OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Evaluation Report Summary / February 2009

MINNCOR Industries

Overall, MINNCOR has been successful in maintaining high levels of inmate employment and generating enough revenue to cover its costs.

Major Findings:

- MINNCOR Industries employed about 16 percent of Minnesota's adult prison population in fiscal year 2008—one of the highest rates in the nation.
- For fiscal year 2008, MINNCOR reported revenues of $35.8 million, expenses of $32.8 million, and net income—or profit—of $3.0 million.
- Although MINNCOR has shown a profit in recent years, the Department of Corrections (DOC) has annually transferred over $1 million deducted from inmates' wages for their confinement costs to MINNCOR.
- Most of MINNCOR's profits come from two industries that employ relatively few inmates: license plates and the canteen.
- Profits have gone toward improving internal operations and supporting other inmate-related programs.
- Sales to inmates and state agencies accounted for nearly 79 percent of MINNCOR's sales revenue in 2008; sales to all other levels of government were about 4 percent.
- In 2008, inmates spent about 55 percent of their work hours manufacturing, assembling, or packaging products for private businesses.
- MINNCOR has used purchase orders rather than formal contracts when allowing private businesses to use inmate labor and prison space.
- MINNCOR does not adequately track revenues and expenditures related to its labor arrangements with private businesses.
- Although MINNCOR has begun to market its products more aggressively, it has not developed a formal marketing plan.
- Most state agency staff doing business with MINNCOR were satisfied with the results.

Recommendations:

- MINNCOR should report its full cost for inmate wages and the amount it receives from DOC for inmates' confinement costs in its annual financial statements and reports.
- MINNCOR should use contracts rather than purchase orders when allowing private businesses to use inmate labor.
- MINNCOR should monitor and annually evaluate each of its labor arrangements with private businesses.
- MINNCOR should develop a formal marketing plan, as required by state law.

REPORT SUMMARY

Minnesota state correctional facilities have operated industrial programs for well over 100 years, beginning with the manufacturing of twine at Stillwater State Prison. Although the types of industries in state facilities have changed over the years, their goals have not: to help inmates learn good work habits, provide them with marketable skills, and reduce inmate idleness. In the mid-1990s, the Legislature and the Department of Corrections (DOC) added another goal: to operate without a state subsidy. To help make this possible, in 1994 the department consolidated and centralized its individual facility programs into a single statewide business known as MINNCOR Industries.

With net income close to $3 million, FY 2008 was MINNCOR's most profitable year ever.

In FY 2008, MINNCOR employed 16 percent of prison inmates.

The number of inmates employed by MINNCOR increased 50 percent over the last decade, going from 865 inmates in fiscal year 1999 to 1,297 inmates in 2008. Over the same time period, the adult inmate population in state facilities increased 42 percent, from 5,622 to 7,987 inmates. After dipping slightly in the middle of the decade, MINNCOR employed 16 percent of the inmate population in fiscal year 2008, the same as in 2001.

According to National Correctional Industries Association data, the percentage of inmates employed in prison industries in Minnesota was triple the national average in 2007. Minnesota has traditionally had higher participation rates than other states. For example, it employed 18 percent of its inmate population in fiscal year 1998, compared with a national average of 9 percent.

In 2008, seven of the state's nine adult correctional facilities had industry programs. Inmate participation in MINNCOR varied from 4 percent in St. Cloud to 34 percent in Shakopee. In the other five facilities with industries, MINNCOR employed between 20 and 26 percent of inmates.

MINNCOR reported an overall profit of $3 million for FY 2008.

Between fiscal years 1999 and 2008, MINNCOR's sales grew from $18.5 million to $35.8 million, a 91 percent increase. Sales peaked in 2006 at $41.5 million and declined 14 percent over the last two years—due partially to a deteriorating economy.

MINNCOR reported an overall net income—or profit—of nearly $3 million for 2008—its highest level ever. MINNCOR is expected to be self-sufficient overall, and income from some industries can be used to offset losses in others. In recent years though, almost all of its industries have generated enough revenue to cover their costs.

DOC annually transfers over $1 million deducted from inmates' wages for their confinement costs to MINNCOR.

The manner in which MINNCOR reports its expenditures and profits understates its true costs for inmate labor. The federal government requires that prison industries producing goods for interstate sales pay inmates at least prevailing wage rates. States can deduct up to 80 percent from these inmates' wages for a variety of purposes, including taxes, dependent support, restitution, and confinement costs. According to the federal Bureau of Justice Statistics, this provision "reflects a Congressional intent to permit the use of room and board deductions to lower costs otherwise incurred by the public for inmate incarceration."

Rather than using the money withheld from inmate wages to directly reduce its confinement costs, DOC returns the wage deductions to MINNCOR. Instead of recording this as income, MINNCOR

MINNCOR's financial statements do not show its total wage costs or the money DOC transfers to MINNCOR.

simply reduces what it reports for inmate wages by this amount. For example, MINNCOR actually paid $3.7 million in inmate wages in 2008, but its financial statements only show wage costs of $2.5 million. Likewise, MINNCOR understated its 2006 and 2007 expenditures for inmate wages by $1.5 million and $1.2 million, respectively.

MINNCOR should report its full wage costs and the amount it receives from DOC for inmates' confinement costs in its annual financial statements and reports.

State government should conduct its business in an open, transparent manner. The way MINNCOR records—or, more specifically, does not record—the full cost of inmate wages and the funds it receives from DOC for inmates' confinement costs in its financial statements and reports is not accurate. MINNCOR should report these costs in a manner that aligns with data it compiles for the Department of Finance's *Comprehensive Annual Financial Report*, which complies with generally accepted government accounting principles.

MINNCOR has formal contracts with less than one-third of the private businesses that use inmate labor and prison space.

Using purchase orders when allowing private businesses to use inmate labor places the state at risk.

Over the last few years, MINNCOR has increased its use of private labor arrangements as a source of inmate jobs. These arrangements allow private companies to use inmate labor and prison space to assemble, package, or manufacture products for their own use or resale. Sales from such arrangements made up 15 percent of MINNCOR's total 2008 revenue—more than double the amount for 2005.

During fiscal years 2006 through 2008, MINNCOR had labor arrangements with 45 to 47 private businesses. At most, though, it entered into formal contracts with only 30 percent of them each year; the other 70 percent used inmate labor through purchase orders. Using inmate services based solely on purchase orders comprised about 41 percent of revenue from such work in 2008.

Relying on purchase orders rather than contracts is risky. Purchase orders basically state an agreed upon price for a specific product or service and a due date. They do not cover other items that DOC policy requires in its contracts, including quality control and record keeping procedures. Most importantly, they do not contain standard language that should be present in all Minnesota contracts, including indemnification, audit, cancellation, and data privacy clauses. Purchase orders are not reviewed by DOC's central office, nor do they contain signatures from the Department of Administration (DOA) or MINNCOR. Furthermore, the purchase orders that MINNCOR relies on are not standard forms developed by DOA or even MINNCOR, but forms developed by the businesses themselves.

Because contracts provide important assurances to the state, DOC should amend its policy on revenue contracts to require that MINNCOR use such contracts when allowing private businesses to use inmate labor.

MINNCOR does not adequately track its revenues and expenses from private labor arrangements.

MINNCOR does not track the expenses it has incurred under each of its labor arrangements, nor does it systematically monitor what each company has paid for MINNCOR services over the course of the fiscal year. This creates problems when evaluating whether individual arrangements make or lose money. Without more detailed information on each of its labor arrangements, MINNCOR cannot adequately evaluate whether it has negotiated a "good" arrangement, whether it should amend its price, or whether certain arrangements should be cancelled and others expanded.

MINNCOR needs to develop a formal roadmap to guide its marketing activities.

MINNCOR should develop a formal marketing plan.

Although state law places few restrictions on MINNCOR's customer base, its biggest customers are inmates from state correctional facilities and state agencies. Items sold to inmates through facility canteens accounted for 22 percent of MINNCOR's 2008 sales. Among state agencies, the departments of Public Safety, Corrections, and Human Services collectively accounted for 39 percent of sales revenue.

MINNCOR does not sell to all of its potential customers. For example, it captured slightly less than one-third of state agency purchases for printing services in 2008. Only about 4 percent of its revenue was from sales to other levels of government, including educational institutions, cities, and counties. Furthermore, fewer than 10 percent of school districts used MINNCOR at all.

As government agencies respond to the state's current budget problems, MINNCOR will likely have to expand its customer base to simply stay even. Yet, it has not developed a formal, written plan that sets forth specific marketing goals and strategies to show how it will accomplish this. Also, it has not developed a formal marketing plan to attract private sector businesses to employ inmate labor, as required by the 2008 Legislature.

Although it lacks a formal roadmap to guide its marketing activities, MINNCOR has recently begun to market some products more aggressively. For example, staff have met with Minnesota State Colleges and Universities officials to promote MINNCOR's office, residential, and school products. Also, MINNCOR has begun contacting cities and counties throughout Minnesota and the surrounding states to assess whether its recreational products meet the needs of local governments.

Summary of Agency Response

In a letter dated February 12, 2009, Department of Corrections Commissioner Joan Fabian said that the department has already begun to implement OLA's recommendations regarding improved financial reporting and marketing. The department also supports OLA's recommendations that MINNCOR evaluate its labor arrangements with private businesses on an individual basis and ensure that its contracts adhere to best management practices.

Although the department "supports the intent" of OLA's recommendation that MINNCOR discontinue using purchase orders in lieu of contracts, the commissioner indicated that completely replacing purchase orders with contracts may reduce MINNCOR's ability to respond to businesses' needs in a timely manner and could result in lost opportunities. She writes that MINNCOR will expand its use of revenue contracts, and that the department will address the recommendation "through policy revision that will define the appropriate use of purchase orders."

The full evaluation report, *MINNCOR Industries*,
is available at 651-296-4708 or:
www.auditor.leg.state.mn.us/ped/2009/minncor.htm