DEPARTMENT OF EMPLOYEE RELATIONS
FINANCIAL AUDIT
FOR THE YEAR ENDED JUNE 30, 1989

MARCH 1990

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

90-14

Veterans Service Building, Saint Paul, Minnesota 55155 • 612/296-4708

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

Senator John E. Brandl, Chairman
Legislative Audit Commission

Members of the Legislative Audit Commission

Ms. Nina Rothchild, Commissioner
Department of Employee Relations

Audit Scope

We have conducted a financial related audit of the Department of Employee Relations as of and for the year ended June 30, 1989. Our audit was limited to only that portion of the State of Minnesota financial activities attributable to the transactions of the Department of Employee Relations, as discussed in the Introduction. We have also made a study and evaluation of the internal control structure of the Department of Employee Relations in effect at June 30, 1989.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial activities attributable to the transactions of the Department of Employee Relations are free of material misstatements.

As part of our study and evaluation of the internal control structure, we performed tests of the Department of Employee Relation's compliance with certain provisions of laws, regulations, contracts, and grants. However, our objective was not to provide an opinion on overall compliance with such provisions.

Management Responsibilities

The management of the Department of Employee Relations is responsible for establishing and maintaining an internal control structure. This responsibility includes compliance with applicable laws, regulations, contracts, and grants. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that:

- assets are safeguarded against loss from unauthorized use or disposition;
- transactions are executed in accordance with applicable legal and regulatory provisions, as well as management's authorization; and
- transactions are recorded properly on the statewide accounting system in accordance with Department of Finance policies and procedures.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Internal Control Structure

For purposes of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- Insurance Trust Fund receipts and disbursements,
- Worker's Compensation receipts and disbursements, and
- Centralized Payroll System.

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

Conclusions

Our study and evaluation disclosed the conditions discussed in findings 1 to 6 involving the internal control structure of the Department of Employee Relations. We consider these conditions to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data.

A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial activities being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We believe none of the reportable conditions described above is a material weakness.

The results of our tests indicate that, except for findings 7 and 8, with respect to the items tested, the Department of Employee Relations complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to items not tested, nothing came to our attention that caused us to believe that the Department of Employee Relations had not complied, in all material respects, with those provisions.

This report is intended for the information of the Legislative Audit Commission and 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 23, 1990.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

END OF FIELDWORK: December 18, 1989

REPORT SIGNED ON: March 16, 1990

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, CPA	Staff Auditor
Ron Mavetz	Staff Auditor
Steve Nartker	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 9, 1990:

Nina Rothchild	Commissioner
Richard Thorkee	Director of Administrative Services
Robert Cooley	Benefits Manager
Robert Erickson	Accounting Supervisor
Lettie Sagisser	Insurance Systems Supervisor
Elizabeth Houlding	Worker's Compensation Supervisor
Allison Huiras	Worker's Compensation Supervisor

DEPARTMENT OF EMPLOYEE RELATIONS

I. INTRODUCTION

The Department of Employee Relations (DOER) is the central personnel staff agency for the executive branch of government. Its duties include personnel, administration, and labor relations. The department also operates the insurance and worker's compensation programs for state and University of Minnesota employees.

The personnel bureau is responsible for recruiting, examining, classifying, compensating, and training employees. It also administers the statewide affirmative action program. The labor relations bureau negotiates collective bargaining agreements and develops compensation plans. The department's administrative function operates the personnel system, administers statewide payroll certifications, and provides support services. DOER received general fund appropriations totalling $5.6 million in fiscal year 1989.

DOER also negotiates with private insurance companies to underwrite the medical, dental, and life insurance plan. The department processes enrollment, collects premiums, and pays insurance companies. Premium receipts were $138 million in fiscal year 1989. It also developed the Public Employees Insurance Program which will provide public employees with insurance benefits.

The department determines and pays worker's compensation claims. These costs are billed to the employer. In fiscal year 1989, DOER received $15.3 million in reimbursements. Part of the worker's compensation program includes training employers in safety.

DOER serves 132 operating agencies, and approximately 35,000 employees. It also responds to the general public seeking information about employment, and organizations involved in human and civil rights issues. Nina Rothchild, the current commissioner, was appointed on January 3, 1983.

DEPARTMENT OF EMPLOYEE RELATIONS

II. CURRENT FINDINGS AND RECOMMENDATIONS

1. The Health, Safety, and Worker's Compensation Division is not adequately monitoring the administrative costs of the worker's compensation program.

The Health, Safety, and Worker's Compensation Division (HSWC) did not adequately control its administrative expenditures during fiscal year 1989. The division borrowed $1.5 million from the general fund to meet its obligations and at June 30, 1989, had a $210,000 deficit in its administrative account.

The following schedule compares actual financial activity to DOER's budget, referred to as the "Annual Spending Plan".

	Actual (1)	Annual Spending Plan (2)
Forwarded from Fiscal Year 1988	$ 248,862	$ 335,000 (3)
Receipts	1,526,034	1,500,000
Disbursements	(1,986,440)	(1,835,000)
Balance June 30, 1989	($ 211,544)	$ 0

Sources: (1) Statewide Accounting Receipt and Disbursement Reports
(2) Fiscal Year 1989 Spending Plan
(3) Office of the Legislative Auditor calculation from the Annual Spending Plan

The division did not adjust its budget when the surplus from the previous fiscal year was less than expected. Although, the division had accounting reports to monitor the status of the budget no action was taken to prevent the shortage.

The division administers the worker's compensation program for state and University of Minnesota employees. The division reviews claims and subsequently pays out worker's compensation benefits. The appropriate state agency must reimburse the division for the cost of benefits, plus a 12 percent administrative fee. Administrative expenditures increased from $1.2 million in fiscal year 1988 to $1.95 million in fiscal year 1989.

The administrative account could continue to experience shortages unless management changes its fiscal practices. A budget is a mechanism for planning and controlling financial activity. However, if revenues or year-end balances are less than expected, the division must either reduce spending or increase the administrative fee.

RECOMMENDATIONS

- **The Health, Safety, and Worker's Division should eliminate the deficit in the administrative account.**
- **The division should monitor the activity of the administrative account and ensure that expenditures do not exceed budgeted expenditures or actual revenue, if less than expected.**

2. The accuracy and integrity of the workers' compensation accounts are questionable.

DOER maintains a separate worker's compensation ledger account for each state agency. It records worker's compensation payments, billings, and receipts to the appropriate state agency ledger. However, after recording such transactions, DOER does not reconcile the balances remaining in the individual agency ledger accounts to the control account.

During fiscal year 1989, DOER failed to record several transactions in its worker's compensation ledgers. These transactions totalled approximately $140,000. Also, the amounts due from two agencies were mistakenly eliminated from the ledger. Although a control account for the worker's compensation program is maintained, the activity affecting its balance is not reconciled to the statewide accounting system.

DOER could have detected the errors by reconciling the ledgers to the control account. A reconciliation of ledger balances to the control account is a key internal control. It ensures that benefits paid, which support subsequent billings, and receipts as reflected on the statewide accounting system, are accurately reflected in the individual ledger accounts. DOER could efficiently detect and correct errors by performing a reconciliation on a monthly basis.

RECOMMENDATION

- **DOER should reconcile the worker's compensation ledgers to its control account and statewide accounting monthly.**

3. PRIOR FINDING NOT RESOLVED: DOER needs to improve recordkeeping for Insurance Trust Fund receipts.

Currently, the department is unable to reconcile insurance billings to deposits. 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. The insurance system 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.

Organizations which do not use the state's payroll system provide DOER with the enrollment information necessary to generate billings. The receipts from such billings represent premiums that are partially paid to the various HMO's. Because of programming errors with enrollment adjustments, the insurance system incorrectly calculated billings to those organizations. Since DOER was unable to rely on the insurance system to determine the correct premium amount the payments to the HMO's were estimated.

Also, the insurance system cannot identify the HMO for which premiums from individuals on a leave of absence and the corresponding employer contribution have been collected. As a result, DOER estimates the premium collected and forwards it to the appropriate HMO.

DOER needs to correct the insurance system programming to provide accurate enrollment figures and adjustments, and a totals figure for current billings and system generated backcharges.

RECOMMENDATION

- **DOER should continue its efforts in programming the insurance system to provide the total amount billed and collected. The department should use this information to reconcile billings to deposits and subsequent HMO and carrier payments.**

4. <u>PRIOR FINDING NOT RESOLVED: DOER needs to resolve insurance system discrepancies</u>.

The Benefits Division adjusts enrollment records for changes in employees coverage. Occasionally, this results in a billing error or improper collection. Differences between billings and collections appear on a reconciliation report each payperiod. However, the division does not always correct these errors. This can result in improper payments to insurance companies or unprocessed refunds.

If DOER does not resolve the errors, the payment shows as an individual account balance and appears on another report (the Nozero Balance Report). This report is a cumulative listing of account balances. Between January and June 1989, the amount of employee collections on this report increased by more than $67,000. The division needs to review these accounts, and determine the necessary corrective action.

RECOMMENDATIONS

- **DOER should complete their review of the reconciliation report each payperiod.**

- **The department should determine proper disposition of the amounts listed on the Nonzero balance report.**

5. PRIOR FINDING NOT RESOLVED: Security over receipts needs improvement.

Insurance premiums and worker's compensation recoveries are not adequately safeguarded against loss. The current procedures allow many individuals to handle the checks before deposit into the state treasury.

The Benefits Division receives and reviews insurance premiums but fails to list checks received before sending to Data Entry for input. As a result, accountability over the checks from the Benefits Division, through Data Entry, and finally into the Accounting Division, is lost.

The Health, Safety, and Worker's Compensation Division prepares a listing of benefit recoveries; however, the division does not compare the listing to actual deposits. A periodic comparison of the list to deposits would ensure that receipts are deposited intact.

Good internal control requires a tracking system for those checks which flow through several divisions or individuals before deposit. The purpose of a listing is to provide assurance that all checks entering the department are finally deposited. This process is necessary under DOER's present practice of allowing its various divisions to receive checks. A preferable alternative to the listing of receipts is to have all departmental receipts go directly to the Accounting Division for immediate deposit. Other divisions could obtain necessary receipt information from listings or photocopies.

Also, within the accounting division, one employee deposits insurance receipts, and compares the deposit to insurance reports. Good internal control requires these two functions to be performed by different individuals.

RECOMMENDATIONS

- **DOER should require that all departmental receipts come directly into the Accounting Division to be properly endorsed and deposited.**

- **Someone independent of the depositing and recordkeeping functions should reconcile deposits and insurance reports.**

6. PRIOR FINDING NOT RESOLVED: DOER does not verify the maximum claim liability to Blue Cross Blue Shield.

DOER does not verify or independently calculate the state's contractual liability, referred to as the "aggregate stop loss," to Blue Cross Blue Shield. Under the contract the state's liability for insurance claims is limited to 125 percent of income. The contract defines income as enrollment multiplied by Blue Cross and Blue Shield's suggested premium. For the 15 month contract period ending December 31, 1988, the state paid Blue Cross $82.3 million.

Although Blue Cross and Blue Shield notifies DOER of its calculation of the state's liability, DOER does not verify this amount. DOER would have better assurance that claim payments do not exceed the contract limit if they independently determined the "aggregate stop loss."

RECOMMENDATION

- **DOER should verify the calculation of the maximum claim liability to Blue Cross and Blue Shield.**

7. DOER did not properly administer or monitor a consulting contract.

DOER inappropriately incurred and paid consultant fees to Touche Ross Company before a contract was signed and funds were encumbered. In addition, total expenses incurred as of June 30, 1989 exceeded the contract amount. The following summary highlights the timing of events concerning this contract:

▪ Contract signed and funds encumbered on February 13, 1989 for:	$80,000
▪ Obligations incurred and paid prior to the contract date:	$88,099
▪ Obligations incurred and paid after the contract date to June 30, 1989:	$58,007
▪ Contract supplement signed in July 1989:	$100,000

This particular contract was the second of two contracts that DOER had with Touche Ross. The other contract related to the Public Employees Insurance Plan. Initially, DOER paid invoices for services identified under the second contract with funds encumbered from the first. In addition, Touche Ross billed DOER the higher service rates under the first contract for services rendered under the second contract. This resulted in an overpayment of $5,681 to the consultant.

Minn. Stat. Chapter 16A.15 requires state agencies to encumber funds prior to incurring obligations. Specifically it provides that "A payment may not be made without prior obligation. An obligation may not be incurred against any fund, allotment, or appropriation unless the commissioner has certified a sufficient unencumbered balance in the fund. An expenditure or obligation authorized or incurred in violation of this chapter is invalid and ineligible for payment until made valid".

The statute also allows the Commissioner of Finance to validate the claim if the services were furnished in good faith. DOER notified the Department of Finance of prior obligations, for one $17,000 invoice; however, subsequent notifications were not sent.

DOER needs to follow state law concerning the establishment of a valid encumbrance before incurring contractual obligations. It must also exercise a more stringent monitoring process whereby the contract provisions are followed, funds encumbered under one contract aren't used to pay for services rendered under another or that contractual services provided are overbilled.

RECOMMENDATIONS

- **DOER should not incur or pay any obligations until after an encumbrance is established as provided for in Minn. Stat. Section 16A.15.**
- **DOER should recover $5,681 in overpayments made to the consultant as a result of the consultants over billing under the contract.**
- **The staff should compare invoices to the contract rates.**

8. <u>DOER paid some administrative costs for the Dependent Care Program from the wrong accounts</u>.

DOER began operating the dependent care expense program in 1989. This program provides tax benefits to employers and employees through payroll deductions of child care costs. The department improperly paid $16,359 of dependent care administrative costs from the General and Insurance Trust Funds during fiscal year 1989.

Under this program, state employees may elect to have child care costs withheld from their payroll check. The state uses the amount withheld to pay the child care providers. According to federal tax law, the state does not pay FICA tax on the amount deducted from the employee. The Laws 1988, Chapter 686 authorizes the use of the FICA savings to fund the administrative costs for this program.

The planning and initial operating costs of the program were paid out of the general and insurance trust funds until sufficient FICA savings had been obtained. We believe DOER did not have the authority to fund expenses in this manner and should have requested a loan from the Department of Finance. To correct the error, the department needs to transfer $13,846 to the General Fund and $2,514 to the Insurance Trust Fund. The General Fund portion must be cancelled because it relates to a prior year.

RECOMMENDATION

- **DOER should make the necessary transfer from the dependent care expense account to the General and Insurance Trust Funds.**

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

March 9, 1990

James Nobles
Legislative Auditor
Veterans Service Building, 1st Floor
St. Paul, MN 55155

Dear James Nobles:

Enclosed is the response of the Department of Employee Relations to the comments and recommendations resulting from your audit report for the ending June 30, 1989.

Many of the recommendations have been implemented and work is being done to implement others. DOER will work to complete these changes as resources permit.

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

Sincerely,

Nina Rothchild, by LT.

Nina Rothchild
Commissioner

Response of the Department of Employee Relations to Recommendations of the Legislative Auditor for Fiscal Year Ending June 30, 1989

CURRENT FINDINGS AND RECOMMENDATIONS

1. **THE SAFETY AND WORKERS' COMPENSATION DIVISION IS NOT ADEQUATELY MONITORING THE ADMINISTRATIVE COSTS OF THE WORKERS' COMPENSATION PROGRAM.**

COMMENT:

The loans totaling 1.5 million from the general fund should not be referenced in context with the administrative budget appropriation, as these loans were for meeting the obligation of the fund for workers' compensation benefits, claims system, and payment to the special compensation fund at MN/DOT.

RECOMMENDATION:

The Safety and Workers' Compensation Division should eliminate the deficit in the administrative account.

DOER RESPONSE:

The Safety and Workers' Compensation Division will eliminate the deficit in the administrative account over the next 15 months by changing the funding formula which will generate increased revenue. This will be implemented July 1, 1990.

RECOMMENDATION:

The division should monitor the activity of the administrative account and ensure that expenditures do not exceed budgeted expenditures or actual revenue, if less than expected.

DOER RESPONSE:

In July of 1989, the Safety and Workers' Compensation Division for the first time in the history of the fund developed administrative appropriation and individual AID's to clearly identify expenditures and what they were for. This was necessary to identify what it truly was costing the state to administer the self-insurance program. In the future, these accounts, along with the additional accounting activities, will monitor the self-insurance program expenditures to ensure they do not exceed budgeted expenditures or actual revenue. If actual revenue is less than budgeted expenditures, the fee will be adjusted accordingly to insure costs associated with workers' compensation claims are controlled.

A series of reports and meetings have been established which will provide information on a regular basis to assist in monitoring and controlling the administrative account.

2. **<u>THE ACCURACY AND INTEGRITY OF THE WORKERS' COMPENSATION ACCOUNTS ARE QUESTIONABLE.</u>**

RECOMMENDATION:

DOER should reconcile the workers' compensation ledgers to its control account and statewide accounting monthly.

DOER RESPONSE:

A procedure has been implemented to reconcile the workers' compensation ledger to its control account and statewide accounting on a quarterly basis. The first reconciliation was completed for December 31, 1989.

COMMENT:

The transactions totaling $140,000 mentioned in the audit report have been recorded in this year's ledger.

3. **<u>PRIOR FINDING NOT RESOLVED. DOER NEEDS TO IMPROVE RECORDKEEPING FOR INSURANCE TRUST FUND RECEIPTS.</u>**

RECOMMENDATION:

DOER should continue its efforts in programming the insurance system to provide the total amount billed and collected. The department should use this information to reconcile billings to deposits and subsequent HMO and carrier payments.

DOER RESPONSE:

Implemented as of December 1989 - System calculates total current billings for all billing transactions processed through the bi-weekly payroll system. To be implemented by mid-March - Programming to total the systems generated back-charges for the payroll system.

Completed programming to calculate systems generated billings for organizations which do not use the state's payroll system. Systems billings and reconciliations accurately reflect enrollments and adjustments for these groups. DOER will be current on all billings and carrier payments for these groups by July, 1990.

Implemented programming to generate billings for individuals on leaves of absence. InterTech has committed a Systems Analyst to complete the programming for enrollments, adjustments and reconciliations for this group.

4. **<u>PRIOR FINDING NOT RESOLVED. DOER NEEDS TO RESOLVE INSURANCE SYSTEM DISCREPANCIES.</u>**

RECOMMENDATION:

DOER should complete their review of the reconciliation report each pay period.

DOER RESPONSE:

Corrections have always been made when discrepancies appear on reconciliation reports, but not always in the pay cycle in which they appear. DOER has implemented procedures to insure that the review always occurs each pay period.

RECOMMENDATION:

The department should determine proper disposition of the amounts listed on the non-zero balance report.

DOER RESPONSE:

The backlog on the proper disposition of amounts listed on non-zero balance reports will be resolved after resolution of issues addressed in item 3 above. This should be resolved after July, 1990.

5. **<u>PRIOR FINDINGS NOT RESOLVED. SECURITY OVER RECEIPTS NEEDS IMPROVEMENT.</u>**

RECOMMENDATION:

DOER should require that all department receipts come directly to the Accounting Division to be properly endorsed and deposited.

Someone independent of the depositing and recordkeeping function should reconcile deposits and insurance reports.

DOER RESPONSE:

Partially implemented. All receipts for the Benefits Division (except COBRA) come directly to the Accounting Division for endorsement and deposit. A similar procedure for COBRA will be implemented in the near future.

The Accounting Division Supervisor who is independent of the deposit function is reconciling deposits with the insurance reports.

The Safety and Workers' Compensation Division currently receives and prepares a list of all checks. The checks are forwarded to the Accounting Division for deposit.

The list of checks received is compared to deposits monthly by the Accounting Division Supervisor who is independent of the individual in Safety and Workers' Compensation receiving and listing checks.

6. **<u>PRIOR FINDING NOT RESOLVED. DOER DOES NOT VERIFY THE MAXIMUM CLAIM LIABILITY TO BLUE CROSS/BLUE SHIELD.</u>**

RECOMMENDATION:

DOER should verify the calculation of the maximum claim liability to Blue Cross and Blue Shield.

DOER RESPONSE:

Implemented systems changes to produce enrollment counts for each billing cycle. DOER enrollment records will be reconciled with carrier enrollment records each quarter. Verification of the calculation of claims liability will begin with the first quarter of 1990.

7. DOER DID NOT PROPERLY ADMINISTER OR MONITOR A CONSULTING CONTRACT.

RECOMMENDATION:

DOER should not incur or pay any obligations until after an encumberance is established as provided for in Minnesota Statutes § 16A.15.

DOER RESPONSE:

DOER has processed an M.S. 16A.15 memorandum for the full amount of the obligation and has received approval from the Department of Finance for payment. All contracts will be closely monitored in the future to avoid payment before a contract is properly signed and encumbered in accordance with the statute.

RECOMMENDATION:

DOER should recover $5,681.00 in overpayments made to a consultant as a result of the consultants overbilling under the contract.

DOER RESPONSE:

The Employee Benefits Division has contacted the consultant to recover the $5,681.00 in overpayments.

RECOMMENDATION:

The staff should compare invoices to the contract rates.

DOER RESPONSE:

Both the Benefits Division and Accounting Division will compare invoices to the contract rates before payments are made under the consulting contract to avoid overpayments and to assure the correct rates are applied.

8. DOER PAID SOME ADMINISTRATIVE COSTS FOR THE DEPENDENT CARE PROGRAM FROM THE WRONG ACCOUNTS.

RECOMMENDATION:

DOER should make the necessary transfer from the dependent care expense account to the General and Insurance Trust Funds.

DOER RESPONSE:

On March 7, 1990, $13,846.00 was transferred to the General Fund and $2,514.00 to the Insurance Trust Fund as recommended.

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