OLA

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Management Letter

Department of Employee Relations

Fiscal Year Ended June 30, 2002

MARCH 13, 2003 03-14

Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota State government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately fifty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year and one best practices review.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of Representatives and Senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

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All OLA reports are available at our Web Site: http://www.auditor.leg.state.mn.us

If you have comments about our work, or you want to suggest an audit, investigation, evaluation, or best practices review, please contact us at 651-296-4708 or by e-mail at auditor@state.mn.us

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Brad White, CPA, CISA	Audit Manager
Sonya Johnson, CPA	Auditor-in-Charge
Gena Hoffman	Auditor
Kristen Poore	Auditor

Exit Conference

We discussed the findings and recommendations with the following representatives of the Department of Employee Relations at an exit conference on February 24, 2003:

Cal Ludeman	Commissioner
Bill Eisele	Division Manager
Ed Anderson	Accounting Director
Carolyn Hoel	Accounting
Liz Houlding	Employee Insurance Division
Budd Johnson	SEGIP Program Manager
Scott Anderson	PEIP Program Manager

Report Summary

Key Findings and Recommendations

- The Department of Employee Relations (DOER) does not prepare written agreements with certain non-state organizations enrolled in the State Employee Group Insurance Program. We recommended that written agreements be developed to clarify the billing, payment, and administrative responsibilities, as well as residual funding arrangements should the organizations terminate from the insurance program (Finding 1, page 3).

- DOER needs to improve the reporting of required supplemental financial information for the Public Employees Insurance Program (PEIP). Government accounting standards require that public-entity risk pools present historic balances and financial information for the past ten years. The Department of Finance was able to gather fund-level financial information from prior Comprehensive Annual Financial Reports since the fund became self-insured in 1998; however, the accounting pronouncement also calls for other financial details that were not available for inclusion. We recommended that DOER work with the Department of Finance to gather and report the necessary required supplemental financial information (Finding 2, page 3).

Management letters address internal control weaknesses and noncompliance issues found during our annual audit of the state's financial statements and federally funded programs. The scope of work in individual agencies is limited. During the fiscal year 2002 audit, our work at the Department of Employee Relations focused on financial reporting for statewide payroll and fringe benefit costs, and liabilities for state employee compensated absences and workers' compensation. We also examined the financial reporting of activities of the State Employee Insurance Fund and Public Employee Insurance Fund administered by the department. The department's response to our recommendations is included in the report.

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Cal Ludeman, Commissioner
Department of Employee Relations

We have performed certain audit procedures at the Department of Employee Relations as part of our audit of the financial statements of the State of Minnesota for the year ended June 30, 2002. We emphasize that this has not been a comprehensive audit of the Department of Employee Relations.

The scope of our audit work at the Department of Employee Relations included statewide payroll and related fringe benefit transactions processed through the State Employee Management System (SEMA4) and interfaced into the Minnesota Accounting and Procurement System. Our office performed an information technology audit of SEMA4 and issued a report in August 2002, Legislative Audit Report #02-57, that assessed the adequacy of selected computer general and application controls. State employee payroll costs for fiscal year 2002 totaled \$2.8 billion. In addition, we performed certain audit procedures on the accrued liabilities for compensated absences and workers' compensation, totaling \$269 million and \$119 million, respectively, at June 30, 2002. We also reviewed the financial statements for the State Employee Insurance Fund and Public Employee Insurance Fund, as part of our objective to obtain reasonable assurance about whether the State of Minnesota's financial statements for the year ended June 30, 2002, were free of material misstatement.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Conclusions

Our December 6, 2002, report included an unqualified opinion on the State of Minnesota's basic financial statements for fiscal year 2002. In accordance with *Government Auditing Standards,* we also issued our report, dated December 6, 2002, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

As a result of our procedures, we identified the following weakness in internal control and noncompliance with accounting standards at the Department of Employee Relations.

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Department of Employee Relations

1. The department does not prepare written agreements with certain non-state organizations enrolled in the State Employee Group Insurance Program (SEGIP).

Minn. Stat. 43A.27, Subd. 2 authorizes the insurance fund participation of numerous non-state entities, such as the Science Museum of Minnesota, two credit unions, the State Agricultural Society (state fair) and others. However, the Department of Employee Relations (DOER) does not enter into written agreements with these organizations to clarifying rights and responsibilities of both parties. DOER bills them for their employee and employer share of health and dental insurance premiums. Premium rates are established at a level to generate revenues sufficient to fund claims, including those incurred but not reported, and to maintain a cash level avoiding the need for premium increases or decreases during the contract year. Once premiums are submitted, the SEGIP fund bears the "risk of loss" to pay for insured health costs of participants. Written agreements with these non-state organizations would clarify the billing, payment, and administrative responsibilities, as well as the residual funding arrangements should they terminate from the insurance program.

Recommendation

- *The Department of Employee Relations should develop written agreements with non-state organizations having employees enrolled in SEGIP.*

2. The department needs to improve reporting of required supplementary information (RSI) disclosures for the Public Employee Insurance Program (PEIP).

The department did not gather and report the necessary supplementary RSI disclosures for its self-insured, public-entity risk pool. The department manages one public-entity risk pool, the Public Employee Insurance Program (PEIP), which provides self-insurance coverage to local units of government. Governmental Accounting Standards Board (GASB) Statement #30, paragraph 7, requires that public-entity risk pools present certain RSI on revenue and claims development, including historic balances and financial activities for the past ten years. The Department of Finance gathered historic PEIP revenues, expenses, and claim liabilities from prior Comprehensive Annual Financial Reports going back to 1998 when the fund became self-insured; however, other criteria specified in GASB Statement #30 were not included. For example, claims liability by type of contract and cumulative payments at the end of each policy year were not available for inclusion.

Recommendation

- *The Department of Employee Relations should work with the Department of Finance to identify and report supplementary financial activities and historical balances required for the Public Employee Insurance Program.*

Department of Employee Relations

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Employee Relations. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 13, 2003.

/s/ James R. Nobles	*/s/ Claudia J. Gudvangen*
James R. Nobles Legislative Auditor	Claudia J. Gudvangen, CPA Deputy Legislative Auditor

End of Fieldwork: December 6, 2002

Report Signed On: March 10, 2003

Status of Prior Audit Issues
As of December 6, 2002

Most Recent Audit

Legislative Audit Report #02-57, issued in August 2002, involved an information technology audit of selected areas of the State Employee Management System (SEMA4). The audit assessed the adequacy of selected computer general and application controls. The audit found that the Departments of Employee Relations and Finance have adequate controls protecting the integrity of SEMA4 payroll and personnel data, and ensuring that employees are paid the appropriate rates. The departments have adequate controls to ensure that payroll is accurately processed and recorded in the state's general ledger. The audit report identified two areas where the department could further enhance SEMA4 security infrastructure. The departments are working to resolve the issues.

Fiscal Year 2001 Statewide/Single Audit

We examined the department's activities and programs material to the *State of Minnesota's Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2001. The purpose of the audit was to render an opinion on the State of Minnesota's financial statements for fiscal year 2001. We issued an unqualified opinion on the *State of Minnesota's Comprehensive Annual Financial Report* for the year ended June 30, 2001. No findings or concerns pertaining to the Department of Employee Relations were identified.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota, any quasi-state organizations, such as the metropolitan agencies, or the State Agricultural Society, the state constitutional officers, or the judicial branch.

Department of Employee Relations

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DATE: March 12, 2003

TO: James R. Nobles, Legislative Auditor
Office of the Legislative Auditor

FROM: Cal R. Ludeman */s/ Cal R. Ludeman*
Commissioner

RE: Audit Findings

We have reviewed the audit results as noted in your letter of February – 2003 and our joint meeting. Our responses are noted below.

Finding Number One

The department does not prepare written agreements with certain non-state organizations enrolled in the State Employee Group Insurance Program (SEGIP).

Recommendation

- *The Department of Employee Relations should develop written agreements with non-state organizations having employees enrolled in SEGIP.*

DOER Response:

When the insurance rates for 2004 are known, DOER will begin the process of developing Memorandums of Understanding (MOUs) for the approximately 20 entities entitled to participate in the appropriate life insurance, hospital, medical and dental benefits and optional coverages offered through SEGIP. The timing will be contingent upon the legislature agreeing on a budget and the unions agreeing on a contract. If these agreements occur by June 30, 2003, the MOU process will begin by August 1, 2003. These MOUs will specify eligibility requirements, billing and payment requirements, administrative responsibilities, and separation provisions for participation in the Commissioner's Plan.

Finding Number Two

The department needs to improve reporting of Required Supplementary Information (RSI) disclosures for the Public Employees Insurance Program (PEIP).

Recommendation

- *The Department of Employee Relations should work with the Department of Finance to identify and report supplementary financial activities and historical balances required for the Public Employees Insurance Program.*

DOER Response:

The Public Employees Insurance Program (PEIP) provides health, dental, and life insurance coverage. The dental and life coverages are fully insured (i.e. not self insured), and therefore the program's only claim liability at year-end relates to unpaid medical claims.

The reporting of Required Supplemental Information (RSI) requires that financial data be identified on a fiscal and policy year basis. Public entities that participate in PEIP have different renewal/policy dates (renewals occur during each of the calendar months). We would, therefore, recommend that the RSI be reported on a fiscal year basis (ending June 30th).

Assuming that we use a June 30th policy year, it will then be necessary to identify during which fiscal year the claims were paid. This information can only be provided by the carriers (e.g., Health Partners), and has not yet been requested or provided. We will contact the carriers to determine how much historical information they can provide, and attempt to acquire this information for FY03.

Please let us know if further information is needed at this time.

We appreciate the professional manner in which the audit was conducted.

cc: Brad White, Audit Manager
Claudia Gudvangen, Deputy Legislative Auditor
Edmund Anderson, Fiscal Manager, DOER

can/M-James Nobles