



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

**DEPARTMENT OF LABOR AND
INDUSTRY**
INTERNAL CONTROL AND COMPLIANCE AUDIT
JULY 1, 2004, THROUGH JUNE 30, 2007

August 28, 2008

Report 08-20

FINANCIAL AUDIT DIVISION
Centennial Building – Suite 140
658 Cedar Street – Saint Paul, MN 55155
Telephone: 651-296-4708 • Fax: 651-296-4712
E-mail: auditor@state.mn.us • Web site: <http://www.auditor.leg.state.mn.us>
Through Minnesota Relay: 1-800-627-3529 or 7-1-1

Financial Audit Division

The 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 has a staff of forty 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.

The Office of the Legislative Auditor (OLA) also has a Program Evaluation Division, which evaluates topics periodically selected by the Legislative Audit Commission. Reports issued by both OLA divisions are solely the responsibility of OLA and may not reflect the views of the Legislative Audit Commission, its individual members, or other members of the Minnesota Legislature. For more information about OLA reports, go to:

<http://www.auditor.leg.state.mn.us>

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

To offer comments about our work or suggest an audit, investigation, or evaluation, call 651-296-4708 or e-mail auditor@state.mn.us.



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA • James Nobles, Legislative Auditor

August 25, 2008

Representative Rick Hansen, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Steve Sviggum, Commissioner
Department of Labor and Industry

This report presents the results of our internal control and compliance audit of the Department of Labor and Industry (department) for fiscal years 2005, 2006, and 2007 (July 1, 2004, through June 30, 2007).

We concluded that the department did not adequately fulfill its financial management responsibilities to control certain activities and ensure that transactions comply with state requirements and department policies. We identified an employee travel overpayment that could exceed \$10,000; a \$55,572 overpayment to a claimant; undocumented authorizations for some high-risk transactions; and missing records.

As required by [Minnesota Statutes](#) 2007, 3.975, we are referring the report to the Office of the Attorney General. The Attorney General has the responsibility to recover state funds that were used inappropriately.

Our fieldwork ended on May 6, 2008, and we discussed the results of the audit with department staff on August 15, 2008. The audit was conducted by Brad White, CPA, CISA, CFE (Audit Manager) and Pat Ryan (Auditor-in-Charge), assisted by auditors Sara Becker and Deb Sakrison.

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

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

Table of Contents

	<u>Page</u>
Report Summary	1
Agency Overview	3
Objectives, Scope, and Methodology	4
Conclusions.....	6
Findings and Recommendations	7
Department of Labor and Industry's Response	23

Report Summary

Conclusions

The department's internal controls over workers' compensation assessments and claims, payroll, and administrative expenditures were not adequate. As a result, the department was not able to ensure it safeguarded assets, accurately paid employees and vendors in accordance with management's authorization, produced reliable financial information, and complied with finance-related legal requirements. For the items we tested, the department did not consistently comply with finance-related legal requirements for workers' compensation claims, payroll, and administrative expenditures. The department did resolve a prior finding related to workers' compensation assessments, pending actions and penalty reductions; however, it failed to adequately address a prior finding regarding employee security access to the state's accounting system.

Key Findings

- The department did not fulfill its management responsibility to control financial activities. The audit detected overpayments to employees and a claimant, unclear justification and undocumented management authorization for certain high-risk transactions, missing records, and noncompliance with state requirements and department policies. ([Finding 1](#))
- Poor department controls over employee travel allowed one employee to inappropriately claim over \$10,000 of mileage and meal reimbursements. ([Finding 2](#))
- The department did not effectively restrict employee access to the state's accounting and payroll systems. ([Finding 3](#))
- The department did not have a documented basis for an accounting adjustment that shifted \$45 million of workers' compensation revenue between fiscal years and did not have controls to detect a \$55,572 workers' compensation settlement paid to the wrong party. ([Findings 4 and 5](#))
- Department staff did not document justification and obtain management authorization for some unique personnel and payroll transactions. ([Findings 7 thru 10](#))
- The department could not locate records to substantiate proper use of purchasing cards for a nine-month period. ([Finding 14](#))

Audit Objectives and Scope

Objectives

- Internal Controls
- Compliance

Period Audited

Fiscal Years 2005, 2006, and 2007
(July 1, 2004, through June 30, 2007)

Programs Audited

- | | |
|--|-------------------------------|
| • Special Compensation Fund Assessments and Claims | • Payroll Expenditures |
| | • Administrative Expenditures |

Background

The Department of Labor and Industry's mission is to ensure that Minnesota's work and living environments are equitable, healthy, and safe by inspecting and regulating workplaces through education and enforcement. It annually assessed and expended workers' compensation funds totaling approximately \$100 million for each of the past three years. In May 2005, the Governor transferred functions for safety codes and services into the department.

Department of Labor and Industry

Agency Overview

The Department of Labor and Industry operates under the authority of [Minnesota Statutes](#) 2007, chapter 175. Mr. Scott Brener was the department's commissioner from 2003 to 2007. The Governor appointed Mr. Steve Sviggum as commissioner beginning in July 2007. The department has three main functions:

- to oversee and administer the workers' compensation system for the State of Minnesota;
- to assure conditions of employment, wage safety standards, and construction codes and licensing comply with legal requirements; and
- to enforce employment laws and regulate and promote apprenticeship programs.

On April 4, 2005, Governor Pawlenty issued Executive Order No. 193, transferring new functions to the department, including state building codes and standards (from the Department of Administration), electrical code (from the Board of Electricity), plumbing and water conditioning (from the Department of Health), and the Residential Contractors and Remodelers Fraud Fund (from the Department of Commerce), along with some rulemaking responsibility to work with the fire marshal for the uniform fire code.

The department's primary source of funding for its operations is an open appropriation from the Special Compensation Fund, which totaled about \$100 million for each of the past three fiscal years. To generate the money for the open appropriation, the department annually assesses insurance companies and self insured employers. The department also collected revenues for building codes and standards totaling about \$19 million annually.

Table 1 summarizes the department's total expenditures for fiscal years 2005, 2006, and 2007.

Table 1
Expenditures by Type
July 1, 2005, through June 30, 2007

<u>Expenditures</u>	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>
Special Workers' Compensation Fund –			
Claims and Settlements	\$ 76,494,731	\$ 71,482,268	\$ 69,497,208
Payroll	22,365,567	30,774,710	31,055,613
Professional/Technical Services	583,276	8,253,289	8,608,126
Space Rental	1,751,025	2,129,702	2,177,716
Supplies and Equipment	1,789,146	1,021,405	1,064,007
Travel	635,960	1,004,906	1,092,269
Communications	395,422	549,482	574,950
Other Expenditures ¹	5,066,612	8,359,967	8,530,899
Total ²	<u>\$109,081,739</u>	<u>\$123,575,729</u>	<u>\$122,600,788</u>

¹Other Expenditures include various services, agency and statewide indirect costs, and grants.

²Expenditures increased from fiscal year 2005 levels due to the transfer of the building codes and standards functions pursuant to Executive Order #193.

Source: Minnesota Accounting and Procurement System as of December 31, 2007.

Objectives, Scope, and Methodology

Our audit of the Department of Labor and Industry's Special Compensation Fund's financial activities and a variety of administrative expenditures, including personnel and payroll, supplies and equipment, cellular phones, travel, and purchasing cards use focused on the following audit objectives for the period July 1, 2004, through June 30, 2007 (fiscal years 2005, 2006, and 2007):

- Were the department's internal controls adequate to ensure that it safeguarded receipts and other assets, accurately paid employees and vendors in accordance with management's authorization, produced reliable financial information, and complied with finance-related legal requirements?
- For the items tested, did the department comply with significant finance-related legal requirements over its financial activities, including state and federal laws, regulations, contracts, and applicable policies and procedures?
- Did the department resolve prior audit recommendations that it restrict employee access to the state's accounting system and improve control

over unpaid workers' compensation assessments, monitoring of pending actions, and authorization of penalty reductions?¹

To answer these questions, we gained an understanding of the department's financial policies and procedures. We considered the risk of errors in the accounting records and noncompliance with relevant legal provisions. We analyzed accounting data to identify unusual trends or significant changes in financial operations. We examined samples of transactions and evidence supporting the agency's internal controls and compliance with laws, regulations, policies, and contracts.

We conducted the 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 used various criteria to evaluate internal control and compliance. We used as our criteria to evaluate agency controls the guidance contained in the *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission.² We used state and federal laws, regulations, and contracts, as well as policies and procedures established by the departments of Finance and Administration and the department's internal policies and procedures as evaluation criteria over compliance.

¹ Financial Audit Division [Report 05-45](#).

² The Treadway Commission and its Committee of Sponsoring Organizations were established in 1985 by the major national associations of accountants. One of their primary tasks was to identify the components of internal control that organizations should have in place to prevent inappropriate financial activity. The resulting Internal Control-Integrated Framework is the accepted accounting and auditing standard for internal control design and assessment.

Conclusions

The department's internal controls over workers' compensation assessments and claims, payroll, and administrative expenditures were not adequate. As a result, the department was not able to ensure it safeguarded assets, accurately paid employees and vendors in accordance with management's authorization, produced reliable financial information, and complied with finance-related legal requirements.

For the items we tested, the department did not consistently comply with finance-related legal requirements for workers' compensation claims, payroll, and administrative expenditures.

The department did resolve a prior finding related to workers' compensation assessments, pending actions, and penalty reductions; however, it failed to adequately address a prior finding regarding employee security access to the state's accounting system.

Findings and Recommendations

Overall Financial Management

Finding 1

The department did not adequately fulfill its financial management responsibilities to control certain financial activities and ensure that transactions complied with state requirements and department policies.

The department had several weaknesses in controlling and documenting its financial transactions and had instances of noncompliance with state finance-related legal requirements and department policies. As explained in the following findings, the department had some overpayments, unauthorized transactions, and missing records. Collectively, these weaknesses show an overall lack of proper administrative oversight by the department.

- Department supervisors and its financial services staff did not adequately control employee travel expense reimbursements. The department paid some employees for excessive or duplicate mileage claims; one employee inappropriately received over \$10,000 for reimbursement claims with excessive mileage and falsified meal receipts. ([Findings 2, 12, and 13](#))
 - Several financial services staff had incompatible access to the state's financial accounting systems allowing them to initiate procurements and make vendor payments. ([Finding 3](#))
 - Staff inaccurately recorded transactions in the state's accounting and payroll systems, reducing reliability of financial information and causing erroneous payments or payments from an inappropriate funding source. ([Findings 4, 5, and 7](#))
 - The department had no documentation to show management authorization of some high-risk personnel/payroll transactions affecting employee pay and leave benefits. ([Findings 8 thru 10](#))
 - The department could not locate nine months of purchasing card records. Without these records, the department could not justify the legitimacy of over \$70,000 of credit card purchases. ([Finding 14](#))
 - Staff did not adequately control equipment and sensitive assets, had some missing procurement documents and invoices, and did not sufficiently monitor employees' personal use of state cellular phones. ([Findings 16 and 17](#))
-

The department's financial services section focused on expediting the processing of financial transactions and heavily relied on supervisory or program management approvals. The section did not perform sufficient additional control procedures to ensure that transactions were accurate and in compliance with state and department policy requirements.

Recommendation

- *The department should assess the risks in its financial operations and implement internal controls to mitigate the risks and ensure transactions are sufficiently documented and justified, properly approved, accurately recorded, and in compliance with state requirements and department policies.*

Finding 2

Poor department internal controls over employee travel expenses allowed an employee to claim over \$10,000 of inappropriate mileage and meal reimbursements.

Department controls failed to detect one employee who was overpaid up to \$9,500 in excessive mileage and falsified \$880 of receipts supporting meal costs. The employee's supervisor approved the reimbursement claims, and the department's financial services accounting staff paid the claims without question or challenge.

We estimated that during fiscal years 2006 through 2008, the employee could have been overpaid for as many as 24,000 excess miles, or nearly \$9,500. We based our estimate on mileage between cities listed on the employee's expense report. For example, the employee claimed and was paid for 4,267 miles for one eight-day trip – approximately eight hours of driving a day for eight days. We found this amount to far exceed the actual city-to-city mileage. When questioned by our auditor, the employee could only substantiate 2,216 miles and admitted to an \$831 overpayment on this one claim. From fiscal years 2006 through 2008, the department reimbursed the employee for 45 mileage reimbursement claims totaling \$32,428.

The department generally did not require its employees to adhere to the state's policy³ requiring separate reporting of city-to-city trip miles and local mileage. Separate reporting allows a supervisor to better determine the reasonableness of miles claimed. The policy permits use of Internet mapping tools to measure point-to-point mileage for reimbursement claims. Because the expense reimbursement claims did not differentiate between trip and local miles, supervisors were less able to determine the reasonableness of the mileage claims.

³ Department of Finance and Employee Relations, Operating Policy and Procedure PAY0021.

In addition, the department failed to challenge the same employee's receipts for meal reimbursements. Instead of providing the original meal receipts, as required by department policy, the employee created receipts and submitted them to the department as a basis for reimbursement. The employee collected over \$880 of meal reimbursements using these falsified meal receipts. The deliberate creation of the fictitious receipts and the frequency with which they were used contradict the employee's assertion that he created the receipts because he had lost the originals.

State travel policies⁴ provide meal reimbursements for actual costs up to a maximum level. The policy allows departments to decide whether to require employees to submit receipts for meals as a basis for reimbursement. The Department of Labor and Industry does require employees to submit original receipts for meals. The department policy allows an employee to sign an affidavit if the original receipt is lost.

Recommendations

- *The department should review all mileage and meal reimbursements made to the employee to determine the extent of overpayments. The department should work with the Office of the Attorney General to recover overpayments for the excessive mileage and falsified meal claims.*
- *The department should implement controls requiring employees to support mileage claims with point-to-point measurements and to segregate trip and local miles on their expense reimbursement forms. Supervisors should not approve reimbursement claims unless the employee has documented that the mileage is reasonably accurate and has provided original meal receipts.*

PRIOR FINDING NOT RESOLVED: The department did not effectively restrict or monitor employee access to the state's accounting and personnel/payroll system functions.

Finding 3

Several department staff had access to incompatible financial functions in the state's accounting and personnel/payroll systems.⁵ Separation of incompatible functions is a fundamental internal control that prevents an employee from exclusively handling a transaction from beginning to end without the involvement

⁴ Department of Finance and Employee Relations, Operating Policy and Procedure PAY0021.

⁵ Minnesota Accounting and Procurement System (MAPS) and State Employee Management System (SEMA4).

of another employee. This concern was raised in our last audit.⁶ Although the department had sufficient staff to allow segregation of duties and to restrict access to the minimal level necessary to perform job responsibilities, it opted to monitor transactions entered by those employees rather than limit their access. As explained below, the department's monitoring process was unstructured and ineffective:

- The department had eight employees in the financial services section with incompatible access to the state's accounting system. The staff had the ability to initiate procurements and contracts and make payments to vendors and contractors. This incompatible access allowed these employees to bypass internal controls over procurements or payments. Department of Finance's policy⁷ requires agencies to avoid granting incompatible access unless they develop a written plan describing the independent reviews to be performed. The department did not have a written plan. In addition, although the department produced reports to monitor transactions processed by these employees, the reports may not have included all transactions and were not run frequently. Finally, the department had not provided sufficient direction about what the report reviewer should identify and whether the review had acceptable results.
- The department had one employee with the incompatible access to perform personnel and payroll functions. The department gave the employee with payroll responsibilities access to "on-board" new employees. This access gave the employee the ability to update personnel transactions, which is incompatible with the employee's payroll duties. The department was not aware that the employee had this incompatible access, even though it appeared on their annual payroll system security reports.

Recommendation

- *The department should restrict employee access to accounting and personnel functions based on the minimum level necessary for position responsibilities. If access to incompatible functions is provided, the department should develop and adhere to a written monitoring plan.*

⁶ Office of the Legislative Auditor, Financial Audit Division [Report #05-45](#), issued August 11, 2005.

⁷ Department of Finance Operating Policy and Procedure Number 1101-07, *Security and Access*.

Special Workers' Compensation Fund Assessments and Claims

The department did not adequately document the basis for a \$45 million accounting adjustment.

Finding 4

The department made a large adjustment on the state's accounting system that shifted about \$45 million of the Special Workers' Compensation Fund's assessment revenue from fiscal year 2007 to 2008. The department's financial staff were unable to explain the basis for the adjustment. The adjustment may have resulted from how the state's accounts receivable system records revenue transactions. The following table shows assessment revenues as recorded in the accounting system before and after the adjustment:

Special Workers' Compensation Fund Assessment Revenue Fiscal Years 2005 through 2008				
	<u>FY 2005</u>	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u>
Before Adjustment	\$102,129,802	\$96,098,030	\$96,719,290	\$ 91,951,363
Adjustment ¹	0	0	(44,993,003)	44,993,003
After Adjustment	<u>\$102,129,802</u>	<u>\$96,098,030</u>	<u>\$51,726,287</u>	<u>\$136,944,366</u>

¹ Adjustment made on August 22, 2007, shifted revenues from FY 2007 into FY 2008.

Source: Minnesota Accounting and Procurement System as of June 30, 2008.

The department's financial staff manually accrued revenue totaling \$97 million for the state's fiscal year 2007 financial statements.⁸ However, users of the state's accounting system data and any management reports created from it continue to see the adjusted financial information.

Recommendation

- *The department should work with the Department of Finance to document its intentions for recording of Special Workers' Compensation Fund's accounts receivable and revenue transactions in the state's accounting systems.*

⁸ State of Minnesota, FY 2007 Comprehensive Annual Financial Report, located at: <http://www.finance.state.mn.us/accounting/2007/2007cafr.pdf>.

Finding 5

The department did not have controls to detect a workers' compensation settlement payment made to the wrong party.

The department did not have independent payment verification controls and, as a result, it did not detect a payment to an incorrect payee made in January 2007. The Workers' Compensation Special Compensation Fund had a court order to pay a settlement of \$55,572 to an insurance company. The settlement documentation submitted to the financial services section for payment identified the correct payee. However, when financial staff entered the payment into the accounting system, they entered the injured party as the payee, in error. The department did not detect this error, because it did not have an independent review process that would verify payment to the correct payee. This process could include a comparison of a report of payments processed to the authorizing documents performed by someone who did not process the payment.

Recommendations

- *The department should develop control procedures requiring an independent employee to compare payment information entered into the accounting system against the authorized source documentation.*
- *The department should work with the Office of the Attorney General to seek restitution from the individual paid in error and to issue the settlement payment to the insurance company specified in the court order.*

Finding 6

The department did not pursue the prosecution of employers for failure to carry workers' compensation insurance.

Although the department penalized employers who did not have workers' compensation insurance,⁹ it did not pursue criminal prosecution as a way to hold noncomplying employers accountable. *Minnesota Statutes*¹⁰ state that "any employer willfully and intentionally failing to comply.....is guilty of a gross misdemeanor." A gross misdemeanor has an additional maximum fine of up to \$3,000. To successfully prosecute a non-complying employer, the department

⁹ The department can penalize a noncomplying employer up to \$1,000 per employee per week for the period the employer failed to carry workers' compensation insurance. Statutes further require state or local licensing agencies to withhold the issuance or renewal of a license or permit to operate a business in Minnesota until the applicant presents acceptable evidence of workers' compensation insurance coverage. In addition, state agencies are prohibited from contracting with a company that does not have workers' compensation insurance coverage.

¹⁰ *Minnesota Statutes* 2007, 176.181, subd. 4.

would need to prove in court that the employer's noncompliance was willful and intentional. The department's Workers' Compensation Division unsuccessfully prosecuted one employer who repeatedly did not have the required workers' compensation insurance. After this experience, however, the department concluded that it was not cost beneficial to pursue criminal prosecution of noncomplying employers.

Statutes require employers to have workers' compensation insurance to cover costs related to work-related injuries. When employers do not have appropriate workers' compensation insurance, the state's Special Workers' Compensation Fund must pay the medical and indemnity costs of the uninsured employer's injured workers if that company fails to stay in business or goes bankrupt. Other complying employers are assessed amounts necessary to fund injured worker claims from the uninsured employer.

Recommendation

- *The department should reassess its position on criminal prosecution of noncomplying employers.*

Personnel and Payroll

The department paid an employee a grievance settlement from a federal program without proper approval.

Finding 7

Following a grievance arbitration, the department was ordered to pay a settlement to an employee that worked on the federal Occupational Safety and Health Act (OSHA) program.¹¹ The department initially paid the \$29,070 settlement from the state's Workers' Compensation Fund but then subsequently transferred the cost to the federal OHSA program. The OSHA program is subject to federal cost principles¹² which state:

Fines, penalties, damages, and other settlements resulting from violations (or alleged violations) of, or failure of the governmental unit to comply... are unallowable except when incurred as a result of compliance with specific provisions of the Federal award or written instructions by the awarding agency authorizing in advance such payments.

The department did not obtain OSHA approval to pay this grievance expense from federal resources. Without federal approval, the grievance payment is not an allowable use of OHSA program funds.

¹¹ Catalog of Federal Domestic Assistance (CFDA) #17.503.

¹² Office of Management and Budget (OMB) Circular A-87, Attachment B, Item 16.

Recommendations

- *The department should work with the federal government to resolve the questioned grievance cost charged to the OSHA program.*
- *The department should obtain advanced federal authorization before paying any future grievance settlements from federal program resources.*

Finding 8**The department did not document important compensation decisions.**

The department had no documentation authorizing the initial pay rate of an employee appointed to assistant commissioner in June 2003. In addition, the employee received another pay rate increase in October 2004 and a retroactive payment of \$8,588 applying the new rate back to when the employee was initially appointed. Again, the department had no documentation for the authorization of this additional pay rate increase or for it to be retroactive. Department staff stated they acted on verbal authority of the Department of Employee Relations.¹³ Without documentation, the department was unable to support that it had authorized this pay rate change and retroactive payment.

Recommendations

- *The department should document justification and management authorization supporting personnel decisions.*
- *The department should work with the Department of Finance to determine if this additional compensation is authorized. If not authorized, the department should seek recovery of the overpaid amount.*

¹³ The Department of Employee Relations merged with the Department of Finance in June 2008.

The department's controls did not detect an inaccurate pay rate increase to one employee causing them to be overpaid by \$6,183.

Finding 9

The department inappropriately processed a two-step salary increase to an information technology employee whose bargaining agreement allowed only an annual one-step increase. The error occurred because the department lacked an independent review and verification that it had accurately entered pay rate changes into the personnel system. Once we alerted the department to the pay rate error, it initiated a repayment arrangement with the employee to recover the \$6,183 of incorrect wages paid.

Recommendation

- *The department should implement controls to independently verify pay rate changes entered into the personnel system to ensure compliance with bargaining unit agreements and management authorization.*

The department adjusted two employees' leave balances without documented justification and management authorization.

Finding 10

The department increased leave balances for two employees without a documented explanation and management authorization. Leave adjustments are unusual and high-risk, warranting review and authorization by management. Without clear justification and management oversight, there is an increased risk of an employee receiving inappropriate leave benefits and possibly an inaccurate severance payment. Following are examples of leave adjustments that the department did not adequately document:

- The department did not adequately document why it increased an employee's sick leave balance by 46.75 hours and vacation leave balance by 20.5 hours in addition to paying the employee for overtime worked. The employee claimed to have worked unpaid overtime hours during a period when there was some question about whether the position was eligible to earn overtime. We were told that after determining that the position was eligible, the department agreed to return the employee's sick and vacation leave taken in lieu of paying all of the overtime earned. We saw no evidence describing the situation in the employee's personnel file and both the employee and the supervisor, during the period in question, are no longer with the department. The current human resources director indicated that her predecessor made her aware of the additional overtime worked and that they had warned the employee on several occasions not to work more than the scheduled hours. However, the department did not document its explanation or authorization for this unusual attempt to coordinate retroactive overtime and changes to leave.
-

- A department payroll clerk provided additional leave to an employee when the benefit had already expired. Bargaining agreements provided employees with one floating holiday per fiscal year; employees must use the holiday by June 30 each year or lose their right to it. However, based on an email request from one employee in November 2004, the payroll clerk retroactively changed a day of vacation used in June 2004 to a floating holiday and restored the vacation hours. The department had no evidence of management authorization to provide this expired benefit.

Recommendation

- *The department should document its justification and obtain management authorization when adjusting leave balances.*

Finding 11

The department did not consistently conduct performance evaluations for its employees.

The department did not complete annual employee performance evaluations, as required in *Minnesota Statutes*,¹⁴ and respective state personnel plans (Managerial and Commissioners Plans) and various bargaining unit contracts. The department could not provide performance evaluations for five of seven employees tested. Department staff stated that completing annual evaluations have become a lower priority because managers and supervisors do not have time available to document the evaluations or meet with employees to discuss their performance. *Minnesota Statutes* require annual performance reviews to ensure that departments assess the quality of the state's workforce, provide employees with important feedback, and have a basis for pay increases and disciplinary actions.

Recommendation

- *The department's human resources office should implement procedures to ensure that all employees receive an annual performance evaluation.*

¹⁴ *Minnesota Statutes* 2007, 43A.20 requires annual performance evaluations for employees of the executive branch.

Administrative Expenditures

Finding 12

Department controls did not detect two employees that were reimbursed twice for the same mileage.

In addition to the poor control over mileage measurements identified in Finding 2, the department's internal controls failed to detect that it had reimbursed employees twice for the same trip. Audit testing identified two employees who received reimbursement for mileage even though they had included those miles on a previous reimbursement claim.

- One employee received two reimbursements of \$836 by submitting the same reimbursement claim in two consecutive pay periods.
- A second employee was overpaid \$1,037 by including the same trip mileage on two different reimbursement claims.

Many employees traveled as a part of their job duties, performing inspections throughout the state. During fiscal years 2005 through 2007, the department processed 2,780 mileage expense reimbursement claims to its employees totaling \$443,533.

Recommendations

- *The department should recover overpayments for the duplicate mileage claims.*
- *The department should establish controls to verify it had not paid for mileage on a previous reimbursement claim.*

The department did not control eligibility for meals and lodging when staff combined personal and business out-of-state travel, or meals were provided as part of a conference the employee attended.

Finding 13

The department did not have adequate documentation to control eligibility for meal and lodging reimbursements when staff combined personal travel with out-of-state business travel. In addition, the department did not compare employee meal reimbursement claims to conference agendas to ensure that it did not reimburse employees for meals already paid for through conference fees. Following are examples of undocumented meal and lodging costs:

- For some out-of-state trips, employees left early or stayed longer and incurred additional state-paid meal and lodging costs. For example, one employee left early for two different conferences without documenting
-

why the department paid for additional lodging and meals costing \$350. The out-of-state travel authorization form did not explain why these additional costs were business related or cost beneficial. When requesting approval for out-of-state travel, the employee should disclose any personal travel added to the itinerary and distinguish between reimbursable costs and personal costs. The department should document when cost effective travel arrangements result in earlier arrivals or later departures than needed to attend the business event.

- The department reimbursed one employee \$83 for meals that were already provided as part of the conference registration fee. The employee should have attached the conference agenda to the out-of-state travel request, and the department should have referred to the agenda when evaluating the employee's expense reimbursement claim. An employee should disclose any dietary restriction that requires meals to replace those provided as part of a conference.

Without effective controls, employees could be inappropriately reimbursed for meal and lodging costs that they were not entitled to. During fiscal years 2005 through 2007, the department reimbursed employees \$52,158 for out-of-state meals and \$215,989 for out-of-state lodging.

Recommendation

- *The department should improve control over out-of-state travel reimbursements by requiring employees to justify the business purpose for early departures or extended stays on the out-of-state travel authorization form, or clearly identify nonreimbursable personal travel, and by obtaining conference itineraries to identify conference-provided meals.*

Finding 14

The department did not have sufficient documentation to support about \$70,000 of purchases made with state purchasing cards.

The department was unable to locate nine months of purchasing card records to support transactions totaling about \$70,000. Without supporting documentation, the department was unable to support that employee purchasing card purchases served a public purpose and were in compliance with state policies.

*Minnesota Statutes*¹⁵ require all officers and agencies of the state to maintain records necessary to provide full and accurate documentation of official activities. Statutes further require that the chief administrative officer of each agency preserve the agency's records connected to the transaction of public business,

¹⁵ [*Minnesota Statutes*](#) 2007, 15.17, subd. 1 and 2.

including protecting these records from deterioration, mutilation, loss, or destruction. State policies reinforce this requirement. Preserving public financial records is an important responsibility and also protects employees from accusations of noncompliance or inappropriate purchases.

Recommendation

- *The department should improve controls over the storage and protection of accounting records that support purchase card transactions.*

The department's purchasing card policy did not contain criteria for selecting employees to be issued cards and establishing transaction limits and maximum levels.

Finding 15

The department's purchasing card policy did not address two key areas required by the Department of Administration's state purchasing card policy.¹⁶ The department's policy did not establish criteria for selecting which employees or positions could be issued purchasing cards and did not define purchasing limits or a process to authorize changes to card limits. These policy statements are necessary to avoid unauthorized issuance or excessive use without management awareness.

Recommendation

- *The department should revise its purchasing card policy to include criteria required by the Department of Administration.*

The department did not adequately safeguard its equipment.

Finding 16

The department did not update all equipment purchases in its fixed assets records. In addition, it did not conduct a biennial physical inventory to verify asset existence. An accurate record and periodic inventory of all equipment is necessary to safeguard assets and detect missing items.

Department controls did not ensure that it added all equipment purchases over \$5,000 to its inventory records, as required by the Department of Administration's policy.¹⁷ For example, department staff did not assign an asset number to equipment purchased for \$9,516 and did not update the inventory records for this item. The department also could not locate purchase orders or invoices to identify equipment purchased through three transactions of \$27,447, \$27,798, and \$5,082.

¹⁶ Department of Administration Policy 99.4.

¹⁷ Department of Administration Policy ADMIN 06-03 [Property Management User Guide](#).

The \$27,798 payment was coded as a computer supply purchase, and the department was unable to identify what was bought. If the department acquired sensitive items, such as laptops, it should have updated the items in its inventory records for appropriate control. Without the procurement documents and invoices, the department had no assurance the items were actually received and updated in asset records for safeguarding.

The department had not completed a physical inventory of equipment and sensitive assets since 2005. The Department of Administration's *Property Management User Guide*¹⁸ requires agencies to conduct at least a biennial physical inventory of capital assets. Without a periodic physical inventory to validate the existence of recorded assets, the department was not able to know if items are missing.

Recommendations

- *The department should ensure it updates all purchases of equipment and sensitive items in the asset inventory records.*
- *The department should conduct a periodic inventory of equipment and sensitive items, as required by state policies.*

Finding 17 **The department did not monitor personal use of state-owned cell phones and did not comply with some aspects of the state cell phone policy.**

The department did not require employees to review monthly cell phone bills to identify personal calls. In addition, the department could not provide evidence that employees with state-owned cell phones had received and reviewed state policies over cell phones before the issuance of the cell phones. State policy required that employees acknowledge in writing the receipt and acceptance of the conditions for the individual assignment of a state-owned cell phone before the issuance of the cell phone.¹⁹ The department had 113 cell phones as of April 2008 and expended \$112,912 over the three-year audit period.

State policy also required employees who received state-issued cell phones to review and identify all personal calls, including essential calls and nonessential calls, and submit the information for supervisory review and approval each month. The policy defines essential calls as being of minimal duration and frequency, urgent in nature, and unable to be made at another time from a different phone; all other personal calls are considered nonessential. Any nonessential personal calls must be reimbursed to the state within 30 days. The

¹⁸ Department of Administration Policy ADMIN 06-03 [Property Management User Guide](#).

¹⁹ Department of Administration Statewide Policy: *Appropriate Use of Electronic Communication and Technology*.

intent of the policy is to ensure compliance with federal Internal Revenue Service (IRS) regulations for employers who issue cell phones to employees. According to current IRS rules, unless employers enforce a policy that employees track personal cell phone use and require employee reimbursement of the personal calls, including a prorated share of the monthly service fee, employers must report the total cell phone expense as income to the employee.

In addition to not complying with state and IRS regulations, the department may be paying for unallowable personal cell phone expenses and may not be able to determine whether the extent of business use justifies the cost of the cell phone.

Recommendations

- *The department should obtain and retain written acknowledgments that employees have received a state-owned cell phone and understand state policies governing cell phone use.*
 - *The department should monitor the personal use of state-owned cell phones by employees and require reimbursement for nonessential personal calls, including a prorated share of the monthly service plan.*
-



August 22, 2008

Mr. James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Centennial Office Building
658 Cedar Street
Saint Paul, Minnesota 55155-1603

Dear Mr. Nobles:

Thank you for the opportunity to review and respond to your office's evaluation of the internal controls within the Department of Labor and Industry (DLI) in regards to worker's compensation claims, payroll, and administrative expenditures. We appreciate the thoroughness with which your staff conducted the evaluation.

The report's overall finding indicates there is room for improvement regarding our internal controls. This is consistent with our own assessment as we strive to improve our documentation of our decision-making processes.

DLI has taken steps to resolve many of the findings included in the report. Our responses to your findings and recommendations are provided below.

Findings and Recommendations

Finding 1:

The department did not adequately fulfill its financial management responsibilities to control certain financial activities and ensure that transactions complied with state requirements and department policies.

Audit Recommendation:

- The department should assess the risks in its financial operations and implement internal controls to mitigate the risks and ensure transactions are sufficiently documented and justified, properly approved, accurately recorded, and in compliance with state requirements and department policies.

Department Response:

DLI agrees with the recommendation. DLI has completed an initial assessment on key areas found within this report in Findings 2 through 17 below. The Department of Finance will be consulted to ensure proper controls are implemented. We believe this is

an ongoing process and will strive to improve our internal controls over financial reporting.

Finding 2:

Poor department internal controls over employee travel expenses allowed an employee to claim over \$10,000 of inappropriate mileage and meal reimbursements.

Audit Recommendations:

- The department should review all mileage and meal reimbursements made to the employee to determine the extent of overpayments. The department should work with the Office of the Attorney General to recover overpayments for the excessive mileage and falsified meal claims.
- The department should implement controls requiring employees to support mileage claims with point-to-point measurements and to segregate trip and local miles on their expense reimbursement claims unless the employee has documented that the mileage is reasonably accurate and has provided original meal receipts.

Department Response:

DLI agrees with the recommendation. DLI is in the process of conducting a detailed assessment of the employee travel expenses. In order to ensure that the mileage is captured accurately, DLI is reviewing travel logs, expenses, and hours worked to ensure we have a complete picture of daily travel. Expenses that have been over paid will be recovered.

DLI is also implementing a new "Daily Travel Log" which will provide details regarding employee travel. The "Daily Travel Log" will provide an improved reimbursement process. All employees will be notified of the appropriate procedures for submitting expense reimbursements.

Implementation Date: September 2, 2008

Finding 3:

PRIOR FINDING NOT RESOLVED: The department did not effectively restrict or monitor employee access to the state's accounting and personnel/payroll system functions.

Audit Recommendations:

The department should restrict employee access to accounting and personnel functions based on the minimum level necessary for position responsibilities. If access to incompatible functions is provided, the department should develop and adhere to a written monitoring plan.

Department Response:

DLI agrees with the recommendation. DLI has written a policy on who has authority to grant security access and has updated its Financial Services Contact List to reflect staff

turnover, new staff assignments, and backup assignments. Security access is based on the responsibilities and the access necessary to perform financial transactions. Based on the number of staff in the office, DLI has assessed our risk and have determined that there will be incompatibilities that will be unavoidable. These incompatibilities will be monitored and adjusted as necessary.

Finding 4:

The department did not adequately document the basis for a \$45 million accounting adjustment.

Audit Recommendation:

The department should work with the Department of Finance to document its intentions for recording of Special Workers' Compensation Fund's accounts receivable and revenue transactions in the state's accounting system.

Department Response:

DLI agrees to the extent that we could not immediately locate the procedure developed by the Department of Finance in 2007. DLI has worked closely with the Department of Finance to ensure that funds are available to make worker's compensation claim payments as they become due. DLI and the Department of Finance developed the process in 2007 for the annual transfer for monies invoiced in June (which is the end of the state fiscal year) to the next state fiscal year so that DLI can ensure prompt payment for claims.

Finding 5:

The department did not have controls to detect a worker's compensation settlement payment made to the wrong party.

Audit Recommendations:

- The department should develop control procedures requiring an independent employee to compare payment information entered into the accounting system against the authorized source documentation.
- The department should work with the Office of the Attorney General to seek restitution from the individual paid in error and to issue the settlement payment to the insurance company specified in the court order.

Department Response:

DLI agrees with this recommendation. The department is working with the Office of the Attorney General and taking measures to be reimbursed. Payment has been issued to the insurance company specified in the court order. DLI will develop a system of internal controls to ensure that this type of error is prevented in the future.

Implementation Date: October 6, 2008

Finding 6:

The department did not pursue the prosecution of employers for failure to carry worker's compensation insurance.

Audit Recommendation:

The department should reassess its position on criminal prosecution of non-complying employers.

Department Response:

DLI agrees with this recommendation. The agency has worked with the county attorneys and unfortunately there are not sufficient resources for counties to pursue all crimes. DLI does and has penalized employers for failure to carry workers compensation insurance. The investigatory burden is on the agency it is up to the county attorney offices to pursue prosecution of these cases. DLI is in the process of determining how to best use prosecution as a tool or to recommend other statutory actions.

Implementation Date: October 1, 2008

Finding 7:

The department paid an employee a grievance settlement from a federal program without proper approval.

Audit Recommendation:

- The department should work with the federal government to resolve the questioned grievance cost charged to the OSHA program.
- The department should obtain advanced federal authorization before paying any future grievance settlements from federal program resources.

Department Response:

DLI agrees with this recommendation.

Finding 8:

The department did not document important compensation decisions.

Audit Recommendations:

- The department should document justification and management authorization supporting personnel decisions.
- The department should work with the Department of Finance to determine if this additional compensation is authorized. If not authorized, the department should seek recovery of the overpaid amount.

Department Response:

DLI agrees with this recommendation. DLI is taking steps to improve written documentation and justification for personnel decisions. This is an on-going process. DLI believes the retroactive payment was made appropriately to the employee.

Finding 9:

The department's control did not detect an inaccurate pay rate increase to one employee causing them to be overpaid by \$6,183.

Audit Recommendations:

The department should implement controls to independently verify pay rate changes entered into the personnel system to ensure compliance with bargaining unit agreements and management authorization.

Department Response:

DLI agrees with this recommendation. The employee is repaying the incorrect wages paid. DLI will develop a process to monitor pay increases to ensure compliance with the bargaining unit agreements.

Implementation Date: September 15, 2008

Finding 10:

The department adjusted two employees' leave balances without documented justification and management authorization.

Audit Recommendation:

- The department should document its justification and obtain management authorization when adjusting leave balances.

Department Response:

DLI agrees with this recommendation. We recognize this adjustment could have been documented in greater detail. An employee took a floating holiday in June 11, 2004 and inadvertently recorded this as vacation. This was retroactively adjusted in November 2004. DLI believes the retroactive payment was made appropriately to the employee.

Finding 11:

The department did not consistently conduct performance evaluations for its employees.

Audit Recommendation:

The department's human resources office should implement procedures to ensure that all employees receive an annual performance evaluation.

Department Response:

DLI agrees with this recommendation. Employees are held accountable for their performance and do receive on-going informal feedback. Every effort is made to try to get employees with performance issues back on track and help them be successful in their job.

Finding 12:

Department controls did not detect two employees that were reimbursed twice for the same mileage.

Audit Recommendations:

- The department should recover over payments for the duplicate mileage claims.
- The department should establish controls to verify it had not paid for mileage on a previous reimbursement claim.

Department Response:

DLI agrees with this recommendation. DLI has recovered the overpayments made to the two employees. A new procedure for tracking mileage will be implemented effective September 2, 2008 that requires employees to submit their daily travel mileage, cell phone usage, and any personal mileage traveled. Those employees whose job requires constant travel will need to include their assignment logs, daily travel logs and actual receipts for meals with the expense reimbursement requests. DLI will then have a complete set of documentation for review and approval of expenses.

Implementation Date: September 2, 2008

Finding 13:

The department did not control eligibility for meals and lodging when staff combined personal and business out-of-state travel, or meals were provided as part of a conference the employee attended.

Audit Recommendation:

The department should improve control over out-of-state travel reimbursements by requiring employees to justify the business purpose for early departures or extended stays on the out-of-state travel authorization form, or clearly identifying non-reimbursable personal travel, and by obtaining conference itineraries to identify conference provided meals.

Department Response:

DLI agrees in this instance with this recommendation. DLI will remind employees of the appropriate documentation required for out-of-state travel. DLI's policy will be updated to ensure employees are aware of documentation requirements.

Implementation Date: October 6, 2008

Finding 14:

The department did not have sufficient documentation to support about \$70,000 of purchases made with state purchasing cards.

Audit Recommendation:

The department should improve controls over the storage and protection of accounting records that support purchase card transactions.

Department Response:

DLI agrees with this recommendation. DLI will be moving to image its files and request that vendors send electronic files instead of paper. The electronic files can be more easily stored and retained than paper records. Starting in August 2008, managers and supervisors will be receiving monthly financial reports electronically. Implementation will be on-going.

Finding 15:

The department's purchasing card policy did not contain criteria for selecting employees to be issued cards and establish transaction limits and maximum levels.

Audit Recommendation:

The department should revise its purchasing card policy to include criteria required by the Department of Administration.

Department Response:

DLI agrees with this recommendation. The Department of Administration is currently in the process of revising the state's purchasing card policy. When agencies receive the final revision, DLI will update its policy to reflect the most current requirements. In the meantime, DLI has reviewed the list of current card holders and will review again with the philosophy that we will issue as few as possible.

Finding 16:

The department did not adequately safeguard its equipment.

Audit Recommendations:

- The department should ensure it updates all purchases of equipment and sensitive items in the asset inventory records.
- The department should conduct a periodic inventory of equipment and sensitive items, as required by state policies.

Department Response:

DLI agrees with this recommendation. DLI revised its Fixed Asset Inventory Policy effective April 14, 2008 to include an annual inventory of fixed assets which is a higher standard than every 2-years as required by the Department of Administration. As purchases are made the asset inventory records will be updated.

Finding 17:

The department did not monitor personal use of state-owned cell phones and did not comply with some aspects of the state cell phone policy.

Audit Recommendations:

- The department should obtain and retain written acknowledgments that employees have received a state-owned cell phone and understand state policies governing cell phone use.

- The department should monitor the personal use of state-owned cell phone by employees and require reimbursement for nonessential personal calls, including a prorated share of the monthly service plan.

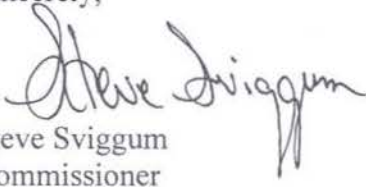
Department Response:

DLI agrees with this recommendation. DLI revised its cell phone policy to include cell phones and other personal communication devices and requires employees and supervisors to sign an "Acknowledgement of Receipt" form that the need for the cellular device is required for business purposes. The policy was effective June 6, 2008. In addition, DLI has created a new "Daily Travel Log" form for the tracking of mileage and personal calls which will take effect September 2, 2008. DLI believes that these steps will ensure that employees understand their responsibilities regarding use of cellular devices and payment for personal cellular usage.

Certainly, our processes and procedures can always be improved with the help of the good people working here at DLI and the Department of Finance. As you can tell, we have already changed or are in the process of implementing improved practices.

Thank you for the work your office has done on behalf of the State and the opportunity afforded to the Department to have a constructive discussion with you about the issues raised in your evaluation.

Sincerely,



Steve Sviggum
Commissioner