

Department of Corrections
and Rehabilitation
BISMARCK, NORTH DAKOTA

Audit Report

For the Biennium Ended
June 30, 2009

ROBERT R. PETERSON
STATE AUDITOR

Office of the State Auditor
Division of State Audit

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Transmittal Letter

January 27, 2010

The Honorable John Hoeven, Governor
Members of the North Dakota Legislative Assembly
Ms. Leann Bertsch, Director, Department of Corrections and Rehabilitation

We are pleased to submit this audit of the Department of Corrections and Rehabilitation for the biennium ended June 30, 2009. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was Kevin Scherbenske, CPA. Delan Hellman was the staff auditor. Fred Ehrhardt, CPA, was the audit supervisor. Inquiries or comments relating to this audit may be directed to the audit supervisor by calling (701) 328-2241. We wish to express our appreciation to Director Bertsch and her staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

A handwritten signature in cursive script that reads "Bob Peterson".

Robert R. Peterson
State Auditor

Executive Summary

Introduction

The North Dakota Department of Corrections and Rehabilitation's mission is to protect the public while providing a safe and humane environment for both adults and juveniles placed in the Department's care and custody. The Department carries out the judgments of the North Dakota courts and provides rehabilitation programs in an effort to successfully reintegrate offenders back into society.

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies. Those items and the Office of the State Auditor's response are noted below.

Responses to LAFRC Audit Questions

1. What type of opinion was issued on the financial statements?

Financial statements were not prepared by the Department of Corrections and Rehabilitation in accordance with generally accepted accounting principles so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified opinion was issued.

2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?

Yes.

3. Was internal control adequate and functioning effectively?

Other than our finding addressing the "fraud risk assessment" (page 10) and "computer access control weakness" (page 11), we determined internal control was adequate.

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

No.

5. Has action been taken on findings and recommendations included in prior audit reports?

The Department of Corrections and Rehabilitation has not implemented one of the recommendations included in the prior audit report as noted in our finding addressing "computer access control weakness" (page 14).

6. Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.

Yes, a management letter was issued and is included on page 15 of this report, along with management's response.

LAFRC Audit Communications

7. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

8. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

The Department of Corrections and Rehabilitation's financial statements do not include any significant accounting estimates.

9. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

10. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

None.

11. *Identify any serious difficulties encountered in performing the audit.*

None.

12. *Identify any major issues discussed with management prior to retention.*

This is not applicable for audits conducted by the Office of the State Auditor.

13. *Identify any management consultations with other accountants about auditing and accounting matters.*

None.

14. *Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.*

ConnectND Finance, Human Resource Management System (HRMS), Macola and the Department of Corrections Subject Tracking and Reporting System (DOCSTARS) are high-risk information technology systems critical to the Department of Corrections and Rehabilitation.

Audit Objectives, Scope, and Methodology

Audit Objectives

The objectives of this audit of the Department of Corrections and Rehabilitation for the biennium ended June 30, 2009 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the Department of Corrections and Rehabilitation's operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the Department of Corrections and Rehabilitation and are they in compliance with these laws?
3. Are there areas of the Department of Corrections and Rehabilitation's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the Department of Corrections and Rehabilitation is for the biennium period ended June 30, 2009. We conducted this performance audit in accordance with generally accepted government auditing standards. 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 based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Department of Corrections and Rehabilitation has operations in the following locations. Each location was included in the audit scope:

- North Dakota State Penitentiary
- James River Correctional Center
- Missouri River Correctional Center
- Youth Correctional Center

Audit Methodology

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and reviewed management's discussion and analysis of the financial statements.
- Performed detailed analytical procedures including computer assisted auditing techniques. These procedures were used to identify high risk transactions and potential problem areas for additional testing.
- Tested internal control and compliance with laws and regulations which included selecting representative samples to determine if controls were operating effectively and to determine if laws were being followed

consistently. Non-statistical sampling was used and the results were projected to the population. Where applicable, populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.

- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) system. Significant evidence was obtained from ConnectND.
- Observed Department of Corrections and Rehabilitation's processes and procedures.

In aggregate there were no significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

Management's Discussion and Analysis

The accompanying financial statements have been prepared to present the Department of Corrections and Rehabilitation's revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

The following management discussion and analysis was prepared by Department of Corrections and Rehabilitation's management. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of this supplementary information to ensure it does not conflict with the knowledge we gained as part of our audit.

For the biennium ended June 30, 2009, operations of the Department of Corrections and Rehabilitation were primarily supported by appropriations from the state's general fund. This is supplemented by federal funding and fees credited to the agency's operating fund.

Financial Summary

With the exception of the \$41 million transfer from the state general fund to the state penitentiary land fund, made in fiscal year 2008 for the purpose of construction of correctional facilities in the 2009–2011 biennium, revenues consisted primarily of Roughrider Industries (RRI) sales, federal funds, and correctional fees collected from individuals on parole and/or probation (supervision fees).

Excluding the \$41 million transfer noted above, total revenues decreased approximately 6% in fiscal year 2009 compared to fiscal year 2008. Federal revenue continues to decrease from year to year. It appears this is a trend that is likely to continue as federal funding for correctional programs continues to decrease. Revenue from correctional fees decreased approximately 5% from fiscal years 2008 to 2009. This decrease is a direct result of a decline in number of individuals under supervision (parole and probation) in the community. It is anticipated that future revenues from correctional fees will reverse this trend and increase from the fiscal year 2009 level, as the population of individuals under supervision in the community has stabilized and is showing signs of once again increasing. Revenue from the sale of meals realized a decrease from fiscal year 2008. The decrease is directly attributable to the cost of providing meals to the North Dakota State Hospital. Interest earnings decreased approximately 49% from fiscal year 2008 as a result of the sharp decline in interest rates during the 2007–2009 biennium.

Total expenditures for the Department of Corrections and Rehabilitation increased approximately 8% in fiscal year 2009 compared to fiscal year 2008. The majority of the increase to expenditures was the result of increased salary and benefits costs; legislatively approved salary increases, increased employee health insurance premiums, and an increase in authorized positions.

Although inmate and offender counts for the 2007–2009 biennium remained somewhat stable, the cost to provide housing and programming to inmates and offenders outside of the DOCR system increased from fiscal year 2008 to fiscal year 2009. The main cause of the increase

was the expansion in the number of contract community beds. Forty additional male transition beds were brought on-line in the last quarter of fiscal year 2008.

The increase to IT related expenditures is attributable to the purchase and implementation of an Electronic Medical Record (EMR). The increase in expenditures for equipment reflect the timing of payments. Equipment purchases are typically held off when possible until the second year of the biennium, when the department is more certain of what, if any resources will be available to purchase the asset(s).

Analysis of Significant Changes in Operations

Although authorization to proceed with construction was not obtained, funding in the amount \$41 million dollars was transferred to the penitentiary land fund for the purpose of construction of correctional facilities to take place beginning in the 2009–2011 biennium.

The number of contract community beds was increased by up to 40 additional male transition beds. These beds began to come on-line in the last quarter of fiscal year 2008. The beds are located in the City of Fargo.

Analysis of Significant Variances Between Final Budgeted and Actual Expenditures

The Department of Corrections and Rehabilitation ended the 2007-2009 biennium with \$8.5 million of remaining appropriation authority. \$4.2 million of that amount is general fund authority with the remaining amount \$4.3 million being other fund authority.

The majority of the other fund authority is a result of Roughrider Industries aggressive budgeting. Roughrider Industries employs the philosophy of aggressive budgeting in order to respond to additional sales and business opportunities when they become arise. The general fund turn back of \$4.2 million is the direct result of lower than anticipated adult and juvenile populations place under the supervision and control of the department. The result of lower populations is lower than anticipated costs related to housing, supervision and medical care.

Financial Statements

Statement of Revenues and Expenditures

	<u>June 30, 2009</u>	<u>June 30, 2008</u>
<u>Revenues and Other Sources:</u>		
Roughrider Industries Sales	\$4,857,665	\$4,495,740
Federal Revenue	2,510,558	2,775,433
Correctional Fees	1,412,323	1,494,155
Meal Sales	474,884	596,710
Interest Earnings	391,817	764,682
Revenue from Counties	210,259	282,350
Mineral Lease Royalties	61,441	122,260
Miscellaneous Revenue	185,443	140,680
Transfers in from General Fund		41,000,000
Other Transfers in	1,402,769	1,533,384
Total Revenues and Other Sources	<u>\$11,507,159</u>	<u>\$53,205,394</u>
<u>Expenditures and Other Uses:</u>		
Roughrider Industries Expenditures	\$4,552,093	\$4,162,065
Salaries and Benefits	37,372,355	34,873,981
Field Service Programming	8,868,999	8,142,698
Contract Housing	5,579,363	5,484,685
Medical, Hospital, Dental, Optical	4,103,851	4,240,699
Food and Clothing	2,996,857	2,889,455
IT – Processing/Services/Equipment	2,046,762	1,367,259
Grants	2,323,716	2,071,243
Utilities	1,525,246	1,347,576
Bond Payments	1,487,791	1,476,013
Repairs	1,141,350	1,029,771
Travel	940,293	761,783
Equipment	903,943	506,953
Buildings and Grounds	685,332	746,399
Supplies	588,321	484,277
Inmate Wages	385,286	345,409
Rent of Building Space	307,514	294,490
Professional Development	178,662	175,654
Insurance	141,703	143,336
Other Expenses	808,121	1,001,075
Total Expenditures and Other Uses	<u>\$76,937,558</u>	<u>\$71,544,821</u>

Statement of Appropriations

For The Biennium Ended June 30, 2009

Expenditures by Line Item:	<u>Original Appropriation</u>	<u>Adjustments</u>	<u>Final Appropriation</u>	<u>Expenditures</u>	<u>Unexpended Appropriation</u>
Capital					
Construction Carryover		\$ 303,209	\$ 303,209	\$ 293,045	\$ 10,164
Adult Services	\$ 131,210,715	1,813,712	133,024,427	126,034,653	6,989,774
Youth Services	23,447,110	242,069	23,689,179	22,156,487	1,532,692
Totals	<u>\$ 154,657,828</u>	<u>\$ 2,358,990</u>	<u>\$ 157,016,815</u>	<u>\$ 148,484,185</u>	<u>\$ 8,532,630</u>
Expenditures by Source:					
General Fund	\$ 130,606,873	\$ 1,977,244	\$ 132,584,117	\$ 128,371,975	\$ 4,212,142
Other Funds	24,050,952	381,746	24,432,698	20,112,210	4,320,488
Totals	<u>\$ 154,657,825</u>	<u>\$ 2,358,990</u>	<u>\$ 157,016,815</u>	<u>\$ 148,484,185</u>	<u>\$ 8,532,630</u>

Appropriation Adjustments:

The \$303,209 adjustment from the Capital Construction Carryover line item was unexpended last biennium and was approved for carryover by the Capital Construction Carryover Committee. The carryover is in accordance with NDCC 54-44.1-11.

The \$242,069 adjustment in the Youth Services line and \$1,297,857 of the adjustment in the Adult Services line is due to additional appropriation authority granted by Senate Bill 2189 of the 2007 session for market equity increases for classified state employees.

The remaining \$515,855 of the adjustment in the Adult Services line is due to carryover funds authorized by House Bill 1015 of the 2007 session.

Internal Control

In our audit for the biennium ended June 30, 2009, we identified the following areas of the Department of Corrections and Rehabilitation's internal control as being the highest risk:

Internal Controls Subjected to Testing:

- Controls surrounding the processing of revenues at Roughrider Industries.
- Controls surrounding the processing of hourly payroll.
- Controls surrounding purchases made using P-cards.
- Controls effecting the safeguarding of pharmacy and Roughrider Industries inventory.
- Controls surrounding inmate accounts.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the Macola information system.
- Controls surrounding the Department of Corrections Subject Tracking and Reporting System (DOCSTARS) system.

The criteria used to evaluate internal control is published in the publication *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk. We concluded that internal control was not adequate noting certain matters involving internal control and its operation that we consider to be significant deficiencies.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect (1) misstatements in financial or performance information, (2) violations of laws and regulations, or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we identified the following significant deficiencies in internal control. We also noted other matters involving internal control that we have reported to management of Department of Corrections and Rehabilitation in a management letter dated January 27, 2010.

Fraud Risk Assessment (Finding 09-1)

The Department of Corrections and Rehabilitation does not have a system in place to identify possible instances of fraud or fraudulent activities in their financial and operational areas.

The most important guidance relating to internal control is contained in *Internal Control – Integrated Framework* published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This guidance dictates that a Fraud Risk Assessment program be established and practiced to identify risks of fraudulent type activities, including when special

circumstances arise, when changing operating environments, and for restructuring. In addition, the Department of Corrections and Rehabilitation does not have the necessary control activities designed/documented to ensure significant fraud exposures are identified and mitigated. Management must design the necessary internal controls to ensure that each of the significant fraud exposures identified during the risk assessment process are adequately mitigated and that the system of control activities addressing each of the identified fraud risks has been adequately tested by management.

Recommendation:

We recommend the Department of Corrections and Rehabilitation:

- Establish and perform a fraud risk assessment on a recurring basis.
- Design and document the necessary control activities to ensure that each significant fraud exposure identified during the risk assessment process has been adequately mitigated, including background investigations, and that each of the identified fraud risks has been adequately tested by management.

Department of Corrections and Rehabilitation Response:

The Department of Corrections and Rehabilitation (DOCR) concurs with this recommendation. The DOCR is currently in the process of performing a fraud risk assessment. In addition, policy and procedure will be established and adopted to ensure that such an assessment will be completed on a recurring basis.

Computer Access Control Weakness (Finding 09-2)

During our review of the financial information system access controls, it was noted that 8 of 50 former employees tested still had active user ID's. Proper internal controls dictate employee computer access rights be cancelled immediately upon termination. Without this control, it could be possible for former employees to access the state computer system for unauthorized purposes.

Recommendation:

We recommend the Department of Corrections and Rehabilitation:

1. Establish policies and procedures to restrict access privileges to only necessary individuals.
2. Assign ongoing responsibility for security for each information technology application.
3. Perform continuing reviews of access privileges..

Department of Corrections and Rehabilitation Response:

The Department of Corrections and Rehabilitation (DOCR) concurs with this recommendation. Policy and procedure will be established and adopted, and security roles will be assigned to appropriate individuals to address the weaknesses in the control structure surrounding computer access.

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2009, we identified and tested Department of Corrections and Rehabilitation's compliance with legislative intent for the following areas that we determined to be significant and of higher risk of noncompliance:

- Transfer \$1,631,044 from the general fund for treatment services at the north central correctional and rehabilitation center (2007 North Dakota Session Laws chapter 15, section 7).
- The Bureau of Criminal Investigation shall provide a statewide and nationwide criminal history record check to the Department of Corrections and Rehabilitation for all agents and employees (North Dakota Century Code section 12-60-24 2u).
- Proper use of the following legally restricted funds:
 - Penitentiary Land Replacement Fund.
 - Crime Victims Gift Fund.
 - Community Service Supervision Fund.
- Compliance with appropriations including any appropriation changes (2007 North Dakota Session Laws chapter 15).
- Compliance with OMB's Purchasing Procedures Manual.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).

The criteria used to evaluate legislative intent are the laws as published in the *North Dakota Century Code* and the *North Dakota Session Laws*.

Government Auditing Standards require auditors to report all instances of fraud and illegal acts unless they are inconsequential within the context of the audit objectives. Further, auditors are required to report significant violations of provisions of contracts or grant agreements, and significant abuse that has occurred or is likely to have occurred.

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. Thus, we concluded there was compliance with the legislative intent identified above.

While we did not find any items that were required to be reported in accordance with *Government Auditing Standards*, we noted certain inconsequential or insignificant instances of non-compliance that we have reported to management of the Department of Corrections and Rehabilitation in a management letter dated January 27, 2010.

Operations

This audit did not identify areas of the Department of Corrections and Rehabilitation operations where we determined it was practical at this time to help to improve efficiency or effectiveness.

However, we did note a certain matter involving operations that we have reported to management of Department of Corrections and Rehabilitation in a management letter dated January 27, 2010.

Prior Recommendations Not Implemented

Prior recommendations have been implemented with the exception of the following:

Computer Access Control Weakness (Finding 07-1)

Recommendation:

We recommend the DOCR:

- Establish policies and procedures to restrict access privileges to only necessary individuals.
- Assign ongoing responsibility for security for each information technology application.
- Perform continuing reviews of access privileges.

Status: Not implemented – see page 11.



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Management Letter (Informal Recommendations)

January 27, 2010

Ms. Leann Bertsch, Director
Department of Corrections and Rehabilitation
3100 Railroad Avenue
Bismarck, ND 58501

Dear Ms. Bertsch:

We have performed an audit of the Department of Corrections and Rehabilitation for the biennium ended June 30, 2009, and have issued a report thereon. As part of our audit, we gained an understanding of the Department of Corrections and Rehabilitation's internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status.

The following present our informal recommendations.

CASH

Informal Recommendation 09-1: We recommend the Department increase controls over inmate accounts to ensure all withdrawals are appropriate.

INVENTORY

Informal Recommendation 09-2: We recommend the Department implement an inventory system that will enable them to determine all drugs were properly received and disbursed.

Informal Recommendation 09-3: We recommend the Department:

- Maintain supporting documentation for any adjustments to inventory.
- Have someone independent review and approve all inventory adjustments on MACOLA on a timely basis.

LEGISLATIVE INTENT

Informal Recommendation 09-4: We recommend the Department follow State Procurement purchasing procedures as outlined in NDCC 54-44-4 when using P-cards.

Informal Recommendation 09-5: We recommend the Department comply with their policy manual and complete criminal background checks on all new employees.

OPERATIONAL

Informal Recommendation 09-6: We recommend the Department look for ways to increase their usage of the P-card as a form of payment. We further recommend, if necessary, they meet with officials from OMB to facilitate this process by raising P-card limits, determining which of their vendors they could be making P-card payments to, or changing the accounting on their P-cards so as to limit or eliminate the need to re-allocate P-card expenditures.

Management of Department of Corrections and Rehabilitation agreed with these recommendations.

I encourage you to call myself or an audit manager at 328-2241 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,



Kevin Scherbenske
Auditor in-charge

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