DEPARTMENT OF EMPLOYEE RELATIONS
FINANCIAL AND COMPLIANCE AUDIT
FOR THE THREE YEARS ENDED JUNE 30, 1988

APRIL 1989

89-26

STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
VETERANS SERVICE BUILDING, ST. PAUL, MN 55155 • 612/296-4708
JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Randolph W. Peterson, Vice-Chairman
Legislative Audit Commission

Members of the Legislative Audit Commission

and

Ms. Nina Rothchild, Commissioner
Department of Employee Relations

Audit Scope

We have completed a financial and compliance audit of the Department of Employee Relations for the three years ended June 30, 1988. We have issued separate management letters, dated December 31, 1986 and December 28, 1987, as part of our Statewide Financial Audit work in the department for fiscal years 1986 and 1987. Section I provides a brief description of the department's activities and finances. Our audit was made in accordance with generally accepted auditing standards, and the standards for financial and compliance audits contained in the U.S. General Accounting Office Government Auditing Standards, and accordingly, included such audit procedures as we considered necessary in the circumstances. Fieldwork was completed January 10, 1989.

The objectives of the audit were to:

- study and evaluate the department's internal control systems in effect over revenues, expenditures, assets, and liabilities as of December 1, 1988;
- verify that financial transactions were made in accordance with applicable laws, regulations, and policies, including Minn. Stat. Chapter 43A, and other finance-related laws and regulations for the three years ended June 30, 1988;
- verify that financial transactions were properly included in the State of Minnesota's Comprehensive Annual Financial Report for the activity of the Insurance Trust Fund for the year ended June 30, 1988; and
- determine the status of prior audit recommendations.

Management Responsibilities

The management of the Department of Employee Relations is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a control system are to provide management with reasonable, but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition, and transactions are executed in accordance with management's authorization and recorded properly.

Because of the inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projections of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

The management of the Department of Employee Relations is also responsible for the department's compliance with laws and regulations. In connection with our audit, we selected and tested transactions and records from the programs administered by the department. The purpose of our testing of transactions was to obtain reasonable assurance that the department had, in all material respects, administered its programs in compliance with applicable laws and regulations.

Audit Techniques

During our audit we employed a variety of audit techniques. These include, but were not limited to, auditor observation, interviews with department staff, analytical reviews to unusual transactions or trends, and the examination of documentation supporting a representative number of transactions. Random sampling techniques were used to assure that representative samples of transactions were chosen. However, the use of random sampling did not prohibit us from reviewing additional transactions which may have come to our attention during the audit.

Status of Prior Audit Findings

We reviewed the status of audit findings included in our audit report of the department for the three years ending June 30, 1984 (report dated August 13, 1985). We concur with the corrective action you have taken resolving recommendation #1 and consider it implemented. Concerns regarding the unresolved recommendation #2 have been expanded in this report in finding #6. The management letters for fiscal years 1986 and 1987 contained no audit findings.

Conclusions

We have issued an unqualified opinion on the State of Minnesota's general purpose financial statements for the year ended June 30, 1988. Our audit opinion, dated December 1, 1988 is included in the state's Comprehensive Annual Financial Report prepared by the Department of Finance.

In our opinion, except for the issues discussed in Section II, the Department of Employee Relations' system of internal control in effect on December 31, 1988, taken as a whole, was sufficient to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly.

In our opinion, for the three years ended June 30, 1988, the department administered its program in compliance, in all material respects, with applicable finance-related laws and regulations.

Section II of this report contains the findings we developed during this audit. The recommendations are presented to assist you in resolving the audit findings and in improving accounting procedures and controls. We will be monitoring and reviewing the department's progress on implementing these recommendations.

We would like to thank the Department of Employee Relations staff for the cooperation extended to us during the audit.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

Janaury 10, 1989

DEPARTMENT OF EMPLOYEE RELATIONS

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AUDIT PARTICIPATION

The following staff from the Office of the Legislative Auditor prepared this report:

John Asmussen, CPA	Deputy Legislative Auditor
Tom Donahue	Audit Manager
Alan Finlayson, CPA	Auditor-in-Charge
Rhonda Regnier	Staff Auditor
Eric Jacobson	Audit Intern

EXIT CONFERENCE

The findings and recommendations included in this report were discussed with the following staff of the Department of Employee Relations at the Exit Conference held on January 27, 1989:

Nina Rothchild,	Commissioner
Elaine Johnson,	Deputy Commissioner
Richard Thorkee,	Administrative Services Manager
Michael Holmquist,	Division Manager
Robert Cooley,	Employee Benefits Manager
Robert Erickson,	Accounting Supervisor

DEPARTMENT OF EMPLOYEE RELATIONS

I. INTRODUCTION

The Department of Employee Relations (DOER) is the central personnel staff agency for the executive branch of state government. It directs and coordinates a comprehensive personnel management and labor relations program. The principles for these programs are embodied in a set of laws, collective bargaining agreements, rules, policies, procedures, and equal employment opportunity programs. Its goal is to maintain an efficient and effective personnel management system for the state. DOER also acts as the state's representative for the purpose of collective bargaining. The department offers training courses to meet the development needs of state employees. Fiscal year 1988 appropriations for these activities were $5.4 million.

DOER also negotiates with private insurance companies to underwrite the state's medical, dental, and life insurance plans. Beginning in August 1987, the department started processing enrollment and collecting premiums. Previously, the state had contracted with a private company to perform this function. The department collected approximately $125 million in premiums during fiscal year 1988.

DOER also began administering the worker's compensation program for state employees in fiscal year 1988. This function was transferred to DOER from the Department of Labor and Industry at the end of fiscal year 1987. The worker's compensation division reviews and determines claims and bills the cost to the appropriate state agencies. During fiscal year 1988, state agencies reimbursed the worker's compensation program approximately $14.4 million.

The primary clientele of the department are the operating agencies in state government and their employees, including the Legislature, 16 collective bargaining units, and those members of the general public seeking state employment. DOER also responds to organizations involved in human and civil rights issues. Nina Rothchild, the current Commissioner of the Department of Employee Relations, was appointed on January 3, 1983.

II. CURRENT FINDINGS AND RECOMMENDATIONS

1. Problems with the insurance system resulted in improper recording of fiscal year 1988 transactions.

The State of Minnesota provides life, health, and dental insurance to its employees under the provisions of Minn. Stat. Chapter 43A. The different collective bargaining agreements and salary plans specify the eligibility requirements, employee deductions and state contributions. The University of Minnesota and quasi-state agencies may also participate in the program at their own expense. Total employer and employee contributions collected and deposited into the Insurance Trust Fund in fiscal year 1988 were $125 million.

The Department of Employee Relations (DOER) has contracted with private insurance carriers to underwrite and service the various benefit plans. The terms of the contracts vary among the 16 insurance carriers. For the larger insurance carriers, like Blue Cross Blue Shield, Delta Dental, and Minnesota Mutual, the state pays the amount of the claim plus an administrative fee. Under the Blue Cross Blue Shield contract however, the state's liability to Blue Cross is limited to 125 percent of monthly income. As defined in the contract, income equals the number of employees enrolled times the contract premium. For the remaining carriers, mainly health maintenance organizations (HMO), the state pays the amount of premiums collected.

The contracts with the carriers specify the premium that employees should pay for the desired coverages. If DOER believes a different premium is necessary to cover claims, it may adjust the premium. The premium amount specified in the contract plus or minus any DOER adjustments, if any, is the basis for the state contribution. DOER maintains separate appropriation accounts in the Insurance Trust Fund to monitor the adequacy of the Blue Cross Blue Shield, Minnesota Mutual, and Delta Dental premiums.

DOER and the Department of Administration's Intertech Division developed a computer system to record enrollment and premium collections. The system interfaces with the state's payroll system to process employee coverages and to deduct the proper premium amounts. DOER also uses the system to generate billings and record collections for organizations and individuals not on the state payroll system.

Several design and programming errors were discovered after the new insurance system began operating in August 1987. Reports were inaccurate, and consequently, DOER was unable to determine the appropriate depository account for all receipts. They deposited unidentified collections into a clearing account. As of September 3, 1988, the clearing account had a $1.5 million balance. Since prior year results effect future premium decisions, the department needs to determine the proper accounts for this money.

The staff used the information from the insurance system to determine the amount of HMO premiums collected. They transferred money from the clearing account to the HMO account in order to pay the amount calculated from the insurance system. We believe the HMO premiums collected were approximately $400,000 less than DOER's determination. Our calculation also included information obtained from the state's payroll system. As a result, HMO carriers may have been overpaid by approximately $400,000. Since the Insurance Trust Fund combines these HMO carriers into one account, we could not determine which ones received incorrect payments. DOER needs to review the prior year transactions and discuss recovery of the money with the carriers.

A report (Nonzero Balances Report) lists individuals with account balances. An individual account balance occurs when collections exceed premiums. When the staff resolve the difference, they clear the amount. Some of the entries on the report are unreasonable. Three individuals have balances totalling $6.5 million. DOER does not know the reason for the balances. They think the amounts resulted from a programming error when the system was first placed in operation. However, the report could represent amounts collected and owed to the insurance companies. It could also show refunds owed to individuals from over collections. The staff needs to determine which amounts are valid and take corrective action.

RECOMMENDATIONS

- **DOER should correct fiscal year 1988 transactions by recalculating the premium income using information from both the insurance and the payroll systems. Overpayments should be recovered or offset against future payments.**

- **DOER should review and determine the proper insurance carrier accounts for the premiums deposited in the clearing account.**

- **DOER should review the Nonzero Balances report and correct all invalid balances.**

2. Procedures for processing insurance receipts need improvement.

Currently, the department is unable to reconcile total billings to deposits because total current billings and system generated backcharges are unknown. The department bills state agencies and employees for insurance coverage through the state's payroll system. The billings consist of current period charges plus backcharges. A backcharge results from uncollected premiums, and is either system generated or manually input by the Benefits Division. Although the insurance system compares billings to collections on an individual basis, it does not calculate total current billings or system generated backcharges. If this information were known, it would ensure that all billings were collected or listed on a reconciliation report for follow up. This information could also alert the department to potential problems when large or unusual amounts appear on the report.

For those organizations or individuals not on the state's payroll system, such as the University of Minnesota and state employees on leaves of absence, the system does not reconcile billings and collections on an individual basis. These organizations and individuals are referred to as IBU's or individual billing units. The department is currently working with the Department of Administration's Intertech Division to create a program to provide the necessary reconciliation. Until that reconciliation program is operational the Benefits Division is keeping a manual record of amounts billed and collected.

Currently, the division receives the checks, compares them to the amounts billed, and sends them to data entry for input into the insurance system. The department needs this information in the insurance system when the systems reconciliation program becomes operational. Finally, the checks are given to the Accounting Division for deposit into the state treasury.

This process as it now exists, does not adequately safeguard receipts because the person maintaining the accounting records receives the checks. When these two functions are performed by the same person or unit, a necessary process of checks and balances is eliminated. As a result, errors and irregularities are more likely to go undetected. To have a good internal control system, a separation of these two functions is required. To provide the insurance system with the necessary receipt information the Accounting Division could provide either photocopies of checks or a listing of checks deposited. In addition, the department does not reconcile billings to deposits. This procedure ensures that all entries to the insurance system for premiums collected represent actual collections for premiums billed. To ensure the integrity of the reconciliation, someone independent of the receipt and recordkeeping functions needs to perform or review the reconciliation.

RECOMMENDATIONS

- **The department should work with the Department of Administration's Intertech Division to program the insurance system to provide a totals figure for current billings and system generated backcharges. This information should be used to reconcile total billings to deposits.**

- **The department should require that all insurance system receipts come directly into the department's Accounting Division to be properly endorsed and deposited.**

- **Someone independent of cash and recordkeeping functions should reconcile the IBU manual accounting records to the deposits.**

3. <u>DOER does not verify the maximum liability to Blue Cross Blue Shield</u>.

The state's contract with Blue Cross Blue Shield limits the state's liability for insurance claims to 125 percent of income. The contract defines income as monthly enrollments multiplied by BCBS's suggested premiuum. In fiscal year 1988, Blue Cross Blue Shield calculated the state's maximum liability based on its enrollment records and listed coverages. DOER was unable to calculate a reliable maximum liability for the state because enrollment figures on the insurance system were not completely accurate. We have reviewed payroll and deposit documentation and are satisfied that DOER did not overpay Blue Cross Blue Shield. However, since the department did not calculate the state's maximum liability under the contract there was no point of contention on which to challenge the amount specified by Blue Cross Blue Shield.

In the future, DOER plans on periodic comparisons of their enrollment data to Blue Cross Blue Shield's enrollment data. This process will provide reasonable assurance that both parties agree on the enrollment participation and insurance coverages of individuals. DOER can use the agreed upon enrollment count to calculate the states maximum liability under the contract.

RECOMMENDATION

- **DOER should periodically verify its enrollment data to Blue Cross Blue Shield data and independently calculate the state's maximum liability to Blue Cross Blue Shield under the contract.**

4. Controls over workers' compensation and training receipts need to be improved.

DOER administers the workers' compensation program for state and University of Minnesota employees. The Health, Safety, and Workers Compensation Division determines the claim award. The Accounting Division pays the individual and bills the employing department the cost plus an administrative fee. Total receipts for fiscal year 1988 were $14.5 million.

DOER also provides training classes, conferences, and seminars to other state agencies. The Accounting Division bills participating agencies monthly. Fiscal year 1988 receipts were $260,000.

Although the Accounting Division maintains activity ledgers for these programs, they are not reconciled to the statewide accounting system. In one instance, the department recovered $298,572 from a contested workers' compensation claim. The staff deposited the money in the state treasury, but failed to record it in the activity ledger. As a result, the amount was not refunded to the proper agency. The Accounting Division could have detected the error by comparing the ledger entries to the deposits.

The Training Division can waive a fee when a person misses a class because of unexpected circumstances. Currently, the Training Division verbally instructs the Accounting Division to delete the charge. As a result, no documentation exists to support or authorize the ledger entries made to cancel training fees.

RECOMMENDATIONS

- **DOER should reconcile the workers' compensation and training ledgers to the statewide accounting system on a regular basis.**

- **The Training Division should provide the Accounting Division with written authorization to cancel training invoices.**

5. <u>Controls over training equipment need improvement</u>.

The Training Division maintains an inventory of audio-visual equipment for use by its instructors and those of other state agencies. A department requesting training equipment must sign a form which identifies the type of equipment borrowed. However, the item's asset number is not recorded and the equipment is not appropriately checked in when returned to the division.

DOER could not locate $9,200 of training equipment during a recent physical inventory. A later count completed by the training equipment custodian noted another $500 of missing equipment. The missing assets indicate a serious recordkeeping problem as to the whereabouts and disposition of those assets. It may also indicate a loss due to theft or misappropriation.

Unless DOER strengthens its procedures for lending equipment, further problems may occur. The Training Division needs to improve its inventory records and lending procedures. The state's Fixed Asset Record Managements System (FARMS) lists items costing over $500, but DOER has many sensitive items under this limit. Inventory records for these items are necessary. The division could improve its process of lending equipment to other departments through the use of a more complete form. The form could contain a description of the equipment, asset number, signatures for checking out the equipment and signatures for checking the equipment in. The inventory custodian needs to acknowledge the item's return.

Another weakness exists because the Training Division staff perform the inventory counts. Effective internal control provides that someone independent of the custody function participate in the physical inventory counts. This provides better assurance of the assets existence.

RECOMMENDATIONS

- **The Training Division should record the asset number of items taken from inventory, and document its return.**

- **DOER should more aggressively investigate the whereabouts or disposition of its missing assets.**

- **DOER should have someone independent of the Training Division participate in a periodic physical inventory of training equipment.**

State of Minnesota
DEPARTMENT OF EMPLOYEE RELATIONS
3rd Floor
520 Lafayette Road, St. Paul, MN 55155 • 612/296-2616

April 5, 1989

James Nobles, Legislative Auditor
Veterans' Service Building
First Floor
St. Paul, MN 55155

Dear James Nobles:

Enclosed is the response of the Department of Employee Relations to your comments and recommendations resulting from the 1988 audit.

We consider the implementation of these recommendations to be a priority project and will work to complete these changes in conjunction with our other responsibilities and as resources permit. Some of the recommendations have already been implemented and work has begun on implementing others.

I wish to thank you and your staff for the assistance given to us.

Sincerely,

Nina Rothchild

Nina Rothchild
Commissioner

Enclosure

RESPONSE OF THE DEPARTMENT OF EMPLOYEE RELATIONS
TO RECOMMENDATIONS OF THE LEGISLATIVE AUDITOR
SUBMITTED ON MARCH 21, 1989

1. Problems with the insurance system resulting in improper recording of fiscal year 1988 transactions.

RECOMMENDATION: DOER should correct fiscal 1988 transactions by recalculating the premium income using information for both the insurance and the payroll systems. Payments should be recovered or offset against future payments.

DOER RESPONSE: DOER accessed payroll records before authorizing payment to vendors. DOER will recalculate premiums for fiscal 1988 using both the insurance and payroll systems. We will reconcile this amount to what was actually paid to the Health Maintenance Organizations. If overpayments or underpayments are validated, they will be recovered or corrected.

RECOMMENDATION: DOER should review and determine the proper insurance carrier accounts for the premiums deposited in the clearing account.

DOER RESPONSE: DOER is currently reviewing deposits made to the insurance clearing account and reallocating deposits to newly created clearing accounts based upon the three distinct billing cycles. This, coupled with our response to the next recommendation, provides a complete response to the issues addressed by these two recommendations.

RECOMMENDATION: DOER should review the non-zero balances report and correct all invalid balances.

DOER RESPONSE: DOER is reconciling all individual employee clearing accounts with non-zero balances and will be authorizing payments to carriers or refunds to agencies and individuals as appropriate.

2. Procedures for processing insurance receipts need improvement.

RECOMMENDATION: The department should work with the Department of Administration's InterTech Division to program the insurance system to provide a totals figure for current billings and system generated back charges. This information should be used to reconcile total billings to deposits.

DOER RESPONSE: Since the Department of Administration's InterTech no longer does new programming, DOER's Benefit Division has hired a programmer to complete the necessary programming to implement this recommendation.

RECOMMENDATION: The department should require that all insurance system receipts come directly into the department's accounting division to be properly endorsed and deposited.

DOER RESPONSE: Procedures for implementing this recommendation are being worked out within the department. All insurance receipts will go directly to DOER's Accounting Unit for endorsement and deposit.

RECOMMENDATION: Someone independent of cash and recordkeeping functions should reconcile the IBU manual accounting records to the deposits.

DOER RESPONSE: An additional staff member has been requested in our budget document which would allow us to implement this recommendation.

3. <u>DOER does not verify the maximum liability to Blue Cross/Blue Shield</u>.

   RECOMMENDATION: DOER should periodically verify its enrollment data to Blue Cross/Blue Shield data and independently calculate the state's maximum liability to Blue Cross/Blue Shield under the contract.

   DOER RESPONSE: This was not able to be accomplished during the 1988 year due to computer system difficulties but will be performed on a regular basis. It should be noted that the financial agreement negotiated with Blue Cross/Blue Shield of Minnesota for this period provides for an on-going reconciliation process to validate the state's maximum liability. The reconciliation process begins within 90 days of the conclusion of the contract year and continues in six-month cycles until the state and Blue Cross/Blue Shield mutually agree that the terms of the contract have been fully met.

4. <u>Controls over Workers' Compensation and Training Receipts need improvement</u>.

   RECOMMENDATION: DOER should reconcile the Workers' Compensation and Training Ledgers to the statewide accounting system on a regular basis.

   DOER RESPONSE: This recommendation has been implemented. DOER will do a trial balance for both accounts every other month and reconciled to the Statewide Accounting System.

   RECOMMENDATION: The Training Division should provide the Accounting Division with written authorization to cancel training invoices.

   DOER RESPONSE: Procedures are being worked out so the Training Division will provide written authorization to cancel invoices.

5. <u>Controls over training equipment need improvement</u>.

   RECOMMENDATION: The Training Division should record the asset numbers of items taken from inventory, and document its return.

   DOER RESPONSE: DOER will strengthen its procedures for lending equipment to other agencies by establishing a "library card" system containing a description of the equipment, asset number, signature and dates when the item is checked out and returned.

   RECOMMENDATION: DOER should more aggressively investigate the whereabouts or disposition of its missing assets.

   DOER RESPONSE: The assets in question have been fully depreciated, were junk or broken and beyond repair. Bids were taken through Materials Management and the equipment disposed of, but not removed from inventory. DOER will establish more effective controls for inventory and disposal of equipment.

RECOMMENDATION: DOER should have someone independent of the Training Division participate in a periodic physical inventory of training equipment.

DOER RESPONSE: DOER has completed a physical inventory of training equipment and all other equipment in the department conducted by an employee independent of the Custodial function. Inventory records have been brought up-to-date and periodic physical inventories and/or test samples will be conducted on a regular basis.

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