Department of Corrections

Selected Scope Financial Audit
For the Year Ended June 30, 1994

October 1995

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

95-41

Centennial Office Building, Saint Paul, MN 55155 ● 612/296-4708

STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Representative Ann Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Frank W. Wood, Commissioner
Department of Corrections

We have audited selected components of the inmate earnings and inmate accounts of the Department of Corrections and its activities at some Minnesota correctional facilities as of and for the year ended June 30, 1994, as further explained in Chapter 1. We also reviewed controls through the current period of February 1995 to include the reorganization within the department that created the MINNCOR unit. Our audit scope included financial controls over inmate earnings from private employers and inmate funds held in individual and group accounts. Therefore, we emphasize that this has not been a complete audit of all programs with the Department of Corrections. The following summary highlights the audit objectives and conclusions. We discuss these issues more fully in the individual chapters of this report.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we obtain an understanding of management controls relevant to the audit. Controls were reviewed for the fiscal year 1994 audit period. The standards also require that we design the audit to provide reasonable assurance that the Department of Corrections complied with provisions of laws, regulations, contracts, and grants that are significant to the audit.

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Corrections. This restriction is not intended to limit the distribution of this report, which was released as a public document on October 6, 1995.

We thank the Department of Corrections staff for their cooperation during this audit.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: May 12, 1995

Report Signed On: October 2, 1995

SUMMARY

State of Minnesota
Office of the Legislative Auditor
Centennial Office Building • St. Paul, MN 55155
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Department of Corrections

Selected Scope Financial Audit
For the Year Ended June 30, 1994

Public Release Date: October 6, 1995 No. 95-41

Agency Background

The Department of Corrections is a service and regulatory agency which provides correctional facilities and community programs for adjudicated delinquent and adult felons. Commissioner Frank Wood provided the general management of the department since his appointment, effective September 9, 1993.

During fiscal year 1994, the department initiated a restructuring of the industries program at the correctional facilities. The department created a unit called MINNCOR to centralize control over management, production coordination sales, marketing, designing, purchasing, and accounting operations of the industries program. One objective of MINNCOR is to establish a uniform accounting system. MINNCOR intends to use a wide area network system to send and receive information through an accounting software package to and from production facilities.

Selected Audit Areas and Conclusions

Inmate Work Programs: Private Employers

Our review documented controls over inmate earnings at the ten correctional facilities during fiscal year 1994. We also reviewed controls through February 1995 to include the reorganization within the department that created the MINNCOR unit. We limited testing to the activities at MCF-Shakopee and MCF-Lino Lakes.

Our review concentrated on the financial controls over inmate earnings from private employers at the facilities, but also addressed two private business contracts controlled by MINNCOR. We found inmate wages earned from private employers are not properly controlled. We also found that the department has not executed written contracts to limit the department's financial risks with these private businesses.

The Department of Corrections Central Office and facilities together are responsible for maintaining control over inmate accounts, both individual and group. Dual supervision exists for the finance directors who supervise accounting staff in this area at each facility. The finance directors report typically to the associate warden of administration at each facility as well as the financial services director in the central office. This dual reporting responsibility complicates oversight of the accounting function. As a result, correctional facilities and the Central Office have not established proper control over inmate financial activities to ensure that: (1) financial duties are properly separated, (2) reconciliations are completed for financial activity, and (3) account balances and authorized cash levels are accurate.

Department of Corrections

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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
Ken Vandermeer, CPA	Auditor-in-Charge
Pat Ryan	Auditor
Geniene Herrlich	Auditor
Fubara Dapper	Auditor

Exit Conference

The issues in this report were discussed with the following staff of the Department of Corrections on September 12, 1995:

Frank W. Wood	Commissioner
Lurline Baker-Kent	Assistant Commissioner
Shirley Flekke	Financial Services Director
Peter Maurer	Director of Internal Audit
Mark Thielen	Assistant to Deputy Commissioner
Paul Anderson	MINNCOR Accounting Supervisor
Fred Lafleur	Warden, MCF-Lino Lakes

Chapter 1. Introduction

The Department of Corrections was established to consolidate state correctional functions under one agency. The primary purpose of the department is public protection. The department is a service and regulatory agency which provides correctional facilities and community programs for adjudicated delinquent and adult felons. Commissioner Frank Wood provided the general management of the department since his appointment, effective September 9, 1993.

The department's organization consists of three main divisions:

- The Institution Services Division operates the ten correctional facilities with an inmate population of over 4,600. Support services include health care, education, correctional industry coordination, and inmate classification.

- The Community Services Division administers the Community Corrections Program. This division also provides work release and parole services, inspection of local jails and other correctional facilities, and a wide range of community services programs.

- The Management Services Division provides overall administrative, planning, policy development, training, and staff support service functions for the department. This division includes activities involving personnel, information and analysis, fiscal services, office management, hearings and appeals, and victim services.

During fiscal year 1994, the department initiated a restructuring of the industries program at the correctional facilities. The department created a unit called MINNCOR to centralize control over various operations of the industries program. We reviewed controls through the current period of February 1995 to include the reorganization within the department that created the MINNCOR unit.

Total departmental expenditures for fiscal year 1994 were $227,387,696. Of this total, Institution Services Division expenditures comprised approximately 70 percent ($160.1 million), Community Services comprised 21 percent ($47 million), and Management Services comprised 9 percent ($20.2 million). We concentrated our 1994 review on a segment of the Institution Services Division that pertained to inmate work programs with private employers. As shown in Figure 2-1, that segment is a very small piece of the total departmental expenditures and amounts to approximately $556,000 .

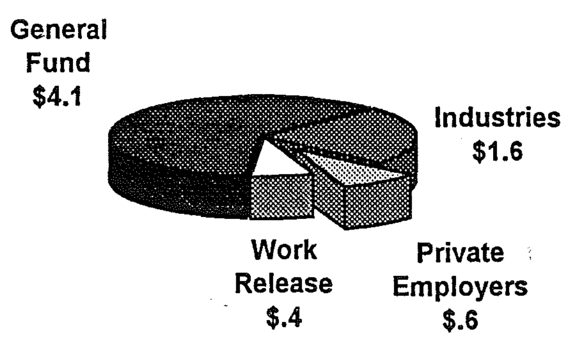
Chapter 2. Inmate Work Programs: Private Employers

Chapter Conclusions

The Department of Corrections established numerous opportunities for inmates to earn wages in various work programs. However, financial controls over inmate earnings from private employers are weak. In addition, financial controls over deductions to inmate earnings from private employers also are weak. The absence of written contracts with private businesses subjects the department to unnecessary financial risks. Required deductions from inmate wages are not properly made by some facilities. Correctional facilities have not established proper controls over inmate financial activities to ensure that: (1) financial duties are properly separated, (2) reconciliations are completed for financial activity, and (3) inmate account balances and authorized cash levels are accurate. Central Office internal audit staff also need to complete more periodic reviews of these areas.

The department provides opportunities for incarcerated inmates to earn wages and acquire vocational skills. Most opportunities for jobs are funded through either General Fund appropriations, Minnesota Correctional Industries (Industries) Program, Work Release Program, or private employers. Figure 2-1 identifies the amount of inmate earnings for each of the four sources.

Figure 2-1
Inmate Earnings by Funding Source
FY 94 ($ Millions)



Source: Statewide Accounting (SWA) System.
Private Entity Payroll Records.

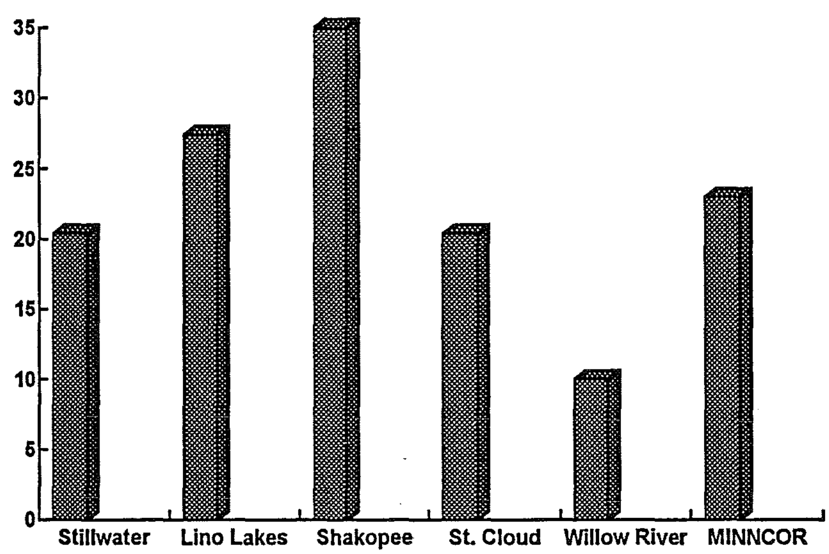
Department of Corrections

This report does not address inmate earnings from services provided to the general public in the Industries Program since we audited that area in fiscal year 1992 and 1993. This report also does not address inmate earnings from work release since we audited that area in fiscal year 1992. The 1992 and 1993 audit reports identified problems for the Industries and Work Release Programs related to issues on the private employers addressed in this report. The department still must resolve MINNCOR's developing written contracts for raw material purchases.

Private businesses, including other state agencies, sometimes contract with the department to hire inmates to perform certain tasks. The outside businesses can hire inmates to work at their place of business, or they can contract with a facility to occupy space within the prison. Inmates earn the prevailing wage for jobs performed as employees of outside businesses. Inmates did not pay any portion of room and board charges. The 1995 Legislature passed enabling legislation to prioritize the department's ability to charge inmates for room and board.

In our review, we examined deductions from earnings of inmates employed with private employers. These deductions encompass credit purchases and other debts, such as gate fees, alimony, restitution, victim service fees, child support, or other court-ordered payments. Minn. Stat. Section 241.08 establishes an inmate account in the state treasury for the care and custody of all money belonging to each inmate at correctional facilities. Each inmate has the option to maintain funds in the facility inmate account and also an additional account in a bank outside the facility. All inmates need to establish a facility inmate account as a matter of convenience. Inmates charge purchases for snacks and personal hygiene items against the inmate account on a routine basis. Facilities apply deposits into the account from inmate earnings against the credit balance. Facilities also make other deductions from inmate accounts for court-ordered payments of restitution, child support, alimony, and aid to victims.

Figure 2-2
Inmate Earnings from Private Employers
FY 94 ($ Thousands)



Source: Private employer and facility records.

Department of Corrections

Our report will concentrate on the financial controls over inmate earnings from private employers at each facility, but will also address the two private business contracts controlled by MINNCOR. Figure 2-2 summarizes the inmate earnings from private employers at each facility and MINNCOR. The objective of our financial control review is as follows:

-- Do facilities utilize contracts and control inmate wage deductions from earnings of inmates employed with private employers?

The methodology used to evaluate the audit objective over inmate earnings included sampling and analytical reviews. We documented the controls at the ten correctional facilities during fiscal year 1994 by conducting a survey. The review of controls included analysis of the cash reconciliation process and the separation of duties at each facility. We inquired about the existence of written agreements with private employers to determine if additional controls existed over the inmate earnings. We tested a sample of inmate accounts for controls over deductions on earnings from private employers. We also reviewed controls through the current period of February 1995 to include the reorganization within the department that created the MINNCOR unit. We limited testing to the activities at MCF-Shakopee and MCF-Lino Lakes. We calculated inmate wages by reviewing facility records and contacting employers for the wage detail.

We conclude financial controls over inmate earnings from private employers are weak. Finding 1 indicates that facilities do not know the extent of inmate earnings and may not fully recover deductions from inmate wages. Finding 2 discusses how written contracts could improve controls. We also conclude financial controls over inmate accounts are weak. Finding 3 identifies weaknesses segregating accounting duties and reconciling accounts.

1. Inmate wages earned from private employers are not properly controlled.

Private employers deliver payroll checks directly to inmates without informing the facilities of the total wages earned by the inmate. This practice results in a loss of control over wages earned. In addition, one facility did not recoup charges for restitution and gate fees from inmate wages.

Facilities must withhold amounts from inmate earnings for credit purchases and other debts, such as gate fees, alimony, restitution, victim service fees, child support, or other court-ordered payments. Department policy allows each facility to decide if inmates can carry cash while incarcerated. Facilities allow inmates to make credit purchases from the canteen for snacks or personal hygiene products. Inmates can deposit any remaining wages into their inmate account or establish an account at a local bank.

Our audit of wages paid to inmates by private employers indicates employers delivered checks directly to inmates at MCF-Shakopee and MCF-Lino Lakes. This method of payment requires the facilities to rely on the inmates to deposit their full check in the inmate's account maintained at the facility. Since the facility does not know how much each inmate earned, it cannot verify that the inmate remitted the full amount. Facilities must know inmate wages to recover court ordered payments or other debts. Various means are available for facilities to learn inmate wages. Private employers could pay inmate wages to the facility, or they could submit a list of earnings each pay period to the facility for verification purposes. Either method would enable the facility to make the proper deductions from the inmates account.

MCF-Lino Lakes did not deduct restitution and gate fees from inmates that worked for two private employers: Insight, Inc., and Stillwater Systems, Inc. Department policy states that facilities must deduct 50 percent of each inmates' earnings until the inmate establishes a gate fee of $100. Inmates receive the gate fee, required by statute, upon their release from prison. If a prisoner did not accumulate sufficient funds to establish the gate fee, then the state must pay them the balance up to the $100 limit upon their release.

Recommendation

- *The department should improve controls over wages paid to inmates by:*
  - *requiring private companies to remit inmate wages directly to the facility for deposit to the inmate's account or requiring employers to submit a list of wages paid to the inmate as an allowable substitute.*
  - *ensuring facilities deduct the required amounts from inmate earnings.*

2. The department does not have written contracts with private employers.

The department did not establish written contracts with private businesses that employ inmates as a work force. Some facilities have executed leases which allow private businesses to use certain work space at the facilities. However, written contracts addressing the liabilities and responsibilities of the private business and the facility do not exist currently. Without written contracts, the department exposes itself to unnecessary risks that can result in losses to the state.

MINNCOR currently is responsible for coordinating contract work with two private companies, but it did not establish contracts with them. These two companies hire inmates through MINNCOR to perform certain tasks. Although the dollar amounts are small, the activity in this area is growing each year with the expansion and reorganization of the unit. MINNCOR needs to address in a written contract the business arrangement agreed to by MINNCOR and each private business.

In addition, three of the five facilities did not establish contracts with private companies or other state agencies. Figure 2-2 shows MINNCOR and the five facilities involved. Two facilities that did not establish contracts, MCF-Lino Lakes and MCF-St. Cloud, allowed the business or state agency to conduct their work at the correctional facility. MCF-Stillwater did not establish a contract with a business that hired inmates that work outside of the facility. Regardless of the arrangement, each facility must establish in a written contract the rights and responsibilities of each party. If this agreement remains undocumented, the facility exposes itself to unnecessary risks that can result in losses to the department. For instance, the lack of a written agreement at MCF-Lino Lakes resulted in the failure to deduct restitution and gate fees from inmate earnings (See finding 1). A written contract could establish the responsibility for the deductions with one party or the other.

Recommendation

- *The department should improve controls over inmate labor agreements by establishing written contracts with private companies that contract for state services.*

3. Correctional facilities have not established proper control over inmate financial activities.

The correctional facilities system of control over financial activity does not include an independent review to:

-- ensure proper separation of duties for accounting functions with access to cash, and

-- ensure monthly reconciliations exist for financial activity.

The Department of Corrections Central Office and facilities together are responsible for maintaining control over the financial activity at the facilities. Dual supervision exists for the finance directors who supervise accounting staff in this area at each facility. The finance directors report typically to the associate warden of administration at each facility as well as the financial services director in the Central Office. This dual reporting responsibility complicates oversight of the accounting function. Facilities may presume Central Office provides oversight and Central Office may presume the facilities provide the oversight.

The difficulty of this supervisory arrangement is illustrated by a situation that occurred at MCF-Lino Lakes. The lack of accountability created by the dual reporting responsibilities facilitated the breakdown in controls at MCF-Lino Lakes. The finance director assumed too much control and performed incompatible duties. At the time of this audit, necessary records were missing and the social welfare individual and group accounts had not been reconciled for three years. The department ultimately dismissed the MCF-Lino Lakes finance director on October 31, 1994, for alleged financial misconduct.

In addition to the problems at MCF-Lino Lakes, our surveys identified several other individuals at various facilities who also performed incompatible duties. Periodic reviews may identify a need to separate accounting duties at the facilities. The duties of some accounting functions are not compatible, especially when access to cash is involved. The person with custody of the cash must not have custody of the records nor perform the reconciliation process. The person who records transactions must not write checks, withdraw cash, nor perform reconciliations to account balances. A supervisor's review of supporting documentation would provide additional separation of critical duties, such as the request for reimbursement of cash accounts. Also, facility supervisors could review reconciliations of account activity to receipt logs, deposit slips, bank records, and the Statewide Accounting (SWA) System. Some facilities do not properly separate these duties.

We also observed problems with the timeliness, completeness, and accuracy of reconciliations on account activity. MCF-Lino Lakes had not completed reconciliations for inmate group accounts since 1991. Without timely reconciliations, the facilities cannot be assured of accurate records.

Recommendations

- *Facilities should improve control over financial activities with periodic reviews performed by facility supervisors or Central Office internal audit staff. The periodic reviews of the financial activity at the facilities should ensure that:*
  - *a proper separation of duties exists for accounting staff with access to cash and*
  - *monthly reconciliations exist for financial activity.*
- *The department should establish clear reporting responsibilities for financial directors at the various facilities.*

State of Minnesota
Minnesota Department of Corrections
Office of the Commissioner

September 28, 1995

James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
First Floor Centennial Building
St. Paul, Minnesota 55155

Dear Mr. Nobles:

We have received and reviewed your audit report of selected components of the inmate earnings and inmate accounts of some correctional facilities as of and for the year ended June 30, 1994. We understand that this was not a complete audit of all programs within the department and was limited to a portion of the department's operations.

Your audit reports are important to us and serve as helpful tools and guides in the management of the department and in safeguarding the state assets under our stewardship. The audits also help the department to meet the professional accreditation standards of the American Correctional Association.

I would like to note that while your audit focused on F.Y. 1994 plus a review of controls through the current period of February 1995 to include the reorganization within the department that created the MINNCOR unit, the department as of January 1, 1995, had already implemented most of the measures that the report included for inmate wages earned from private employers.

If you have any questions or comments about our response, please feel free to call me or members of my staff.

Sincerely,

Frank W. Wood

Frank W. Wood
Commissioner

FW/SF:dl
Attachment

cc: Lurline Baker-Kent, Assistant Commissioner, Management Services
Richard Mulcrone, Deputy Commissioner, Community Services
James Bruton, Deputy Commissioner, Institutions
Shirley Flekke, Director, Financial Services

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MINNESOTA DEPARTMENT OF CORRECTIONS
RESPONSE TO LEGISLATIVE AUDIT
FOR THE FISCAL YEAR ENDING JUNE 30, 1994

CHAPTER 2. INMATE WORK PROGRAMS: PRIVATE EMPLOYERS

RECOMMENDATION: The department should improve controls over wages paid to inmates by:

- requiring private companies to remit inmate wages directly to the facility for deposit to the inmate's account or requiring employers to submit a list of wages paid to the inmate as an allowable substitute.

- ensuring facilities deduct the required amounts from inmate earnings.

RESPONSE: Prior to January 1, 1995, some inmate wages from private employers were deposited in outside bank accounts and not inmate accounts at the correctional facilities. However, effective January 1, 1995, inmate wages paid by private employers are remitted to the appropriate correctional facility along with a list of hours worked and wages earned by each inmate. These monies are deposited into the appropriate inmate account. This method has established proper control over wages paid to inmates by private employers.

Although for a period of time, inmate wages from one private employer were deposited to an outside bank account, it should be noted that during the period F.Y. 1992 through F.Y. 1994, no state funds were ever used for gate money for the inmates working for the private employer.

During the 1995 Legislative Session, Minnesota Statutes 1994, Section 243.88, was amended to specifically provide for the same deductions from wages paid by private employers as for other wages paid to inmates. In addition, Minnesota Statutes 243.23, Subd. 3, was amended to add new deductions and to provide for a specific order of deductions including room and board charges. The department has formed a committee to review the recent legislative changes and to prepare a plan for implementation.

Person Responsible: Shirley Flekke, Director, Financial/Office Services

Projected Completion Date: July 1, 1996

RECOMMENDATION: The department should improve controls over inmate labor agreements by establishing written contracts with private companies that contract for state services.

RESPONSE: The department continues to improve controls over inmate labor agreements by establishing written agreements with private employers. For example, effective January 1, 1995, the department established two written agreements with one private employer. In addition, the department will review its policy and procedure in this area to ensure continued monitoring of these agreements.

Person Responsible: Mark Thielen, Assistant to the Deputy Commissioner, Institutions Division

Projected Completion Date: March 1, 1996

RECOMMENDATION:

Facilities should improve control over financial activities with periodic reviews performed by facility supervisors or Central Office internal audit staff. The periodic reviews of the financial activity at the facilities should ensure that:

-- a proper separation of duties exists for accounting staff with access to cash and

-- monthly reconciliations exist for financial activity.

RESPONSE: The department is aware of the need for improved control over financial activities and plans to establish a peer review process that should provide the appropriate oversight of such activities. The internal audit staff will be involved in planning and setting up the process of this review. The peer review will include the separation of duties and monthly reconciliations for financial activity. A separate financial services policy and procedures manual is also planned.

The department should establish clear reporting responsibilities for financial directors at the various facilities.

RESPONSE: The department supports the current practice of having the Finance Directors at each facility report to the Central Office Director of Financial Services and continues to strengthen clear reporting in this regard. It is also planned that the peer review process mentioned in the reply above will have a significant impact on the operation of financial activities at the facilities. It will also provide for greater consistency and cross-learning within the financial services area.

Person Responsible: Shirley Flekke, Director, Financial/Office Services

Projected Completion Date: March 1, 1996