



Department of Corrections Region 1 Correctional Facilities

Internal Controls and Compliance Audit

July 2014 through February 2017

March 26, 2018
REPORT 18-03

Financial Audit Division

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division

The Financial Audit Division conducts 40 to 50 audits each year, focusing on government entities in the executive and judicial branches of state government. In addition, the division periodically audits metropolitan agencies, several “semi-state” organizations, and state-funded higher education institutions. Overall, the division has jurisdiction to audit approximately 180 departments, agencies, and other organizations.

Policymakers, bond rating agencies, and other decision makers need accurate and trustworthy financial information. To fulfill this need, the Financial Audit Division allocates a significant portion of its resources to conduct financial statement audits. These required audits include an annual audit of the State of Minnesota’s financial statements and an annual audit of major federal program expenditures. The division also conducts annual financial statement audits of the three public pension systems. The primary objective of financial statement audits is to assess whether public financial reports are fairly presented.

The Financial Audit Division conducts some discretionary audits; selected to provide timely and useful information to policymakers. Discretionary audits may focus on entire government entities, or on certain programs managed by those entities. Input from policymakers is the driving factor in the selection of discretionary audits.

The Office of the Legislative Auditor (OLA) also has a Program Evaluation Division. The Program Evaluation Division’s mission is to determine the degree to which state agencies and programs are accomplishing their goals and objectives and utilizing resources efficiently.

OLA also conducts special reviews in response to allegations and other concerns brought to the attention of the Legislative Auditor. The Legislative Auditor conducts a preliminary assessment in response to each request for a special review and decides what additional action will be taken by OLA.

For more information about OLA and to access its reports, go to: www.auditor.leg.state.mn.us.



OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA • James Nobles, Legislative Auditor

March 26, 2018

Senator Mary Kiffmeyer, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Tom Roy, Commissioner
Department of Corrections

This report presents the results of our internal controls and compliance audit of the Department of Corrections' Region 1 correctional facilities for the period from July 1, 2014, through February 28, 2017. The objectives of this audit were to determine if the Department of Corrections' Region 1 correctional facilities had adequate internal controls over its financial activities and complied with finance-related statutes and policies.

We discussed the results of the audit with the office's staff at an exit conference on March 13, 2018. This audit was conducted by Tracy Gebhard, CPA, (Audit Director), Pat Ryan (Audit Coordinator), and auditors Shannon Hatch and Kevin Herrick.

We received the full cooperation of the department's staff while performing this audit.

Sincerely,

Handwritten signature of James R. Nobles in black ink.

James R. Nobles
Legislative Auditor

Handwritten signature of Christopher P. Buse in black ink.

Christopher P. Buse
Deputy Legislative Auditor

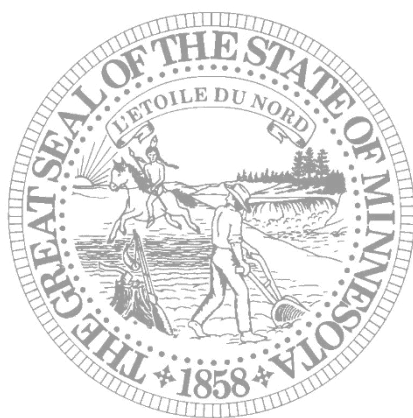


Table of Contents

	<u>Page</u>
Report Summary	1
Audit Overview	3
Department Overview	3
Audit Objectives, Scope, and Methodology	4
Conclusion	5
Findings and Recommendations	7
Agency Response	9



Report Summary

Background

During fiscal years 2015, 2016, and 2017, the Department of Corrections paid approximately \$226 million to operate its Region 1 correctional facilities, which included facilities in Stillwater, Oak Park Heights, and Red Wing.

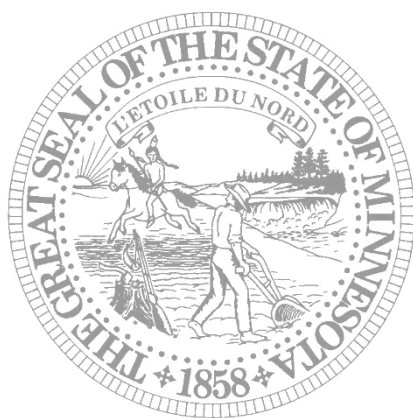
The Office of the Legislative Auditor conducted this audit to determine whether the Department of Corrections' Region 1 correctional facilities had adequate internal controls over its financial activities and complied with finance-related legal provisions.

Conclusion

The Department of Corrections' Region 1 correctional facilities had generally adequate internal controls to ensure that it safeguarded revenues and other assets, accurately paid employees and vendors, created reliable financial information, and complied with finance-related legal requirements. For the items tested, the region complied with most finance-related legal requirements. However, we identified one legal compliance issue and one internal control deficiency.

Audit Findings

- The Department of Corrections did not properly charge counties for the cost of juveniles housed at the Red Wing facility. (Finding 1, page 7)
- The Department of Corrections' Region 1 business office did not accurately reconcile inmate trust account balances. (Finding 2, page 8)



Audit Overview

This report presents the results of an internal controls and compliance audit of selected activities at the Department of Corrections' Region 1 Correctional Facilities. Management is responsible for establishing internal controls to safeguard assets and ensure compliance with applicable laws, regulations, and state policies.

A strong system of internal controls begins with management's philosophy, operating style, and commitment to ethical values. It also includes processes to continuously assess risks and implement control activities to mitigate risks. Successful internal controls systems include iterative processes to monitor and communicate the effectiveness of control activities.



Department Overview

The Department of Corrections operates nine adult correctional facilities and one juvenile correctional facility. In fiscal year 2017, General Fund appropriations for these ten correctional facilities totaled over \$391 million.

The department provides management services for the ten facilities through four regional offices. Region 1 serves the Stillwater, Oak Park Heights, and Red Wing facilities, which are described below:

- **Stillwater.** This facility is the second largest institution for adult male felons. The facility houses about 1,600 inmates and has a minimum-security unit outside the main perimeter. Stillwater operates numerous vocational and industry programs.
- **Oak Park Heights.** This facility has the highest security level in the state's correctional system. The facility houses about 420 inmates, who pose the most extreme risk to the public.
- **Red Wing.** This facility provides treatment, education, and transition services for juvenile males. In addition, the facility provides a separate community re-entry program for 43 minimum-security adult male offenders.

Table 1 summarizes the region's appropriations, revenues, and expenditures for fiscal year 2017.

**Table 1: Appropriations, Revenues, and Expenditures
Fiscal Year 2017^a**

	<u>Stillwater</u>	<u>Oak Park Heights</u>	<u>Red Wing</u>
<u>Appropriations</u>	\$40,414,800	\$23,539,000	\$12,783,000
<u>Revenues</u>			
Juvenile Program Fees ^b	\$ 0	\$ 0	\$ 4,776,880
Federal Grants	0	0	169,137
Inmate Confinement Charges ^c	229,024	51,956	3,733
Commissions ^d	219,290	36,284	11,218
Other Revenues	79,367	16,498	12,750
Total Revenues	<u>\$ 527,681</u>	<u>\$ 104,738</u>	<u>\$ 4,973,718</u>
<u>Expenditures</u>			
Staff Payroll	\$32,580,907	\$20,446,798	\$11,070,714
Food	2,136,764	523,114	249,975
Supplies	2,123,516	879,056	627,708
Utility Services	1,317,544	699,829	304,182
Inmate Payroll	733,261	206,566	125,165
Purchased Services	648,022	164,843	153,059
Information Technology	270,411	170,245	71,632
Repairs	259,479	79,448	19,922
Equipment	223,653	103,623	141,940
Other Expenditures	669,813	219,924	136,133
Total Expenditures	<u>\$40,963,370</u>	<u>\$23,316,731</u>	<u>\$12,900,430</u>

^a This table includes only fiscal year 2017 financial activity through June 30, 2017; however, our audit scope included financial activity from July 1, 2014, through February 2017. This table does not include expenditures and revenues of inmate personal funds.

^b These revenues are from counties for housing juveniles. The funds are deposited into the state's General Fund.

^c The department deducts 10 percent of all nonexempt funds an inmate receives from outside sources. Exempt funds include Veterans' Administration benefits, Social Security benefits, and money from other limited sources, as defined by the department's internal policy.

^d The department receives commissions from contractors who provide phone and e-mail services for inmates.

Source: State of Minnesota's accounting system.

Audit Objectives, Scope, and Methodology

This audit examined Region 1 correctional facilities' fiscal activities for the period of July 1, 2014, through February 28, 2017. Included in the scope were payroll and operating expenditures, Red Wing juvenile program revenue, and the personal funds of inmates held by the institutions.

We planned our audit work to answer the following questions:

- Did Region 1 have adequate internal controls to ensure that it safeguarded revenues and other assets, accurately paid employees and vendors, created reliable financial information, and complied with finance-related legal requirements?
- For the items tested, did Region 1 comply with significant finance-related legal requirements?

To meet the audit objectives, we gained an understanding of the Department of Corrections' financial policies and procedures. We analyzed accounting data to identify unusual trends or significant changes in financial operations. We also tested certain transactions to assess the effectiveness of financial controls and to assess compliance with laws, regulations, policies, and contract provisions.

We conducted the audit in accordance with generally accepted government auditing standards.¹ Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions.

We used various criteria to evaluate internal controls and compliance. We assessed the adequacy of internal controls using guidance published by the U.S. Government Accountability Office.² We used state laws, regulations, contract provisions, and state policies as evaluation criteria for compliance.

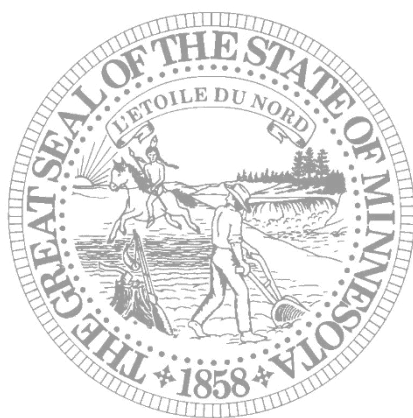
Conclusion

The Minnesota Department of Corrections' Region 1 correctional facilities had generally adequate internal controls to ensure that it safeguarded revenues and other assets, accurately paid employees and vendors, created reliable financial information, and complied with finance-related legal requirements. For the items tested, the region complied with most finance-related legal requirements. However, we identified one legal compliance issue and one internal control deficiency.

The following *Findings and Recommendations* section provides further explanation about this instance of noncompliance and the internal control deficiency.

¹ U.S. Government Accountability Office, Government Auditing Standards, December 2011.

² The Comptroller General of the United States, Government Accountability Office, Standards for Internal Control in the Federal Government (Washington D.C., September 2014). In September 2014, the State of Minnesota adopted these standards as the internal control framework for the executive branch.



Findings and Recommendations

FINDING 1

The Department of Corrections did not properly charge counties for the cost of juveniles housed at the Red Wing facility.

The Department of Corrections did not charge counties a per diem rate that equaled 65 percent of the cost of confinement, as required by statute.³ We estimated that General Fund revenue losses were approximately \$6.3 million over the last four fiscal years due to inaccurate per diem rates.

The department calculates a per diem rate annually. The rate takes into consideration total anticipated expenditures and the projected population of juveniles. Our audit identified two factors that resulted in inaccurate per diem rates and lost General Fund revenue:

- **Inaccurate inmate projection counts.** The department used significantly overstated inmate projection counts in its per diem calculations in all four years that we tested. On average, the department's inmate projection counts were overstated by 21 percent for fiscal years 2014 through 2017. Dividing the total anticipated expenditures across an inflated inmate base results in per diem rates that were artificially low.
- **Failure to charge calculated rates.** The department charged counties rates that were less than the rates it calculated in all four years that we tested. On average, the per diem rates that the department charged to counties were approximately 10 percent lower than the rates it calculated, resulting in more revenue losses.

To improve controls and ensure compliance with state law, the department needs to revisit the methodology that it uses to calculate per diem rates. We recognize that rates rely on estimated data, and there will invariably be slight year-to-year variances. However, significantly understated rates and persistent revenue losses indicate that there are flaws in the current methodology used to comply with state law.

³ *Minnesota Statutes* 2017, 242.192.

RECOMMENDATION

The Department of Corrections should develop a per diem rate setting methodology that promotes compliance with state law.

FINDING 2

The Department of Corrections' Region 1 business office did not accurately reconcile inmate trust account balances.

Inmates are allowed to have a personal bank account, called an inmate trust account. The department uses accounting software to record detailed transactions, including deposits and withdrawals to send money outside the facility and for internal canteen purchases. The department deposits inmate trust cash in the state treasury, which had an average balance of approximately \$1.3 million during fiscal year 2017.

Our audit identified a significant deficiency in the process used to reconcile the detailed accounting records to the cash in the state treasury. Specifically, we found that the department did not reconcile the detailed accounting records to the actual cash balance in the treasury for 54 of 105 months that we tested. Monthly variances ranged from an overstatement of approximately \$223,000 to an understatement of approximately \$18,000.

Reconciling detailed records to the treasury cash balance is a key control to detect errors in inmate trust account balances. Without these reconciliations, there also is an increased risk that fraud could occur and go undetected by management in the Department of Corrections.

RECOMMENDATION

The department should periodically reconcile detailed inmate trust account records to the cash balance in the state treasury.

March 20, 2018

James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St. Paul, MN 55155-1603

Dear Mr. Nobles,

Thank you for the opportunity to review and respond to the findings and recommendations reported as a result of the internal controls and compliance audit of selected activities within the Department of Corrections (DOC) for the period July 1, 2014 through February 28, 2017. The DOC recognizes the importance of sound and effective internal controls, and places a high emphasis on compliance. Below you will find our responses to the findings identified in your audit report:

Finding 1: The Department of Corrections did not properly charge counties for the cost of juveniles housed at the Red Wing facility.

Recommendation

- *The Department of Corrections should develop a per diem rate setting methodology that promotes compliance with state law.*

Response:

The DOC partially agrees with this finding and recommendation. The methodology used to determine the cost of confinement per diem is appropriate, but other factors must be considered when determining the per diem rate to charge to counties.

The juvenile population at the Red Wing facility is difficult to predict. Over the last four years the actual average daily population has ranged between 22 percent lower than the previous year and 5.2 percent higher than the previous year. Additionally M.S. 242.192 requires the consideration of pricing incentives and market conditions. The rate approval process includes a thorough review of population trends and a comparison of rates charged by other facilities providing similar or related services, to ensure we charge the counties of responsibility a fair and competitive cost of confinement per diem.

The DOC has taken steps to address the issue. The juvenile capacity at the Red Wing facility was adjusted on January 1, 2018 to a number that should be more reflective of the annual average daily population in the future. We have increased the per diem rate charged to counties by more than ten percent over the last two years. We plan to conduct a mid-year review to determine if an additional rate adjustment should be considered.

Person Responsible:
Chris Dodge, Agency Chief Financial Officer

Completion Date:
Completed January 2018

Finding 2: The Department of Corrections' Region 1 business office did not accurately reconcile inmate trust account balances.

Recommendation

- *The department should periodically reconcile detailed inmate trust account records to the cash balance in the state treasury.*

Response:

The DOC partially agrees with this finding and recommendation. Regional finance staff record daily transactions from the state's automated accounting system (SWIFT) into a comprehensive spreadsheet, and cross-reference those transactions with items posted in the department's inmate banking system. While individual accounts were routinely reconciled to the spreadsheet, in about one-half of the instances there was no documentation to verify the sum of the accounts was reconciled to an actual SWIFT report showing the cash balance. Upon discovery, reconcilers generated a SWIFT report showing cash balances and were able to reconcile all caseloads.

The reconciliation process has been modified to include reconciliation to a SWIFT report that shows the cash balance in the state treasury. The documentation will be retained in accordance with the DOC's records retention policy.

Person Responsible:

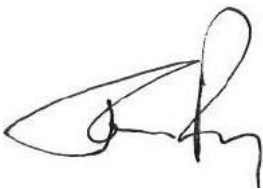
David Hinrichsen, Accounting Manager

Estimated Completion Date:

Completed June 2017

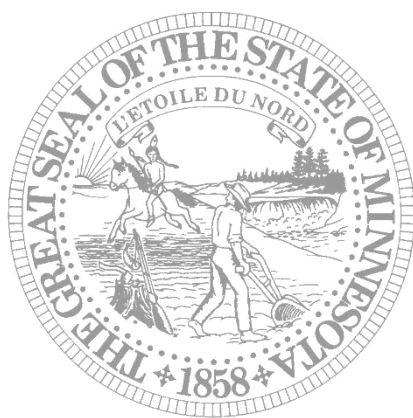
Thank you again for this opportunity to respond, and for the professional work demonstrated by your staff.

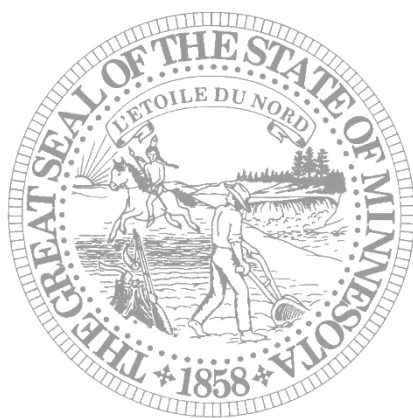
Sincerely,



Tom Roy
Commissioner

CC: Lisa Wojcik, Assistant Commissioner
Chris Dodge, Agency Chief Financial Officer
Nicole Green, Financial Management Director
David Hinrichsen, Accounting Manager
Eddie Miles, Warden, MCF-Stillwater
Michelle Smith, Warden, MCF-Oak Park Heights
Shon Thieren, Warden, MCF-Red Wing





Financial Audit Staff

James Nobles, *Legislative Auditor*
Christopher Buse, *Deputy Legislative Auditor*

Education and Environment Audits

Sonya Johnson, *Audit Director*
Kevin Herrick
Paul Rehschuh
Kristin Schutta
Emily Wiant

General Government Audits

Tracy Gebhard, *Audit Director*
Tyler Billig
Scott Dunning
April Lee
Tavis Leighton
Gemma Miltich
Erick Olsen
Ali Shire
Valentina Stone

Health and Human Services Audits

Valerie Bombach, *Audit Director*
Michelle Bilyeu
Jordan Bjonfald
Kelsey Carlson
John Haas
Jennyfer Hildre
Dan Holmgren
Todd Pisarski
Melissa Strunc
Robert Timmerman

Information Technology Audits

Mike Fenton

Non-state Entity Audits

Lori Leysen, *Audit Director*
Shannon Hatch
Heather Rodriguez
Pat Ryan

Safety and Economy Audits

Scott Tjomsland, *Audit Director*
Bill Dumas
Gabrielle Johnson
Natalie Mehlhorn
Alec Mickelson
Tracia Polden
Zach Yzermans

For more information about OLA and to access its reports, go to: www.auditor.leg.state.mn.us.

To offer comments about our work or suggest an audit, evaluation, or special review, call 651-296-4708 or email legislative.auditor@state.mn.us.

To obtain printed copies of our reports or to obtain reports in electronic ASCII text, Braille, large print, or audio, call 651-296-4708. People with hearing or speech disabilities may call through Minnesota Relay by dialing 7-1-1 or 1-800-627-3529.



Printed on Recycled Paper



OFFICE OF THE LEGISLATIVE AUDITOR
CENTENNIAL OFFICE BUILDING – SUITE 140
658 CEDAR STREET – SAINT PAUL, MN 55155