

Department of Corrections

Selected Scope Financial Audit For the Period July 1, 1994, through March 31, 1997

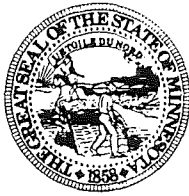
July 1997

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**Financial Audit Division
Office of the Legislative Auditor
State of Minnesota**

97-37

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STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

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Senator Deanna Wiener, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Gothriel J. La Fleur, Commissioner
Department of Corrections

We have audited selected components of the Department of Corrections and its activities at some Minnesota correctional facilities for the period July 1, 1994 through March 31, 1997, as further explained in Chapter 1. Our audit scope included a review of MINNCOR Industries receipts and inventory expenditures and also Special Revenue Fund dedicated revenues and expenditures. 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 auditing standards and *Government Auditing Standards*, as issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of management controls relevant to the audits. The standards also require that we design the audit to provide reasonable assurance that the Department of Corrections complied with the provisions of laws, regulations, contracts, and grants significant to the audit. The management of the Department of Corrections is responsible for establishing and maintaining the internal control structure and for compliance with applicable laws, regulations, contracts, and grants.

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 July 18, 1997.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: June 6, 1997

Report Signed On: July 11, 1997

SUMMARY

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Department Of Corrections

Selected Scope Financial Audit

For the Period July 1, 1994, through March 31, 1997

Public Release Date: July 18, 1997

No. 97-37

Agency Background

The Minnesota Department of Corrections was created in 1959 to consolidate state correctional functions under one agency. The department is a service and regulatory agency which provides correctional facilities and community programs for adjudicated delinquent and adult felons. The Governor appointed Mr. Gothriel J. La Fleur commissioner of the department effective August 5, 1996.

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.

The department also administers several programs funded by dedicated receipts. Among these programs are work programs associated with counties, indirect cost allocation, special projects, aid to victims, shared services with other state agencies, and reimbursement agreements with counties.

Conclusions

The Department of Corrections operated MINNCOR as a business enterprise beginning in fiscal year 1995. Continued losses required the General Fund to subsidize MINNCOR. While it has implemented some changes to its business practices, the deficit for fiscal year 1996 increased over fiscal year 1995. Preliminary fiscal year 1997 data shows, however, that MINNCOR's operating results may be improving. We noted that MINNCOR was unable to determine the profitability of individual products and services. We also identified several issues related to billings, written agreements, and the accounting system.

The Department of Corrections has several programs that have dedicated revenues and are accounted for in the Special Revenue Fund. We noted that the General Fund was incurring costs on behalf of the Special Revenue Fund. This resulted in several programs having excessive fund balances. We also noted several problems in the accounting for Special Revenue Programs. These issues included failing to analyze the rates charged for housing nonstate inmates, no contracts with local governmental units, and not matching revenues and expenditures in the same fund for the Sentencing to Service Program.

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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
Jack Hirschfeld, CPA	Auditor-In Charge
Fubara Dapper, CPA	Auditor
Steve Johnson	Auditor
Susan Kachelmeyer, CPA	Auditor
Anna Lamin	Student Worker

Exit Conference

We discussed the findings and recommendations with the following representatives of the Department of Correction at the exit conference held on June 23, 1997:

Gothriel J. La Fleur	Commissioner
Dennis Benson	Deputy Commissioner
Janet Entzel	Assistant Commissioner, Juvenile Services and Legislative Relations
R.T. Mulcrone	Assistant Commissioner, Community Services
Karen Robinson	Assistant Commissioner, Management Services
Erik Skon	Assistant Commissioner, Adult Facilities
John Calabrese	Accounting Manager
Paul Anderson	MINNCOR Finance Director
Everett Hageman	Accounting Supervisor
John McLagan	Director, Sentencing to Service Program
Deborah A. Eng	Director, Juvenile Services

Chapter 1. Introduction

The Minnesota Department of Corrections was created in 1959 to consolidate state correctional functions under one agency. The department is a service and regulatory agency which provides correctional facilities and community programs for adjudicated delinquent and adult felons. The Governor appointed Mr. Gothriel J. La Fleur commissioner of the department effective August 5, 1996.

The department currently operates ten correctional facilities, including seven for adults, two for juveniles, and one serving both adults and juveniles. Adult prison populations total more than 5,000 inmates. Juvenile offenders number approximately 200. The department supervises more than 12,000 offenders on probation, supervised release, and parole. The inmates are incarcerated at the ten Minnesota correctional facilities (MCF): MCF-Faribault, MCF-Lino Lakes, MCF-Oak Park Heights, MCF-Red Wing, MCF-St. Cloud, MCF-Sauk Centre, MCF-Shakopee, MCF-Stillwater, MCF-Willow River/Moose Lake, and Thistledeew Camp.

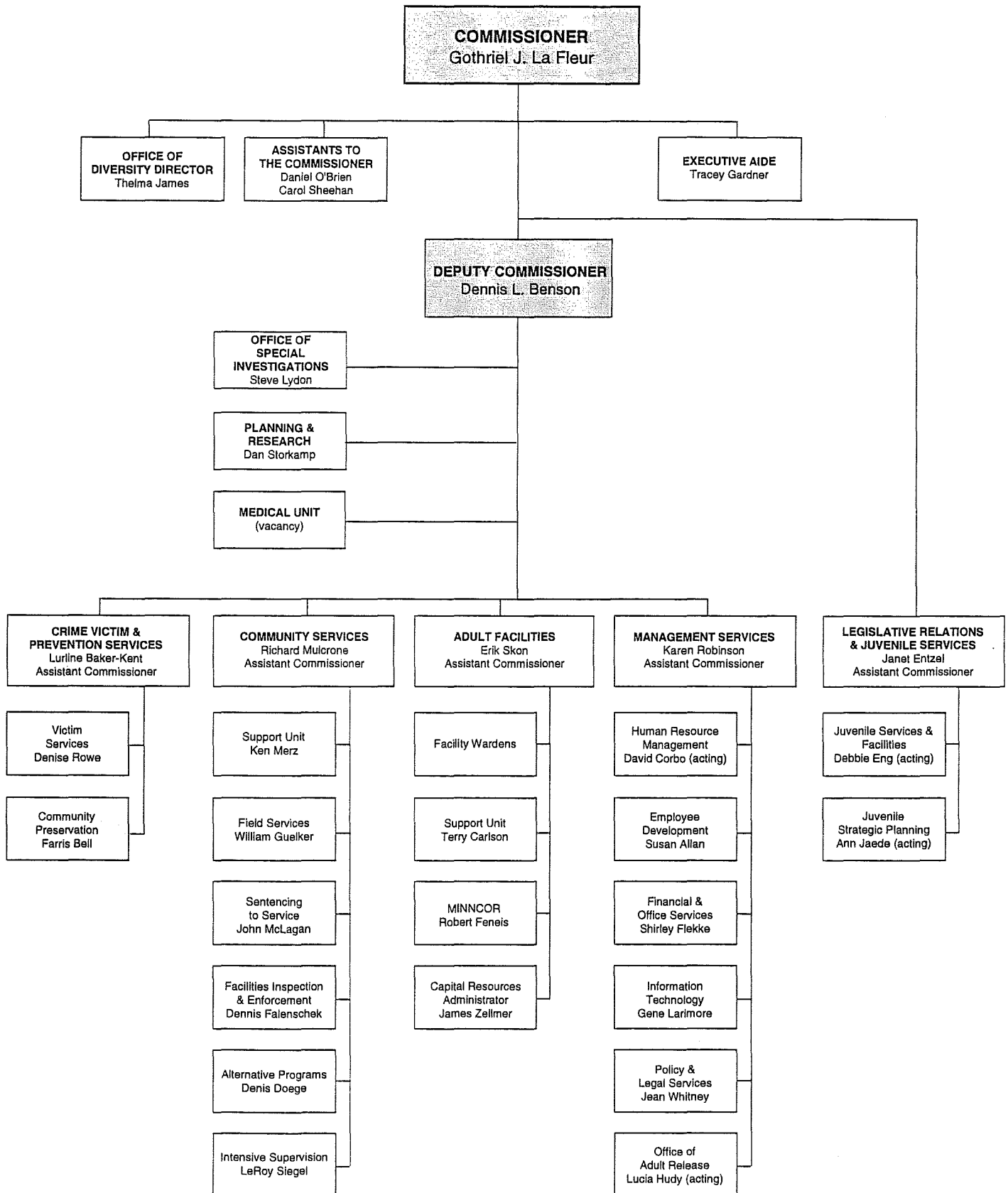
The department is organized into five main divisions:

- The Adults Facilities Division includes the department's seven adult correctional facilities, including six for males and one for females. This division includes MINNCOR Industries, which provides work programs within the correctional facilities.
- The Legislative Relations and Juvenile Services Division is responsible for legislative relations, juvenile services, and juvenile strategic planning. Additionally, the juvenile correctional facilities are part of this division.
- The Community Services Division is responsible for providing probation and supervised release/parole services. This division also provides community service, inspection of correctional facilities, and administers the Community Corrections Act and interstate compacts.
- The Crime Victim and Prevention Services Division is responsible for providing overall administrative assistance, planning, and policy direction for the victim services and community preservation units. Additional responsibilities of this division are the administration of grant funds paid to victim service providers and development of partnerships with communities impacted by crime.
- The Management Services Division provides management support services for the department. Units in this division include human resource management, information technology, financial and office services, employee development, policy and legal services, and adult release.

A copy of the organizational chart for the Department of Corrections is shown in Table 1-1.

Table 1-1

Minnesota Department of Corrections
Organization Chart — June 1997



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The department is funded by state appropriations, dedicated receipts, federal grants, and sales of MINNCOR Industries products. Total departmental expenditures for fiscal year 1996 totaled \$287 million. State appropriations funded \$276 million of the department's expenditures. The department financed the remaining expenditures in the Special Revenue Fund, the Enterprise Fund, and the Social Welfare and Gift Funds. We concentrated our 1997 review of the department on revenue and expenditures in the Enterprise Fund and in the Special Revenue Fund. These two funds accounted for approximately \$20 million in expenditures for 1996. Table 1-2 shows the revenues and expenditures for fiscal year 1996 by fund type.

Table 1-2
Revenues and Expenditures
Fiscal Year 1996

	<u>Enterprise Fund</u>	<u>Special Revenue Fund</u>
<u>Balance Forward:</u>	<u>\$ 2,506,982</u>	<u>\$ 9,596,076</u>
<u>Revenues:</u>		
Dedicated		\$ 9,985,157
Sales and Services	\$11,848,064	
Transfers In		<u>13,699</u>
Total Revenues and Amount Forward In	<u>\$14,355,046</u>	<u>\$19,594,932</u>
<u>Expenditures:</u>		
Payroll	\$ 3,027,201	\$ 2,894,769
Administrative	6,635,663	3,314,440
Grants		548,900
Inmate Activities	1,752,308	27,159
Other Expenditures	696,494	281,140
Transfers Out		<u>1,244,099</u>
Total Expenditures (1)	<u>\$12,111,666</u>	<u>\$ 8,310,507</u>
Balance Out	<u>\$ 2,243,380</u>	<u>\$11,284,425</u>

- (1) MINNCOR Industries Program is accounted for in the Enterprise Fund. The General Fund contributed \$5.5 million to MINNCOR to reduce the operating deficit. These expenditures are reflected in the General Fund.

Source: State of Minnesota Fiscal Year 1996 Managers Financial Reports and Allotment Balance Within Appropriation Reports as of March 31, 1997.

In Chapter 2 we discuss our findings related to MINNCOR Industries. In Chapter 3 we discuss the findings regarding Special Revenue Fund revenue and expenditures.

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Chapter 2. MINNCOR Sales and Inventory Purchases

Chapter Conclusions

The Department of Corrections operated MINNCOR as a business enterprise beginning in July 1994. Continuing losses required the General Fund to subsidize MINNCOR from fiscal year 1995 through 1997. Although MINNCOR implemented some changes to its business practices, it could not determine the profitability of its individual products and services. Furthermore, MINNCOR's accounting system did not interface with the state's accounting system.

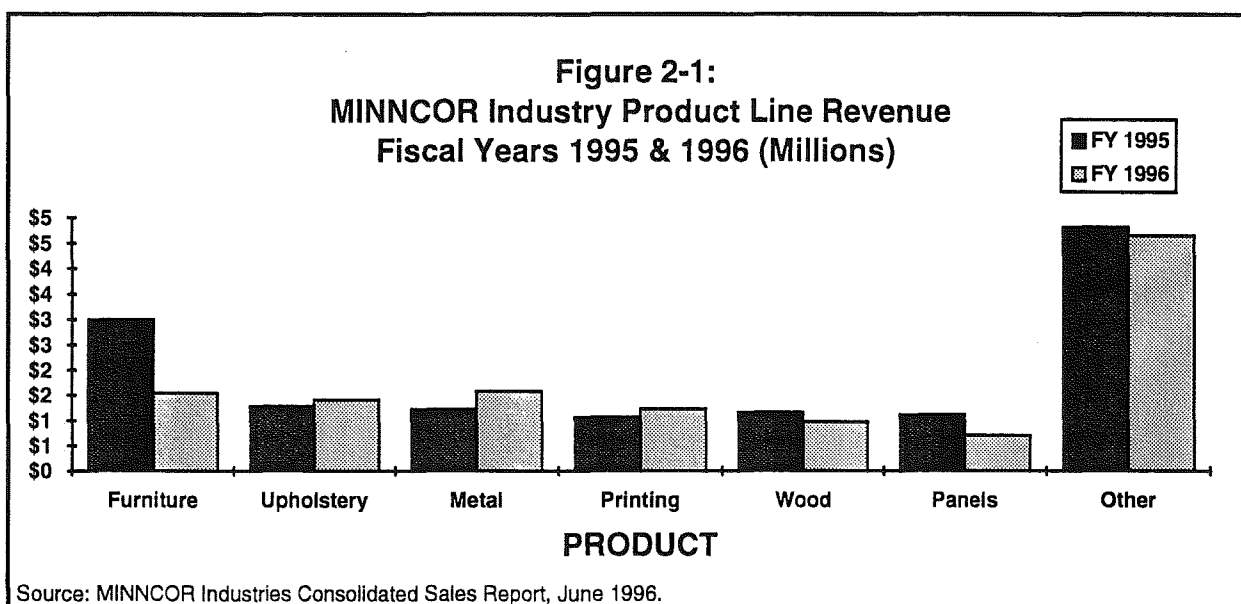
MINNCOR designed and implemented internal controls to provide reasonable assurance that it properly recorded sales, receipts, and inventory purchases on its accounting system and the state's accounting system. However, MCF-Shakopee did not implement internal controls to ensure that it properly billed for products and services provided. This facility also did not comply with the central office contract and cost allocation policies.

Background

Prior to 1994, each Minnesota correctional facility operated its own industry program. The wardens administered each program separately. In June 1994, the Department of Corrections created MINNCOR, a centralized organizational structure for the correctional industry program. MINNCOR consolidated product development, marketing, and financial operations into one agency-wide operation and introduced new business practices and technologies throughout the organization. A change in the philosophy of the correctional industries program from running it as a program for keeping inmates busy, to managing it more as a profit centered "business," drove this consolidation. MINNCOR also provided job training to inmates to increase the ex-offender's likelihood of success upon release.

MINNCOR produced and sold products and services to government agencies and other customers. Industries exist at seven correctional facilities. Figure 2-1 identifies the primary industry product lines or cost centers and compares revenue generated between fiscal year 1995 and 1996. The furniture, upholstery, metal products, printing, wood products, and panels cost centers combined total accounted for approximately 63 percent of sales revenue during the fiscal years. These six cost centers generated at least \$1,000,000 in revenue. Other large cost centers included: farm machinery, sewn products, truck/auto repair, and notebooks. Each of those cost centers generated between \$500,000 and \$1,000,000 of revenue and accounted for an additional 21 percent of total revenue. Numerous other products accounted for the remaining 16 percent of revenue.

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MINNCOR operated as a business with the goal of becoming financially self-sufficient. The program, however, has experienced losses every year since its inception. General Fund appropriations subsidized these losses. This subsidy increased from \$2.8 million in 1989 to a high of \$5.7 million in 1995. In 1995, MINNCOR implemented a business plan that called for a progressive subsidy reduction resulting in financial self-sufficiency by the year 2002. To achieve that goal, MINNCOR eliminated or consolidated unprofitable cost centers, evaluated product pricing, improved service with its customers, and consolidated business responsibilities. However, these business changes did not increase net income. Table 2-1 shows MINNCOR revenues and expenditures for fiscal years 1995 and 1996. This table shows that MINNCOR's operating losses actually increased, resulting in a larger deficit in fiscal year 1996 than in fiscal year 1995. Preliminary data shows that in fiscal year 1997 the MINNCOR operating deficit began to diminish.

**Table 2-1
MINNCOR Revenue and Expenditures
Fiscal Years 1995 - 1996**

	1995	1996
Sales	\$13,687,955	\$12,096,031
Other Income	75,529	383,755
Total Revenue	<u>\$13,763,484</u>	<u>\$12,479,786</u>
Materials	\$14,158,799	\$13,623,560
Payroll	3,606,221	3,320,693
Other Expenditures	922,630	750,197
Total Expenditures	<u>\$18,687,650</u>	<u>\$17,694,450</u>
Deficit - Note 1	<u>(\$ 4,924,166)</u>	<u>(\$ 5,214,664)</u>

Note 1: MINNCOR's preliminary fiscal year 1997 financial statements show improved operating results. For the nine months ended March 31, 1997, MINNCOR reported revenues of \$11.1 million and expenditures of \$13.6 million, resulting in an operating loss of \$2.5 million.

Source: MINNCOR financial statements for fiscal years 1995 and 1996.

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Audit Scope

Our review focused on MINNCOR's billing process, the collection of receivables, purchasing procedures, and inventory control. We performed audit work at MINNCOR's central office, MCF-Stillwater, and MCF-Shakopee. The period of our audit scope was July 1, 1994, through March 31, 1997.

Objectives and Methodology

While conducting our audit, we considered the following objectives:

- Did MINNCOR design and implement internal controls to provide reasonable assurance that sales, receipts, and inventory purchases were properly recorded on its accounting system and the state accounting systems?
- Did MINNCOR design and implement internal controls to provide reasonable assurance that it operated in compliance with applicable legal provisions and management authorization?
- Did MINNCOR design and implement internal controls to provide reasonable assurance that it properly billed customers for products and services provided?
- Did MINNCOR design and implement internal controls to provide reasonable assurance that inventory was adequately safeguarded and that usage was properly recorded?

To achieve our objectives, we interviewed MINNCOR personnel, reviewed policies and procedures, observed controls, and tested samples of billings and inventory purchases.

Conclusions

MINNCOR designed and implemented adequate internal controls to provide reasonable assurance that it properly recorded sales, receipts, and inventory purchases on its accounting system and the state accounting systems. However, it did not develop an accounting system that could identify production costs associated with specific products. Thus, MINNCOR management was unable to determine the profitability of individual products, as discussed in Finding 1. We also identified several issues relating to controls over inventory, billing of customers, written agreements, and the interface of its business system with the state's accounting system. These issues are discussed in Findings 2 through 5.

1. PRIOR FINDING NOT RESOLVED: MINNCOR cannot determine whether individual products are profitable.

MINNCOR's computer system could not identify and track fixed or variable costs for each product. MINNCOR's computer system provided information about the overall sales and costs in each cost center or product line for all seven facilities with industry programs. However, MINNCOR could not measure the relative profitability of individual products.

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MINNCOR's inability to analyze costs for specific products may have prevented it from recognizing unprofitable products. In order to achieve its goal of financial self-sufficiency, MINNCOR needs to decide whether to proceed with new products or discontinue existing products based on cost-benefit analyses. Without an adequate methodology, MINNCOR cannot be assured that its prices cover production costs.

Recommendation

- *MINNCOR should implement methods that provide information on the profitability of individual products.*

2. Two facilities did not have written agreements with private businesses.

MCF-Shakopee and MCF-Lino Lakes did not establish written agreements with private businesses to which they provided products and services on a continual basis. These businesses called the facilities and ordered certain quantities of products or services. The arrangements and the prices were established verbally over the telephone. MCF-Shakopee did not have written agreements for a majority of its customers. These customers collectively accounted for sales totaling over \$600,000. MCF-Lino Lakes did not have a written agreement with one of its customers whose purchases exceeded \$12,000. Beginning in fiscal year 1997, Lino Lakes discontinued performing work for this client. If these agreements remain undocumented, the facility and MINNCOR continue to expose themselves to unnecessary risks. Disagreements over prices, order quantities, and specific terms could result in financial losses to the department.

Recommendations

- *The correctional facilities should execute written agreements with private businesses.*

3. MCF-Shakopee did not adjust its prices for revised overhead rates.

MCF-Shakopee did not bill customers using revised overhead rates. MINNCOR established revised overhead rates quarterly for all facilities. The facilities are supposed to use those rates to reevaluate prices charged to current customers and to establish prices for new customers. MCF-Shakopee did not use the revised overhead rates in its pricing. Instead, MCF-Shakopee used quarterly financial reports to evaluate pricing for cost centers. MCF-Shakopee's overhead rate includes inaccurate central office overhead costs. As a result, MCF-Shakopee did not allocate the proper costs to its customers for services performed.

Recommendation

- *MCF-Shakopee should use the revised overhead rates in order to recover costs from its customers.*

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4. MINNCOR's business system did not interface with the state's accounting system.

MINNCOR's business system, Open Systems, did not interface with MAPS (Minnesota Accounting and Procurement System). MINNCOR used Open Systems to handle most finance activities including budgeting, tracking accounts receivable, billing, controlling inventory, and maintaining its general ledger. MINNCOR entered all of its inventory purchases and summaries of receipts onto both systems. This resulted in personnel unnecessarily entering the same financial information twice. Since the two systems were not integrated, MINNCOR needed to compile information from both the MAPS and Open Systems to create financial reports. MINNCOR has recognized this problem since the inception of MAPS and has been working with the Department of Finance to find a solution.

Recommendation

- *MINNCOR should integrate its accounting system with MAPS in order to provide management with timely and accurate information.*

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Chapter 3: Special Revenue Fund Dedicated Revenues and Expenditures

Conclusions

The Department of Corrections had several sources of dedicated receipts that were legally restricted for specific purposes. The department accounts for these receipts in the Special Revenue Fund. We noted that for some programs the department did not reimburse the General Fund for costs incurred on behalf of the Special Revenue Fund.

We noted several other problems in the accounting for revenues and expenditures. The department did not:

- analyze the rates charged for housing nonstate inmates;*
- have adequate contracts with local governmental units; and*
- resolve a large accumulated balance in the Sentencing to Service Program.*

We also noted other issues at particular facilities. Thistledeew Camp did not verify the accuracy of its accounting records and did not properly establish a basis for a reserve account.

Background

The department had several sources of dedicated revenues which were legally restricted for specific purposes. The department accounts for these activities in the Special Revenue Fund. We reviewed financial activities within the Special Revenue Fund at the central office and at MCF-Faribault, MCF-Lino Lakes, MCF-Shakopee, and Thistledeew Camp.

Two of the larger programs within the Special Revenue Fund were associated with Thistledeew Camp. The facility bills the counties and the school districts for its operating costs. Other major programs funded with dedicated revenues include agency indirect cost allocations, special projects, the Aid to Victims Program, the Sentencing to Service Program, shared services with state agencies, and agreements with counties. The department expended over \$7 million from the Special Revenue Fund in fiscal year 1996. Financial activities in the department funded with dedicated receipts and the related expenditures for fiscal year 1996 are shown in Table 3-1. We reviewed the financial activity for the programs listed in the table.

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Table 3-1
Fiscal Year 1996
Expenditures From Dedicated Revenue

<u>Financial Activity</u>	<u>Activity Description</u>	<u>Beginning Balance</u>	<u>Revenues and Transfers</u>	<u>Expenditures, Encumbrances, and Transfers</u>	<u>Ending Balance</u>
Facility Use	Thistledeew Camp bills participating counties for the cost of operating the camp.	\$1,025,961	\$1,858,200	\$1,992,324	\$ 891,837
Special Education	Thistledeew Camp bills participating school districts for the cost of providing high school education.	\$ 126,841	\$ 661,892	\$ 788,733	\$ -0-
Sentencing to Service	This program provides an alternative to jail time for county offenders who would otherwise serve full sentences.	\$1,355,795	\$1,703,829	\$ 973,482	\$2,086,142
Special Projects	This program includes the reimbursement of facilities for housing nonstate inmates. Receipts are used for special projects.	\$ -0-	\$1,014,222	\$ 645,854	\$ 368,368
Indirect Costs	The Special Revenue Fund reimburses the General Fund for costs incurred on its behalf.	\$ 329,593	\$ 277,133	\$ 105,899	\$ 500,827
Aid to Victims	This programs results in the deduction of earnings from inmates' accounts to reimburse crime victims.	\$ 514,316	\$ 206,702	\$ 721,018	\$ -0-
Shared Services, MCF-Faribault	Some state agencies reimburse MCF-Faribault for the cost of providing utilities and other services.	\$ -0-	\$ 688,344	\$ 380,697	\$ 307,647
Agency Agreements	MCF-Lino Lakes and MCF-Shakopee have agreements with Anoka County and Hennepin Technical College for specific services.	\$ 308,880	\$ 414,878	\$ 336,313	\$ 387,445

Source: State of Minnesota Allotment Balance within Appropriation Report for Fiscal Year 1996 as of March 31, 1997.

Most department programs in the Special Revenue Fund were funded exclusively by program revenues. The only program that had supplemental funding was the Sentencing to Service Program. The department also used General Fund appropriations to pay for salaries and other operating costs of the program.

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Objectives and Methodology

The primary objectives of our review were to answer the following questions:

- Did the central office or facility design and implement internal controls to provide reasonable assurance that revenue and related expenditure transactions were properly recorded on the accounting systems and were in compliance with applicable legal provisions and management's authorization?
- Did the central office or facility design and implement internal controls to provide reasonable assurance that the Special Revenue Fund programs fully reimbursed the General Fund for costs incurred on behalf of Special Revenue Fund programs?

To meet these objectives, we made inquiries to gain an understanding of the accounting for dedicated revenues and related expenditures and the objective for each program with dedicated receipts. We reviewed accounting records, agreements, and other financial documents. We also completed tests of receipts and disbursement transactions.

Conclusion

We found that some programs did not reimburse the General Fund for costs incurred on behalf of the Special Revenue Fund. As a result, some programs in the Special Revenue Fund were inappropriately developing large fund balances. This issue is discussed in Finding 5. Several accounting problems for the Special Revenue Fund also were identified and discussed in Findings 6 to 10.

5. The General Fund was inappropriately absorbing the costs of some Special Revenue Fund activities.

The General Fund was incurring costs related to several Special Revenue Fund programs. As a result, these Department of Corrections programs were developing excessive fund balances. The General Fund incurred costs for the following programs.

- MCF-Lino Lakes did not reimburse the General Fund for costs related to an agreement with Anoka County. MCF-Lino Lakes had an agreement with Anoka County to provide meals for inmates incarcerated in the county's facility. The agreement also required MCF-Lino Lakes to provide maintenance for the buildings. The county and the facility established the agreement in 1988 and it extends for 25 years. MCF-Lino Lakes billed the county for meals and maintenance based upon terms of the agreement. MCF-Lino Lakes had allowed the General Fund to absorb payroll, supplies, and maintenance costs related to this agreement. Since MCF-Lino Lakes did not charge these direct costs to the dedicated receipts, the fund balance had grown to \$307,646 as of June 1996. MCF-Lino Lakes also did not charge agency indirect costs to this program. The General Fund absorbed over \$2,000 in indirect costs related to this program.
- MCF-Faribault had not reimbursed the General Fund for costs related to an agreement with other governmental agencies. The facility operated a power plant which provided

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steam to the correctional facility, the Regional Treatment Center (RTC), and the Academy for the Blind. The correctional facility billed the RTC and the academy based on actual operational costs. MCF-Faribault incurred the operating costs in the General Fund and transferred the costs to the Special Revenue Fund account. The facility had not transferred all of the General Fund costs to the Special Revenue Fund. As a result, the Special Revenue Fund increased its fund balance to \$380,697 as of June 30, 1996. In addition, in fiscal year 1996, MCF-Faribault did not reimburse the General Fund for indirect costs totaling \$7,821.

- MCF-Lino Lakes and MCF-Shakopee did not deposit meal receipts in the General Fund. These facilities accumulated \$10,000 and \$14,000, respectively, mostly from staff purchasing meals at the two facilities. Receipts were deposited in a separate account within the Special Revenue Fund. Minn. Stat. Section 16A.72 requires that all income, unless specifically exempted, be credited to the General Fund. No specific authority allows these receipts to be deposited in the Special Revenue Fund.

The Special Revenue Fund programs are required to reimburse the General Fund for any costs incurred on behalf of the programs.

Recommendation

- *The Department of Corrections should review its Special Revenue Fund programs and reimburse the General Fund for any costs, including agency indirect costs, incurred on behalf of Special Revenue Fund programs.*

6. Thistledew Camp had not properly established a basis for a reserve account balance and did not reimburse the General Fund for agency indirect costs.

Thistledew Camp billings to counties did not include all costs of operating the camp. The camp had an agreement with some counties to bill the cost of operations to each county based on inmate attendance. The camp prepared an annual budget based on the estimated cost of operating the camp for the fiscal year and used the budget for billing the counties. The budget did not consider capital and other accrued costs. Unless the Legislature appropriates funding for capital projects and other accruals, the camp needs to identify these accruals in order to include the costs in the billing.

The receipts over the past few years had exceeded cash outlays for operations by a total of \$891,837 as of June 1996. The camp indicated that some of the balance was needed for accrued liabilities. In particular, it was concerned about severance pay for several employee retirements in the near future. The camp, however, had not developed a comprehensive plan for accrued costs and a reserve account. As a result, we were uncertain as to how much of the cash balance related to accrued costs and necessary reserves, or whether any of it related to a possible overbilling of the counties.

Thistledown Camp also did not accurately reimburse the General Fund for indirect costs. The camp had two contracts for which the General Fund incurs indirect costs. The camp did not

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transfer \$1,254 in indirect costs for fiscal year 1996 for the school district contract. Conversely, the camp overpaid the indirect cost for the county contract by \$10,000.

Recommendations

- *Thistledew Camp should analyze the fund balance and determine its need for a reserve balance. Any excess balance should be incorporated in calculating future billings to the counties.*
- *The department should reimburse the General Fund for any costs, including agency indirect costs, incurred on behalf of Special Revenue Fund programs.*

7. The department has not analyzed the rates it charged a federal agency and one county for housing its inmates.

The department did not analyze the rates it charged for housing nonstate inmates. The department had contracts with the U.S. Bureau of Prisons, the U.S. Marshall, counties, and other states to house inmates in the state's correctional facilities. In fiscal year 1997, 32 nonstate inmates were housed in the state's correctional facilities. Through March 31 of fiscal year 1997, these contracts generated \$901,000 in receipts. The receipts generated by these agreements were deposited into the Special Revenue Fund. We reviewed the rates included in these agreements and noted that the rates were significantly lower than the fiscal year 1996 average daily cost. For instance, the 1996 billed amount for nonstate inmates in MCF-Oak Park Heights was \$98. However, the 1996 average daily cost for MCF-Oak Park Heights totaled \$118. The department indicated that it did not accept nonstate inmates who required special services. As a result, it believed that the housing costs for nonstate inmates would be lower than the average daily cost for other inmates. The department has not, however, developed different cost rates for state and nonstate inmates.

The department had not reviewed these contracts for a number of years. The contracts date back to 1994. Minn. Stat. Section 243.51, Subd. 1, states that such contracts shall provide for reimbursing the state of Minnesota for all costs or other expenses involved.

Recommendation

- *The Department of Corrections should review the agreements with the U.S. Bureau of Prisons, the U.S. Marshall, counties, and other states and negotiate the reimbursement based on the incremented costs for housing of nonstate inmates.*

8. The department did not adhere to agreements with two local governmental units and did not establish a written contract with another governmental unit.

Two facilities did not adhere to agreements with local governmental units, and one facility failed to establish a written contract with another governmental unit. These facilities had agreements to provide services to other governmental units. These agreements stated the terms for the services

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that the department provided and the respective billing rates. We found problems with the following agreements.

- MCF-Faribault did not adhere to its agreement with the Academy for the Blind. A description of the agreement is discussed in Finding 6. The facility billed the academy based on the actual cost of providing the service. However, the agreement with the academy had a cap or maximum billing amount of \$180,000 for fiscal year 1997. We estimated that the total billing costs for fiscal year 1997 will approximate \$246,000. MCF-Faribault continued to provide the services and will lose \$66,000 in fiscal year 1997 if the academy does not pay an amount exceeding the agreement. The academy has disputed the charges over the maximum billing amount. MCF-Faribault would, in effect, subsidize the academy for its operating costs. MCF-Faribault does not have the legal authority to subsidize another state agency's operational costs.
- MCF-Lino Lakes had an agreement with Anoka County to provide meals for its inmates. The agreements stated that food processing costs are to be billed to the county on a formula of total county meals to total meals prepared. The facility billed the county for approximately 30 percent of its food processing costs. However, the facility has prepared an analysis of meals served during fiscal year 1997. That analysis showed that the county's share of food processing costs was only 16 percent. As a result, we estimated that the facility will overbill the county by \$44,000 for fiscal year 1997.
- MCF-Shakopee had an arrangement with Hennepin Technical College to provide instructors for an educational program. The facility reimburses the college for this program. However, as of March 1997, no signed agreement with the college for fiscal year 1997 existed. The fiscal year 1996 payments totaled \$87,000.

The correctional facilities need to have written contracts with the local governmental units to ensure that all terms are satisfactory to both parties. Without a contract, disagreements could arise over the terms and condition of the services.

Recommendation

- *When buying or providing services, the facilities should establish written contracts with local governmental units and adhere to them. The contracts should be based upon full recovery of the cost of providing the services. The facilities should ensure that billing for services provided by the correctional facilities is accurate.*

9. Thistledeew Camp did not verify the accuracy of its accounting records.

Thistledeew Camp did not verify the accuracy of its accounting records. Thistledeew Camp, as stated in Finding 7, had an agreement with some counties and school districts to recover its costs for operating the facility. An accounting officer billed the counties and the school districts, collected the cash, and prepared the deposits. Another employee was appointed the responsibility for reconciling the accounting records. However, no other business office staff completed the reconciliation.

Department of Corrections

We reconciled the billing amount for the school district program and noted that the accounting records were accurate. However, we noted that for the county agreements, the amount of receipts recorded on the accounting system differed from the billings. For fiscal years 1995 and 1996, the differences amounted to \$8,400 and \$10,000, respectively. Without verifying the accuracy of the accounting records, the camp cannot be sure that it deposited and accurately recorded the receipts.

Recommendation

- *Thistledew Camp should have an independent business office staff verify the accuracy of its accounting records by reconciling the billings to the amount of revenue received.*

10. The department paid incorrect costs out of the General Fund for the Sentencing to Service Program.

The department was not properly accounting for the Sentencing to Service (STS) Program. The STS Program provides an alternative to jail time for county offenders who would otherwise serve full sentences. The STS Program allows county inmates to complete supervised projects at state and county parks and other public facilities as a means of reducing their sentence. This program was funded by state appropriations and Special Revenue Fund revenue. The department charged salaries, supplies, and equipment to the General Fund. Financial activity in the Special Revenue Fund was as follows:

- State Supervised Activity Some counties contracted with the state to provide supervisory and administrative direction for the STS Program. The state billed these counties in advance for 50 percent of the projected cost. These receipts were deposited into the Special Revenue Fund.
- County Supervised Activity Some counties elected to provide supervisory staff and administer the STS Program at the county level. The state reimbursed the counties for 50 percent of the cost of the county program. The payments were made from the Special Revenue Fund.

The department's accounting for the STS Program did not match revenues and related expenditures in the same fund. The department recorded revenue for the state supervised activity in the Special Revenue Fund. However, the expenditures for this activity were recorded in the General Fund. Both the receipts and the related expenditures need to be recorded in the Special Revenue Fund. The correct accounting for this program would result in no additional increase in the Special Revenue Fund balance. If the receipts and expenditures are not matched, the fund balance for this program will continue to grow, and the General Fund will continue to incur unnecessary expenditures.

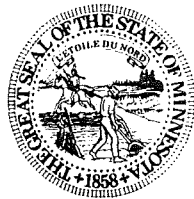
Under the county-supervised activity, the department needs to account for payments to the counties in the General Fund. Part of the department's appropriation included funding for the STS Program.

Department of Corrections

Since fiscal year 1993, Special Revenue Fund receipts have exceeded its expenditures. The ending fund balance has grown from \$753,000 in fiscal year 1993 to \$2,086,000 in fiscal year 1996.

Recommendations

- *The department should match the state-supervised revenues in the Sentencing to Serve Program with related expenditures in the Special Revenue Fund.*
- *The department should transfer the excess of amount earned over related expenditures under the Sentencing to Service Program from the Special Revenue Fund to the General Fund, or seek legislative authority to retain the balances.*



State of Minnesota
Minnesota Department of Corrections

July 8, 1997

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

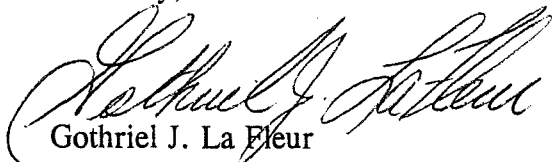
Dear Mr. Nobles:

We have received and reviewed your audit report of selected components of the Department of Corrections and its activities at some Minnesota correctional facilities for the period July 1, 1994 through March 31, 1997. 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 a helpful tool and guide in the management of the department and the safeguarding of state assets. The audits also assist department staff in meeting the professional accreditation standards of the American Correctional Association.

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

Sincerely,



Gothriel J. La Fleur
Commissioner

GLF/PCM:dl
Attachment

cc: Dennis Benson: Deputy Commissioner
Robert Feneis: CEO, MINNCOR
Janet Entzel: Deputy Commissioner
Richard Mulcrone: Assistant Commissioner
Karen Robinson: Assistant Commissioner
Erik Skon: Assistant Commissioner
Shirley Flekke: Financial Services Director

MINNESOTA DEPARTMENT OF CORRECTIONS
RESPONSE TO LEGISLATIVE AUDIT
FOR THE PERIOD JULY 1, 1995 THROUGH MARCH 31, 1997

CHAPTER 2: MINNCOR Sales and Inventory Purchases

- 1) RECOMMENDATION: MINNCOR should implement methods that provide information on the profitability of individual products.

RESPONSE: The department is aware that MINNCOR does not determine individual product profitability. Currently, MINNCOR determines profitability by product line or cost center. Gross margin statements by cost center are prepared which enable management to determine profitability by product line.

The diversity of MINNCOR products makes it extremely difficult if not prohibitive to implement a cost accounting system which can handle the cost accounting details of all products. Additionally, the staff resources required to maintain a cost accounting system by product cannot be supported financially and is greater than the benefit which might be received from individual product costing.

MINNCOR has implemented a product pricing procedure to determine sales prices for products. This procedure combined with cost center/production line cost accounting should be adequate to determine product profitability.

Person Responsible: Paul Anderson, MINNCOR Finance Director

Proposed Completion Date: Completed

- 2) RECOMMENDATION: The correctional facilities should execute written agreements with private businesses.

RESPONSE: The department concurs that written agreements with private businesses should be developed.

When a business approaches MINNCOR, a trial period is often involved so that the company acquires an understanding of the parameters of working in a correctional facility environment. Formal contracts will be processed when the relationship progresses beyond the trial period. Details supporting the relationship during the trial period will be contained in a memorandum of understanding or purchase order between the private company and MINNCOR.

Person Responsible: Robert Feneis, CEO MINNCOR

Completion Date: September 1, 1997

- 3) RECOMMENDATION: MCF-Shakopee should use the revised overhead rates in order to recover costs from its customers.

RESPONSE: The department concurs that a systematic approach to determine product pricing is essential.

MINNCOR established overhead rates based on inmate labor hours; however, it was not intended that ongoing contracts be adjusted quarterly to these published overhead rates. The published rates are intended to be used as guides or tools for product pricing. Staff at individual sites have the authority to use the type of pricing structure that maximizes the ability of MINNCOR to recover costs from customers. The profitability of each site including MCF-Shakopee is examined quarterly by MINNCOR management to assure that pricing structures are adequate and costs are recovered to the extent possible.

Person Responsible: Robert Feneis, CEO MINNCOR

Completion Date: Completed

- 4) RECOMMENDATION: MINNCOR should integrate its accounting system with MAPS in order to provide management with timely and accurate information.

RESPONSE: Department of Corrections (DOC) staff were involved in the planning of both the procurement and accounting functions of MAPS. DOC staff were told by Department of Finance staff and independent contractor staff working on the project that MAPS would not meet the financial reporting or cost accounting needs of MINNCOR. Additionally, DOC staff were told that importing MINNCOR data to MAPS was not allowable due to concerns about the introduction of possible erroneous or harmful data into MAPS. The operation of a "stand-alone" accounting/financial management system by MINNCOR was understood to be the only option available to DOC.

As a result of a meeting during December 1996 with representatives of the Departments of Administration, Finance, and Corrections, MINNCOR staff began working on a download program to transfer data from the MINNCOR accounting system to MAPS. The download is currently in the testing stages.

Person Responsible: Paul Anderson, MINNCOR Finance Director

Completion Date: August 1, 1997

CHAPTER 3: Special Revenue Fund Dedicated Revenues and Expenditures

- 5) RECOMMENDATION: The Department of Corrections should review its Special Revenue Fund programs and reimburse the General Fund for any costs, including agency indirect costs, incurred on behalf of Special Revenue Fund programs.

RESPONSE: MCF-Lino Lakes and Anoka County -- Staff at MCF-Lino Lakes have reviewed costs incurred by the facility on behalf of Anoka County. These costs and supporting factors will be used for fiscal year 1998 and will be refined and modified as needed to assure the matching of revenues and expenses.

Transactions have been processed for fiscal year 1997 so that general fund expenditures incurred for the Anoka County contract were reallocated to the special revenue fund. Additionally, items such as food and utilities were paid directly from the special revenue fund.

Person Responsible: Connie Nelson, MCF-Lino Lakes Finance Director

Completion Date: August 1, 1997

MCF-Faribault and the Regional Treatment Center and the Academy for the Blind -- MCF-Faribault staff corrected the fiscal year 1996 indirect cost discrepancy during the audit field work. Currently, indirect costs are transferred quarterly from the special revenue to the general fund.

Because of several circumstances, costs associated with the provision of power plant services were not assigned to the special revenue fund. During fiscal year 1997, all appropriate costs were transferred to the general fund and several power plant projects were paid directly from the special revenue fund. The remaining balance of \$140,000 in the special revenue fund will be expended during fiscal year 1998 for power plant purposes.

Person Responsible: James Dull, MCF-Faribault Finance Director

Completion Date: January 1, 1998

Meal Receipts at MCF-Lino Lakes and Shakopee -- Existing balances at the facilities will be used for costs associated with the provision of meals to staff. Appropriate expenditure corrections will be done for fiscal year 1997. Staff believe there is authority to deposit these receipts to the Special Revenue Fund; however, DOC will seek specific legislative language to provide for the depositing of meal receipts into the special revenue fund.

Persons Responsible: Connie Nelson, MCF-Lino Lakes Finance Director
James Dull, MCF-Faribault Finance Director

Completion Date: May 1, 1998

- 6) RECOMMENDATION: Thistledew Camp should analyze the fund balance and determine its need for a reserve balance. Any excess balance should be incorporated in calculating future billings to the counties.

RESPONSE: Thistledew Camp (TC) staff will prepare financial statements for the camp in which the balance sheet shows purpose and amount of fund balance reserves. The financial statements will be updated annually or when a significant event requires that the statements be updated.

Persons Responsible: Jean Hilde, TC Finance Director

Completion Date: January 1, 1998

- 7) RECOMMENDATION: The department should reimburse the General Fund for any costs, including agency indirect costs, incurred on behalf of Special Revenue Fund programs.

RESPONSE: TC staff will work together with staff from DOC central office and the Department of Finance to assure that indirect costs have been, and are, correctly paid.

Person Responsible: Jean Hilde, TC Finance Director

Completion Date: January 1, 1998

- 8) RECOMMENDATION: The Department of Corrections should review the agreements with the U.S. Bureau of Prisons, the U.S. Marshall, counties, and other states and negotiate the reimbursement based on the incremented costs for housing of nonstate inmates.

RESPONSE: DOC staff will review rates charged to other governmental agencies to assure that the rates being charged reimburse the costs incurred to house nonstate inmates.

Person Responsible: Erik Skon, Assistant Commissioner Adult Facilities

Completion Date: January 1, 1998

- 9) RECOMMENDATION: When buying or providing services, the facilities should establish written contracts with local governmental units and adhere to them. The contracts should be based upon full recovery of the cost of providing the services. The facilities should ensure that billing for services provided by the correctional facilities is accurate.

RESPONSE: MCF-Faribault and the Academy for the Blind -- The agreement between these two entities contained contradictory language for fiscal years 1996 and 1997. Rather than stating an amount "not to exceed" the contract should have stated an estimated amount. MCF-Faribault must provide the services because discontinuing the providing of heat and water to the Academy is not an option. MCF-Faribault staff are in the process of negotiating a new agreement with the Academy for fiscal years 1998 and 1999. The agreement will be based on historical data and will not contain a maximum amount.

Person Responsible: James Dull, MCF-Faribault Finance Director

Completion Date: January 1, 1998

MCF-Lino Lakes and Anoka County -- The agreement between the facility and the county has been analyzed as stated previously. Invoicing for fiscal year 1997 is not completed and will be adjusted for new factors and percentages.

Person Responsible: Connie Nelson, MCF-Lino Lakes Finance Director

Completion Date: September 1, 1997

MCF-Shakopee and Hennepin Technical College -- MCF-Shakopee staff will assure that a written agreement for fiscal year 1998 is processed with Hennepin Technical College.

Person Responsible: Woody Watson, MCF-Shakopee Finance Director

Completion Date: October 1, 1997

- 10) RECOMMENDATION: Thistledeew Camp should have an independent business office staff verify the accuracy of its accounting records by reconciling the billings to the amount of revenue received.

RESPONSE: A procedure will be established so that an independent staff member of Thistledeew Camp reconciles amounts invoices to revenue received.

Person Responsible: Dave Hegg, TC Superintendent

Completion Date: October 1, 1997

- 11) RECOMMENDATION: The department should match the state-supervised revenues in the Sentencing to Serve(sic) Program with related expenditures in the Special Revenue Fund.

The department should transfer the excess of amount earned over related expenditures under the Sentencing to Service Program from the Special Revenue Fund to the General Fund, or seek legislative authority to retain the balances.

RESPONSE: Beginning July 1, 1997, the department will match revenues and expenditures for the Sentencing to Service Program in the Special Revenue Fund.

The department will develop a plan to reduce the excess Special Revenue Fund balance through program expansion. Sufficient reserves will be maintained to assure adequate cash flow for the program. Special legislation will be requested to allow DOC to retain the current fund balance.

Person Responsible: John McLagan, STS Director

Completion Date: January 1, 1998