LL into a finished product that is sold as a normal course of business by MCI-LL are NOT considered as items eligible for resale under this policy.

This policy does not otherwise prohibit a DOC employee or other 'insider' from purchasing completely manufactured furniture products -- either custom designed or catalog stock -- from the Lino Lakes Industry Program.

Effective Date: This policy is effective April 27, 1988.

## **MCF-LL / MCI-LL Policy Statement**

**Issue:** Conflict of Interest

**Topic:** Pricing of Custom Services and Products Purchased by DOC Employees

All work performed by MCI-LL in refinishing, reupholstering, custom furniture manufacturing, printing, and any other work which may be performed by MCI-LL for customers who are employees of the Minnesota State Department of Corrections or other individuals who may be deemed as 'insiders' by MCF-LL/MCI-LL officials shall be priced according to the following precedures:

- 1) The Industries Director will assign two technically competent MCI-LL production staff to estimate and verify the bid quotations for performing the work. In no event shall a MCI-LL employee estimate or verify the bid quotation on a job where he/she is the customer or customer's agent.
- 2) The Industries Director will review the bid quotation and either approve or disapprove the proposed job and bid quotation. Disapproved jobs will either be rejected or returned for additional quotation details or estimate workup.
- 3) Approved jobs will be forwarded to and reviewed by the Industry Accountant for adequacy of documentation and comparative reasonableness / consistency of pricing. Jobs which pass this review will be written up as Work Orders and submitted for production. Jobs which do not pass this review will be returned to the Industries Director with concerns noted for remedy.

**Effective Date:** This policy is effective April 27, 1988.

## MCF-LL / MCI-LL Policy Statement

Issue: Sales and Production Management

Topic: Recovery of Production and Overhead Costs and Profit in Pricing Sales

Since the net profitability of production, sales, and administrative efforts is necessary for the continued viability of any business enterprise, MCI-LL is implementing the following procedure to ensure that all reasonable efforts have been made in the pricing of both standard and custom work to recover the costs of direct production and overhead and to provide for the desired profit margin.

This procedure is applicable to all service and production work performed by MCI-LL: Refinishing, Reupholstering, Furniture Manufacturing, Printing, and any other work which may be performed now or in the future.

Raw Materials Consumption @ Finished Size Dimensions x Unit Cost Paid (This to be detailed out for each RM Inventory item)	_____
+ Waste Factor @ 15% * of Above Finished Size RM Cost ..	_____
+ Hardware and Supplies Not Included in Burden Rate (This to be detailed out as appropriate for control)	_____
= Sub Total: Direct Materials Cost for Producing Job .	_____
+ Burden Rate: Inmate Labor Hours @ \$12.00 * per Hour (This to be detailed out as appropriate for control)	_____
= Sub Total: Standard Cost for MCI-LL to Produce Job .	_____
+ 10% * Profit Margin over MCI-LL Standard Cost .....	_____
= Selling Price Quoted to Customer .....	_____

\* denotes rates subject to change.

This calculation will be recorded on the Production Estimate Worksheet and be retained for audit verification and actual - to - estimate analysis. It is not intended that this detailed information be provided to the customer or to anyone outside of MCI-LL. (Modification to format for Printing jobs is allowable.)

Actual costs incurred in performance of the work will also be recorded on the Production Estimate Worksheet for every custom service / production work job and as often as deemed necessary by the Industries Director for catalog / stock item production jobs. Variances in actual - to - estimated costs will be reviewed and will be noted for reflection in cost estimates on similar jobs in the future.

Related Topic: Production Job Controls and Cost Analysis

Effective Date: This policy is effective April 27, 1988.



## MCF-LL / MCI-LL Policy Statement

Issue: Sales and Production Management

Topic: Production Job Controls and Cost Analysis

Production controls in a manufacturing or service type industry can primarily be categorized into 'time' and 'resource' considerations. The time element involves the efficient and effective scheduling of the processes needed to work with the resource elements, which require quality and quantity considerations. Within MCI-LL operations, the Work Order constitutes the control device over which 'time' and 'resources' are orchestrated.

In order to assure the tracking of pending, in-process, and finished jobs; as well as the recording of all labor and material resources estimated and actually used in production, it is necessary that for all work planned and performed in the MCI-LL shops, adequately detailed and properly approved Work Orders must be issued in advance of committing time and resources to any job, no matter how apparently simple, quick, inexpensive, or high in priority the job may be.

The preparation of an adequately detailed Work Order will also aid in the finished goods inventory control as it provides description for Packing Lists and Delivery Receipts and ultimately the Customer Invoice. Such information is valuable for audit verification and can also be used in profitability / cost analysis of production and service work.

Cost analysis of production runs and of specific jobs is primarily afforded by the comparison of actual - to - estimated costs recorded on the Production Estimate Worksheets. Such analysis will be performed on every custom service / production work job performed as well as periodically on catalog / stock item production jobs when ordered by the Industries Director. Variances in actual - to - estimated costs will be reviewed and will be noted for reflection in cost estimates on similar jobs in the future.

Monitoring of waste -- both reusable and trash -- generated by production and service activities will be conducted on every custom work job and periodically on stock item production jobs so as to assess the adequacy of the waste allowance factor as well as to aid in the analysis of overall production efficiency.

Related Topic: Recovery of Production and Overhead Costs and Profit  
in Pricing Sales

Effective Date: This policy is effective April 27, 1988.