

changes

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strengthen

# T o Our Stakeholders:

This year was a year marked with changes that strengthened our business, our programs, and our mission. While some of the changes were difficult, the end result is a streamlined organization, relevant within the markets in which we operate, and reflected in our new mission statement:

**MINNCOR Industries provides services that benefit the community by operating a dynamic and profitable business.**

Fiscal Year 2006 started strong with a 37% increase in sales over FY 2005, and a 15% increase in assigned offenders. Throughout the year, we maintained this financial success, with the end of the year exceeding our budgeted expectations for total sales.

We are now fully onboard a course of change to strengthen this organization. We spent time analyzing our business units and made decisions to close some of our less successful ones. We began implementing new operating systems. We realigned, lost and added people. We spent time and money investing in performance enhancing programs. I am confident these changes will provide MINNCOR a greater opportunity to thrive and contribute to both the Department of Corrections and Minnesota communities.

Change is a challenging and slow process. Throughout the year, we were faced with the challenge of engaging people in our organization to support our purpose of operating a business in government. As time went on, our mission began to gain appreciation. This was a major component of our success this year.

Fiscal Year 2007 will be an opportunity to see the results of the changes we implemented this year. We will remain committed to balancing our role at the correctional facilities with the demands of our customers. We anticipate continued growth and success.

As always, thank you for your interest and support.

Regards,



Chris Pizinger  
Chief Executive Office  
MINNCOR Industries

## **W**hat is MINNCOR?

Minnesota prison industries ☒ Business ☒ Program ☒ Self-sufficient ☒ State entity.....?

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MINNCOR Industries is more than a program; in fact, it is even more than a business.

For 130 MINNCOR employees, being a part of MINNCOR means to support themselves and their families. In addition to this fundamental element, for MINNCOR's employees coming to work everyday means creating a safer environment in Minnesota's Correctional Facilities, lowering the recidivism rate and ultimately contributing to strengthening the safety in Minnesota communities at large; it is a job we take pride in.

For many Minnesota offenders, being a part of MINNCOR provides an opportunity. With operations in seven of the eight Minnesota State Correctional Facilities, MINNCOR has a presence in the state correctional program. This fiscal year, MINNCOR employed more than 1,200 offenders. These 1,200 offenders earned jobs and were trained with real job skills such as carpentry, metal fabrication, sewing, and much more. In addition to learning marketable job skills, offenders have the opportunity to develop a sound work ethic, self-confidence, pride, and self-esteem.

MINNCOR employees and Minnesota offenders are not the only ones that benefit from MINNCOR's efforts. Minnesota businesses, communities and tax payers also benefit. Contributions and deductions from offender wages are earmarked for the payment of state taxes, reducing the overall costs associated with incarceration, and in some cases, provide financial assistance to their dependents and contributions to victim compensation. With the implementation of MINNCOR's newest program, EMPLOY, employers have the opportunity to hire qualified, skilled applicants, who happen to have a criminal past.

EMPLOY is an employment readiness program designed to provide offenders with unique opportunities both while confined and after release. By helping offenders acquire valuable trade and job skills, EMPLOY seeks to reduce recidivism rates and release offenders as employable, productive and contributing citizens.

The creation of EMPLOY was one of the reasons MINNCOR created a new mission statement this fiscal year. The mission statement was updated to further reflect the improvements made to the organization. The new mission statement reads:

***MINNCOR Industries provides services that benefit the community by operating a dynamic and profitable business.***

## **Y**ear in Review

### **Administrative Highlights**

#### *Changes that Strengthen*

Significant changes were made within MINNCOR this fiscal year. The decision to exit the panel systems business was made after careful and thorough analysis of that business unit. The panel system business unit was underperforming financially and employed an insignificant number of offenders. This exit created an opportunity to perform a long awaited restructuring of the product sales organization. The new structure now focuses on a market driven approach – as opposed to the product driven approach taken in the past. This change was created in order to better serve customers and grow business. In addition to the closing of the panel systems business unit, the farm machinery business unit was also closed. The vast majority of the remaining farm machinery inventory consisted of mostly parts and pieces that were more than 30 years old. Potential bidders were invited to bid on the entire lot. These notable decisions reinforce the commitment to sustain or grow offender employment and cover the costs of operating MINNCOR.

#### *Communication Improvements*

An intranet site for MINNCOR employees was created. This site enables all MINNCOR staff to have easy access to helpful information such as news and events, training documents, and manufacturing information. The site also has a survey function. Staff can anonymously provide feedback and suggestions.

#### *All Staff Meeting – The SWOT Finale*

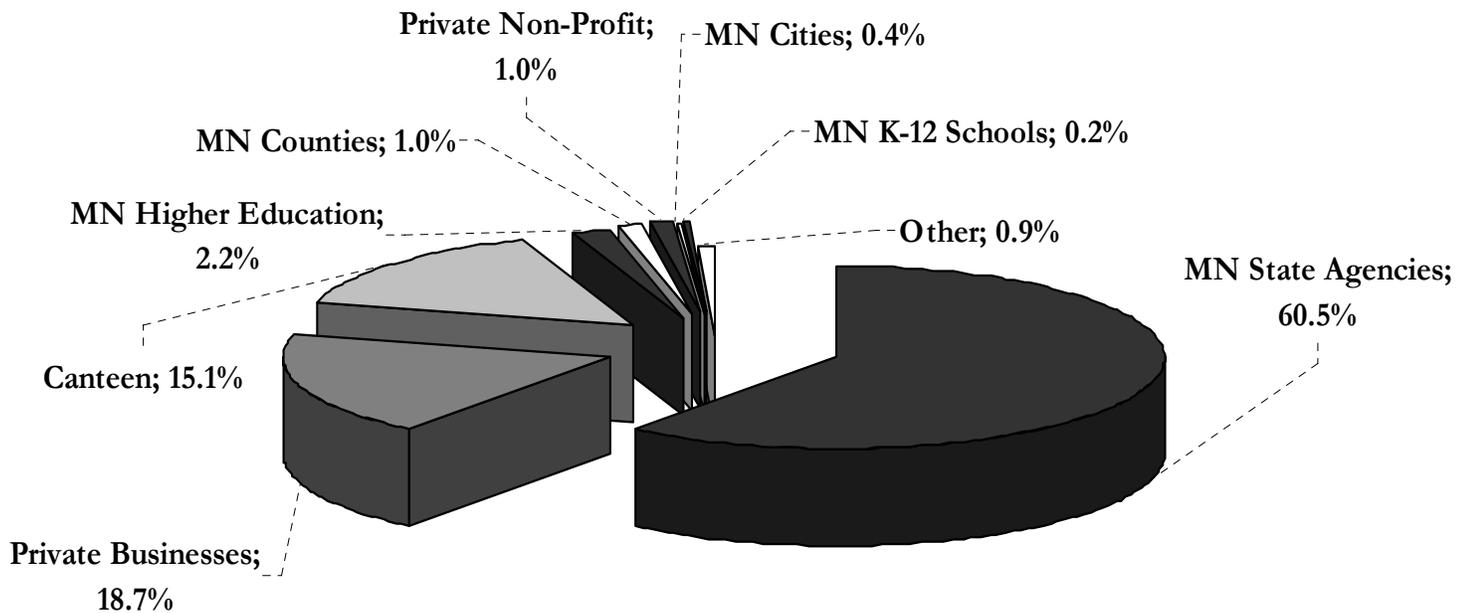
The MINNCOR all staff meeting was held on April 28<sup>th</sup>. Six teams of staff provided their final presentations on the SWOT (Strengths, Weaknesses, Opportunities, Threats) analysis. The presentations were on six topics identified from input of all MINNCOR staff. These six presentations were the finale to MINNCOR's recent strategic planning process.

#### *Technological Advances*

MINNCOR's solution to achieving a paperless office, OnBase, integrated document management software, was been implemented in almost every area of the organization. The electronic purchasing phase was installed and is being utilized by all the facilities for all contracts, requests for purchase (RFPs) and work orders. The Receiving and Accounts Payable phases are in the final stages of testing and will be rolled out in the first quarter of Fiscal Year 2007. A new job-costing module has been implemented as well. Used in all of production, these modules allow for an analysis of the manufacturing process and profit margins in a timely manner. Another benefit of the modules is the ability for planning and control of materials, especially with custom work.

## Year in Review

### MINNCOR Market Segment



#### *Employ*

The EMPLOY program was launched at the end of the fiscal year. This program is designed for offenders to capitalize on work experiences and skills acquired during incarceration, aid in employment readiness for post-incarceration, and offer employment opportunities matching each offender's skills and location of release. An Offender Employment Development Coordinator was hired. The program was put into operation at Moose Lake, Shakopee and Lino Lakes to date. EMPLOY has many benefits for employers as well. Minnesota offers a tax credit incentive to employers who hire individuals from certain target groups, including ex-offenders. Employers and Minnesota communities benefit from ex-offenders acquiring and maintaining stable jobs. Recidivism rates are reduced and communities are safer when ex-offenders are employed. This program is important because most offenders will be returning to their communities under some form of supervision. This supervision will help ex-offenders to remain law-abiding and motivated. The ex-offenders have more to lose than an average employee if fired. The program will continue to grow in Fiscal Year 2007.

## **Y**ear in Review

### **Operational Highlights**

#### *Faribault*

There was significant growth in casework sales, resulting in a very busy Wood Shop in Faribault. New casework software was installed, using Traverse data as the benchmark. This product line is expected to continue to grow in Fiscal Year 2007. Faribault Laundry had a very successful year as well. Sales exceeded expectations, ending the year with more than a \$300,000 increase in sales over Fiscal Year 2005. This year, they washed 4,128,438 pounds of laundry! Another successful business unit at Faribault is sub-contract partnerships. Anagram International, the world's largest manufacturer of metallic balloons, is one of MINNCOR's most significant customers. In the first quarter alone, Anagram employed more than 230 offenders in order to complete 14,000 kits in a 5-day period. The efforts of both the staff and the offenders proved successful; Anagram continued to grow their business with MINNCOR throughout the fiscal year. An additional 9,700 square feet of factory space was made available to Anagram due to the termination of pallet refurbishing. More space resulted in a 63% increase in offender employment.

#### *Stillwater*

The closing of the systems furniture and farm machinery business units allowed more space for other product lines. One new operation at Stillwater was an assembly operation for Anagram International. That grew Stillwater's offender employment to more than 375 men. The Stillwater Subcontract Division produced more than 6,500 school lockers with virtually no returns reported by the customer. That outstanding performance made MINNCOR the customer's preferred vendor. The Stillwater Upholstery Shop upholstered nearly 8,000 pieces of furniture during Fiscal Year 2006. That shop ended the fiscal year with outstanding order-fulfillment performance.

#### *Moose Lake*

A new plate maker was installed in the Print Shop. This removed all chemicals from the plate making process, and reduced the cost of supplies by nearly 20%. It also increased the Print Shop's in-house printing capability by more than 20%. In addition to new equipment, the Print Shop also received OnContact software – making it the only facility to utilize MINNCOR's customer management software. A combined sales and operation effort to grow the Sign Shop's sales was implemented. This resulted in double the amount of sales efforts and production space while creating a more efficient, safe and secure work environment for facility staff. A customized garment ordering program was initiated. The program entails a Sales/Production team from MINNCOR working hand in hand with the Property Department of each institution to analyze and interpret data regarding garment purchasing history and trends.

## **Y**ear in Review

### *Moose Lake – Continued*

The goal is to have each institution establish its needs, budgets, and dates of delivery with a process in place for continued monitoring and adjustment. By working together, an unprecedented level of service will be provided to institutions, cost efficiencies will be realized by all, and reoccurring problems will be resolved. Thus far, the program has been well received by facility staff.

### *Rush City*

Through significant reorganization of the physical plant and development of space previously restricted from use, production space was increased by 10%. This allowed for partnership growth and expansion. One of the companies that expanded was Plastech, a company specializing in tight tolerance, technical and large tonnage injection molding of engineering grade thermoplastic resins. Plastech expanded hours in order to have respirators assembled for use by citizens and rescue workers in the hurricane-damaged areas. Many other companies have partnered with MINNCOR to help with their production and manufacturing needs. These companies include a Minnesota-based industry leader in the manufacturing of pre-finished hardwood moldings and vents in the hardwood flooring, and Anagram International.

### *Shakopee*

Offender assignments rose to 123 offenders – more than 25% of the Shakopee population. In December, Anagram International grew their business with MINNCOR in the Shakopee facility as well. That business unit alone employed more than 40 female offenders and increased sales more than 48% over Fiscal Year 2005. The sewing shop at Shakopee continues to experience success. After careful consideration and evaluation, the decision was made to exit the data processing business unit at Shakopee. This will allow for new growth in the future.

### *St. Cloud*

Many new license plates were introduced in Fiscal Year 2006. These included four new Veteran plates for motor cycles (Golf War Veteran, GWOT (Global War on Terrorism), Afghanistan Veteran, Iraq Veteran). Also, a new Support our Troops motorcycle plate and a new Firefighter motorcycle plate, were both introduced. The proceeds from the Support our Troops plates goes to the families of soldiers serving in Iraq and Afghanistan. During the first two weeks of sales of these plates, more than \$56,000 was generated to help the families of Minnesota soldiers. Nearly 780,000 pair of passenger plates, and another 250,000 miscellaneous plates were produced this year. St. Cloud is researching equipment to produce flat license plates sometime in the next year. In addition to license plates, St. Cloud also produced and distributes more than 12 million validation stickers for the Department of Public Safety this year.

## **Y**ear in Review

### *Oak Park Heights*

MINNCOR began working with the Education Department at Oak Park Heights to develop a work ethic class for offenders. This class will teach offenders the fundamentals of being productive and holding a job. In the Canteen, the error rate remained under 2% this fiscal year; a great accomplishment for both staff and offenders. A new fence was installed in the Canteen. The fence provides a more safe and secure work area in addition to enhancing offender visibility. In addition to the fence, considerable progress was made in the research of a cashless vending system. More information and pricing will be gathered in the next year.



## **F**inancials

Fiscal Year 2006 ended with a total of \$41.5 million in sales. Net income for the year was \$672 thousand. Though the year ended positively in sales, MINNCOR struggled with higher costs, greater competitive pricing, and quality issues which resulted in lower net income from the previous year. Extensive discounting, quality issues, and high general and administrative resource utilization in the systems furniture business unit resulted in substandard margins throughout the year for that business unit. Fiscal Year 2007 will be a year of implementing new processes. While it may be a challenging year, MINNCOR will emerge a much stronger organization with many successes, and as always, room to grow.



## Balance Sheet

<b>Assets</b>			
		<b>FY 2006</b>	<b>FY 2005</b>
Cash	.....	\$11,203,013	\$7,568,451
Total Other Current Assets	.....	\$12,208,192	\$12,263,594
Total Other Assets	.....	\$3,880,828	\$3,956,133
<b>Total Assets</b>	.....	<b>\$27,292,034</b>	<b>\$23,788,178</b>
<b>Liabilities and Equity</b>			
		<b>FY 2006</b>	<b>FY 2005</b>
Total Current Liabilities	.....	\$4,514,808	\$2,023,759
Total Other Liabilities	.....	\$855,701	\$514,796
<b>Total Liabilities</b>	.....	<b>\$5,370,509</b>	<b>\$2,538,555</b>
Contributed Capital	.....	\$6,587,559	\$6,587,559
Retained Earnings	.....	\$14,662,064	\$13,337,564
Current Year Earnings	.....	\$671,901	\$1,324,500
<b>Total Equity</b>	.....	<b>\$21,921,524</b>	<b>\$21,249,623</b>
<b>Total Liabilities and Equity</b>		<b>\$27,292,034</b>	<b>\$23,788,178</b>



## Comparative Income Statement

	FY 2006	FY 2005
Total Sales .....	\$41,542,407	\$32,326,875
Total Cost of Goods Sold .....	\$24,114,814	\$16,591,775
<b>Gross Margin .....</b>	<b>\$17,427,593</b>	<b>\$15,735,100</b>
Total Facility Manufacturing Costs .....	\$9,881,570	\$8,884,064
Total General and Administrative Costs .....	\$6,874,122	\$5,526,536
<b>Net Income .....</b>	<b>\$671,901</b>	<b>\$1,324,500</b>

## Cash Flow Statement

	FY 2006	FY 2005
<b>Cash from Operating Activities</b>		
Income from Continuing Operations .....	\$671,901	\$1,324,500
Adjustments to Reconcile Income from Continuing Operations to Cash Provided by Operating Activities .....	\$2,972,958	(\$1,024,515)
Cash Provided from Financing Activities .....	\$3,644,860	\$299,985
Cash Flow from Financing Activities .....	(\$10,297)	(\$783,481)
Increase/(Decrease) in Cash and Cash Equivalents .....	\$3,634,562	(\$483,496)
Cash, Beginning of Year .....	\$7,568,451	\$8,051,947
<b>Cash, End of Year .....</b>	<b>\$11,203,013</b>	<b>\$7,568,451</b>

# **N**otes to the Financial Statements

## **NOTE 1 NATURE OF THE BUSINESS**

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MINNCOR as a division of the Minnesota Department of Corrections develops and markets premium products and services to various markets and industries. In addition, MINNCOR will provide contract manufacturing services to companies to fulfill their manufacturing needs. MINNCOR Industries provides services that benefit the community by operating a dynamic and profitable business. MINNCOR provides work skills to offenders as well as preparing them for release. MINNCOR operates through an enterprise fund, which is a set of self-balancing accounts comprised of assets, liabilities, equities, revenues and expenses. Beginning with Fiscal Year 2003, MINNCOR has continued to be self-sufficient receiving no appropriations, grants or subsidies from the State of Minnesota.

## **NOTE 2 SUMMARIES OF SIGNIFICANT ACCOUNTING POLICIES**

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### **Principles of Consolidation**

The consolidated financial statements include the accounts of all the individual business units. All inter-company transactions and profits are eliminated in the consolidation.

### **Cash and Cash Equivalents**

Cash and Cash equivalents are invested by the Minnesota Department of Finance and State Board of Investments.

### **Allowance for Doubtful Accounts**

MINNCOR estimates the balance of allowance for doubtful accounts by analyzing accounts receivable balances by age and applying historical write-off trend rates to the most recent 12 months' sales, less actual write-offs to date. Account balances are charged off against the allowance when it is probable the receivable will not be recovered.

### **Inventory Valuations**

Inventories are valued at the Weighted Average or Lower of Cost or Market. Predominately raw materials are priced at Weighted Average and finished goods are Lower of Cost or Market. Merchandise placed in service to support laundry rental operations is amortized over the estimated useful lives of the underlying inventory items, primarily on a straight-line basis, which results in a matching of the cost of the merchandise with the revenue generated by the merchandise. Estimated lives of this merchandise are in a service range of three years. In establishing estimated lives for merchandise in service, management considers historical experience and the intended use of the merchandise.

**Property, Plant and Equipment**

Property, plant and equipment are stated at cost. Depreciation is charged to operations using the straight-line method over the assets estimated useful lives ranging from 20 years for buildings to 4 – 10 years for machinery and equipment. Merchandising equipment consists principally of various systems that dispense MINNCOR's cleaning and sanitizing products. Merchandising equipment is capitalized and depreciated using the straight-line method over the assets estimated life of 5 years.

Expenditures for repairs and maintenance are charged to expense as incurred. Expenditures for major renewals and betterments, which significantly extend the useful lives of existing plant and equipment, are capitalized and depreciated. Upon retirement or disposition of plant and equipment, the cost and related depreciation are removed from the accounts and any resulting gain or loss is recognized in income.

**Capitalized Software**

Purchased software applications in excess of \$25,000 are capitalized and reported according to the Generally Accepted Accounting Principals (GAAP). These assets will appear on the balance sheet and be amortized using the straight-line method over an estimated useful life of 5 years.

**Revenue Recognition**

MINNCOR recognizes revenue as services are performed or on product sales at the time title transfers to the customer. MINNCOR records estimated reductions to revenue for customer programs and incentive offerings, including pricing arrangements, promotions and other volume based incentives at the time of the sale.

**Inter-fund Transactions**

In accordance with Statement 2 – Grant, Entitlement and Shared Revenue Accounting and Reporting by State and Local Governments by the national Council on Governmental Accounting, these transactions are reflected in the financial statements as follows:

1. Funds provided for capital expenditures and fixed assets are recorded and reported in the financial statements as Contributed Capital.
2. Funds provided for payment of operating expenses are recorded and reported in the financial statements as expenses and Operating Grant Revenue.

**NOTE 3 COMPENSATING ABSENCES**

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The liability of the employee's rights to receive compensation for future absences when certain conditions are met has been accrued and recognized in the financial statements according to the Governmental Accounting Standards Board (GASB) Statement Number 16.

Compensated absences are classified as current and non-current. Actuarial determined percentages determine what portion of the liability is current. For Fiscal Year 2006, 6.0% of vacation leave and 14.0% of vested severance is classified as current. 100% of compensatory time is classified as current. The remainder as well as 54% of non-eligible severance pay is classified as non-current. This resulted in a negative adjustment on the balance sheet to record compensated balances for Fiscal Year 2006 of approximately \$26,000.

## **NOTE 4 SPECIAL CHARGES**

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During the fourth quarter of Fiscal Year 2006, management approved plans to undertake restructuring and cost saving actions. These actions included the re-alignment of the sales force to reflect a market orientation approach, workforce reductions and various product line discontinuations. Expected revenue and reduction in costs resulting from these actions should be realized in Fiscal Year 2007. In addition, the consolidation of the Stillwater wood shop to the Faribault wood shop was completed in fiscal year 2006 and resulted in a net income loss at the Stillwater business unit of approximately \$218,000 and a restructuring charge of approximately \$73,000.

## **NOTE 5 DISCONTINUED OPERATIONS**

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In Fiscal Year 2006, MINNCOR terminated its farm machinery and system's operations at the Stillwater facility and the data operations at the Shakopee facilities. These business units resulted in a combined loss after G&A of approximately \$232,000 in Fiscal Year 2006. The system's business units are expected to record the final liquidation of assets in Fiscal year 2007.

## **L**ooking Forward

The effects of the changes that have been implemented this year will continue to yield results for MINNCOR in Fiscal Year 2007.

EMPLOY will continue to be rolled out at all the facilities. Staff will meet with potential companies to offer information to employers on the benefits of hiring released offenders. A tracking system will be implemented in order to document the program's successes.

MINNCOR will explore the option of on-line ordering. On-line ordering may prove very beneficial for MINNCOR Printing. It could provide quick and easy growth, especially in ordering business cards.

In Fiscal Year 2007, MINNCOR anticipates an increase in overall net profit. In order to do this, MINNCOR will undergo both Lean and Six Sigma projects as a means to evaluate efficiencies and product quality.

MINNCOR will also continue to evaluate and develop both OnContact, Customer Management Relations software, and OnBase, Integrated Document Management software.

