Client Code 530

Department of Corrections and Rehabilitation

BISMARCK, NORTH DAKOTA

Audit Report

For the Biennium Ended
June 30, 2013

ROBERT R. PETERSON
STATE AUDITOR

Office of the State Auditor
Division of State Audit

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Transmittal Letter

June 9, 2014

The Honorable Jack Dalrymple, 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, 2013. 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 Delan Hellman. Cindi Pedersen, CPA, was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager 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,

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 responses 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 unmodified 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 "Lack of Controls Over Pharmacy Inventory" (page11), 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?*

   Except "Lack of Controls Over Pharmacy Inventory" as shown on page 15, the Department of Corrections and Rehabilitation has implemented all recommendations included in the prior audit report.

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 16 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), and Macola 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, 2013 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 ended June 30, 2013. 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 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 the 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, 2013, 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, prison industry revenues, and correctional fees credited to the agency's operating fund.

Financial Summary

The Department of Corrections and Rehabilitation revenues primarily consist of Roughrider Industries (RRI) sales, correctional fees collected from individuals on a parole and/or probation (supervision fees), transfers from the common schools trust fund, and federal funds. Total revenues increased approximately 18% in fiscal year 2013 compared to fiscal year 2012. The majority of the increase in the revenue from 2012 to 2013 is attributable to RRI sales. Over this period of time RRI sales increased by 31%. The major factor behind this significant increase is believed to be the continued strong North Dakota economy. Due to the increasing number of individuals under supervision in the community, supervision fee revenue is steadily increasing. Supervision fee revenue increased by 21% in fiscal year 2013. Total fiscal year 2013 revenue includes $1.1 million in loan proceeds. This loan was authorized by the 62nd Legislative Assembly, with the loan proceeds to be used for the State Penitentiary Building Project.

Total expenditures for the Department of Corrections and Rehabilitation decreased 4% from fiscal year 2012 to fiscal year 2013. The decrease is a result of the State Penitentiary Building Project nearing its conclusion. Although total expenditures decreased in total, salary and benefits, food and clothing, and utilities experienced increases from fiscal year 2012 to fiscal year 2013. Increases in these areas are directly attributable to the general salary increases and additional personnel hired to staff the expanded prison, the steadily increasing number of individuals being incarcerated, and the additional building square footage that came on-line in fiscal year 2013.

Analysis of Significant Changes in Operations

Substantial completion of the State Penitentiary Building Project was reached in the last quarter of fiscal year 2013. To adequately staff the expanded State Penitentiary, an additional 59.0 FTE positions were added to the Department of Corrections and Rehabilitation authorized FTE count. The majority of these positions were filled in December 2012. Actual inmate occupancy of the new housing and medical units occurred in June 2013.

Analysis of Significant Variances - Budgeted and Actual Expenditures

Excluding the $4.1 million carried over from the 2011-13 biennium to the 2013-2015 biennium for on-going capital projects, the Department of Corrections and Rehabilitation ended the 2011-2013 biennium with $10 million in unexpended authority. $1.7 million of that authority is general fund with the remaining amount being other fund authority.

The majority of the remaining amount of budgeted authority is a result of lower than expected federal revenues, RRI aggressive budgeting and lower than anticipated offender / inmate populations. The remaining general fund authority and a portion of the remaining other fund authority is attributable to lower than anticipated offender / inmate populations. Also contributing to the amount of remaining other fund authority is decreased federal revenues and RRI aggressive budgeting. RRI employs the philosophy of aggressive budgeting in order to respond to additional sales and business opportunities when they arise.

Financial Statements

Statement of Revenues and Expenditures

	June 30, 2013	June 30, 2012
Revenues and Other Sources:		
Roughrider Industries Sales	$ 8,663,750	$ 6,595,900
Correctional Fees	1,607,216	1,331,102
Federal Revenue	2,599,807	3,128,550
Loan Proceeds	1,100,000	
Meal Sales	546,439	423,109
Revenue from Counties	227,295	169,867
Mineral Lease Royalties	217,617	195,529
Miscellaneous Revenue	214,589	253,554
Transfers In	906,682	1,071,525
Total Revenues and Other Sources	$ 16,083,395	$ 13,169,136
Expenditures and Other Uses:		
Roughrider Industries Expenditures	$ 6,760,144	$ 5,827,462
Salaries and Benefits	49,223,756	46,231,310
Building Expansion / Extraordinary Repairs	14,684,590	26,774,822
Community Housing and Programming	9,440,800	9,107,276
Contract Housing	7,022,726	6,498,305
Medical, Hospital, Dental, Optical	4,411,790	4,635,632
Food and Clothing	3,418,550	3,064,049
Grants	2,020,497	2,550,790
IT- Processing/Services/Equipment	1,836,401	1,783,404
Utilities	1,813,036	1,505,436
Building and Grounds	1,670,846	1,249,285
Equipment	2,190,575	419,095
Travel	981,332	909,282
Bond Payments/Special Assessments	694,514	683,233
Professional Service/Supply/Material	685,228	691,044
Repairs	595,791	431,573
Rent of Building Space	449,956	384,630
Supplies	437,442	299,650
Inmate Wages	456,819	439,443
Professional Development	145,164	254,291
Other Expenses	867,735	912,156
Total Expenditures and Other Uses	$ 109,807,692	$ 114,652,168

Statement of Appropriations

For The Biennium Ended June 30, 2013

Expenditures by Line Item:	Original Appropriation	Adjustments	Final Appropriation	Expenditures	Unexpended Appropriation
Capital Assets Carryover		$47,346,185	$ 47,346,185	$ 43,585,069	$ 3,761,116
Adult Services	$163,587,498		163,587,498	154,577,594	9,009,904
Youth Services	27,584,571	16,824	27,601,395	26,297,197	1,304,198
Totals	$191,172,069	$47,363,009	$238,535,078	$224,459,860	$14,075,218
Expenditures by Source:					
General Fund	$159,565,919	$ 2,828,813	$162,394,732	$160,388,947	$ 2,005,785
Other Funds	31,606,150	44,534,196	76,140,346	64,070,913	12,069,433
Totals	$191,172,069	$47,363,009	$238,535,078	$224,459,860	$14,075,218

Appropriation Adjustments:

The $47,346,185 increase in the Capital Assets Carryover line was approved by the Construction Carryover Committee.

The $16,824 was authorized by Senate Bill 2015 of the 2011 Session Laws, section 7, for increased general fund spending authority for the state internship program.

Internal Control

In our audit for the biennium ended June 30, 2013, 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 expenditures at Roughrider Industries.
- Controls surrounding the processing of revenues for Adult Services and Youth Services.
- Controls surrounding the processing of expenditures for Adult Services and Youth Services.
- Controls surrounding purchases made using P-cards.
- Controls effecting the safeguarding of pharmacy and Roughrider Industries inventory.
- Controls surrounding inmate accounts.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the Macola information 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 a certain matter involving internal control and its operation that we consider to be a significant deficiency.

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 deficiency 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 June 9, 2014.

Lack of Controls Over Pharmacy Inventory (Finding 13-1)

Condition:
The Department of Corrections and Rehabilitation does not have an inventory system that enables them to accurately account for returned medication and inventory balances. In addition, all pharmacy employees have the ability to place drug orders from vendors.

Criteria:
The Committee of Sponsoring Organizations (COSO) guidelines on control activities states "Control policies and procedures must be established and executed to help ensure the actions identified by management as necessary to address risks to achievement of the entity's objectives are effectively carried out."

Cause:
The current inventory system is not capable of perpetual inventory record keeping. Also, management has not implemented proper controls surrounding drug ordering.

Effect or Potential Effect:
Potential discrepancies could go undetected and more drugs could be ordered than needed.

Recommendation:

We recommend the Department of Corrections and Rehabilitation:

- Establish an inventory system that will enable the agency to accurately account for returned medication and inventory balances.
- Ensure there is proper segregation of duties surrounding the ordering of drugs.

Department of Corrections and Rehabilitation Response:

The Department of Corrections and Rehabilitation (DOCR) agrees with this recommendation. The DOCR is currently working with its electronic medical record (EMR) vendor to address this finding. A new version of the EMR application, which will have the capability of accounting for returned medications is currently scheduled to be deployed in last quarter of calendar year 2014. (The development of the upgraded EMR version has experienced delays which has pushed the deployment date from January 2013 to its current target date.) Mitigating controls and proper segregation of duties surrounding the purchase, receipt, and disbursement of medications from pharmacy are now and will continue to be in place.

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2013, we identified and tested Department of Corrections and Rehabilitation's compliance with legislative intent for the following areas we determined to be significant and of higher risk of noncompliance:

- Proper quarterly reporting to the budget section on the prison expansion project (House Bill 1015, section 5 of the 2011 Legislative Session).
- New FTE's were not hired prior to 90 days of the prison expansion project estimated completion date (House Bill 1015, section 6 of the 2011 Legislative Session).
- Compliance with the requirement to employ personnel and establish policies and procedures to supervise sexually dangerous individuals released to community placement on an outpatient basis (Senate Bill 2190, section 2 of the 2011 Legislative Session).
- Compliance with the requirement to not share employee's personnel record information to inmates (Senate Bill 2232, section 6 of the 2011 Legislative Session).
- Established policies and procedures to ensure proper payments to crime victims (NDCC 54-23.4-06).
- Proper use of the following legally restricted funds:
  - Community Service Supervision fund.
  - Probationer Violation Transportation fund.
  - State Penitentiary Land fund.
  - Crime Victims Gift fund.
- Proper authorization of the Department of Corrections and Rehabilitation's funds.
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations and related transfers (2011 North Dakota Session Laws chapter 15).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record-keeping, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.
- Compliance with payroll-related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

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 June 9, 2014.

Operations

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

Prior Recommendations Not Implemented

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

Lack of Controls Over Pharmacy Inventory (Finding 11-1)

Recommendation:

We recommend the Department of Corrections and Rehabilitation establish an inventory system that will enable the agency to accurately account for returned medication and inventory balances.

Status:

Not Implemented. See recommendation 13-1.

Management Letter (Informal Recommendations)

June 9, 2014

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, 2013, 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.

ACCOUNTS PAYABLE/EXPENDITURES

Informal Recommendation 13-1: We recommend Rough Rider Industries have an individual who is not a purchase card holder approve the reconciliation of the state-wide purchase card statement to individual statements.

Informal Recommendation 13-2: We recommend the Department of Corrections and Rehabilitation establish policies and procedures to ensure payments to crime victims are made consistently to eligible individuals for expenses incurred in accordance with NDCC 54-23.4-06.

FIXED ASSETS/INVENTORY

Informal Recommendation 13-3: We recommend Rough Rider Industries ensure an independent person without access to make changes to assets in MaCola review all asset deletions and perform the annual inventory of fixed assets.

Informal Recommendation 13-4: We recommend the Rough Rider Industries Commissary properly review adjustments made to inventory.

LEGISLATIVE INTENT

Informal Recommendation 13-5: We recommend the Department and Corrections and Rehabilitation properly approve the agency's Sex Offender Civil Commitment and Supervision policy.

PEOPLESOFT SYSTEM ACCESS

Informal Recommendation 13-6: We recommend the Department of Corrections and Rehabilitation ensure access privileges are properly restricted to those who need it to complete their job duties and to achieve proper segregation of duties.

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,

Delan Hellman

Delan Hellman
Auditor in-charge

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