DEPARTMENT OF LABOR AND INDUSTRY
FINANCIAL AUDIT
FOR THE FOUR YEARS ENDED JUNE 30, 1989

APRIL 1990

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

90-24

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

DEPARTMENT OF LABOR AND INDUSTRY

FINANCIAL AUDIT
FOR THE FOUR YEARS ENDED JUNE 30, 1989

Public Release Date: April 20, 1990 No. 90-24

OBJECTIVES:

- EVALUATE INTERNAL CONTROL STRUCTURE: Special Workers' Compensation Fund collections and disbursements; distribution of the Occuptional Safety and Health Administration Program grant funds; penalties collected for the Occupational Safety and Health Program; fees collected by the Code Enforcement Division; fees collected by the workers' compensation records center; fees collected by the Labor Standards Division; penalties collected by the Labor Standards Division; administrative disbursements, and payroll.

- TEST COMPLIANCE WITH CERTAIN FINANCE-RELATED LEGAL PROVISIONS.

CONCLUSIONS:

We found four areas where the internal control structure needed improvement:

- The department needs to verify the accuracy of Special Workers' Compensation Fund assessments.
- Internal controls over some departmental receipts are inadequate.
- The department did not adequately review and edit the Labor and Education Advancement 1989 grant payments.
- The department does not have procedures for security over fixed assets.

We found that the department had complied with finance-related legal provisions.

Contact the Financial Audit Division for additional information.
(612) 296-1730

STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator John E. Brandl, Chairman
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Kenneth B. Peterson, Commissioner
Department of Labor and Industry

Audit Scope

We have conducted a financial related audit of the Department of Labor and Industry as of and for the four years 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 Labor and Industry, as discussed in the Introduction. We have also made a study and evaluation of the internal control structure of the Department of Labor and Industry 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 Labor and Industry are free of material misstatements.

As part of our study and evaluation of the internal control structure, we performed tests of the Department of Labor and Industry'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.

For those aspects of the department which have a material impact on the state's various funds and account groups shown on the financial statements, we tested compliance with finance-related legal provisions as part of our fiscal year 1986, 1987, and 1988 Statewide Audits.

Management Responsibilities

The management of the Department of Labor and Industry 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:

- Special Workers' Compensation Fund collections and disbursements;
- distribution of the Occupational Safety and Health Administration Program grant funds;
- penalties collected for the Occupational Safety and Health Program;
- fees collected by the Code Enforcement Division;
- fees collected by the workers' compensation records center;
- fees collected by the Labor Standards Division;
- penalties collected by the Labor Standards Division;
- administrative disbursements, and
- payroll.

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.

Audit Qualification

During the period under audit, we found that one employee had been consistently overpaid for travel expenses. We brought the matter to the attention of the department, which found that other employees in the OSHA Division also were overpaid. The department is working to collect the overpayments from the employees. We believe the overpayments were confined to the Occupational Safety and Health Administration (OSHA) Division.

Conclusions

Our study and evaluation disclosed the conditions discussed in findings 1 to 4 involving the internal control structure of Labor and Industry. 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.

We also noted other matters involving the internal control structure and its operation that we reported to the management of the Department of Labor and Industry at a meeting held on February 8, 1990.

Except for the issue raised in the Audit Qualification paragraph, the results of our tests indicate that, with respect to the items tested, the Department of Labor and Industry complied, in all material respects, with the provisions referred to in the audit scope paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that the Department of Labor and Industry 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 Labor and Industry. This restriction is not intended to limit the distribution of this report, which was released as a public document on April 20, 1990.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

END OF FIELDWORK: December 21, 1989

REPORT SIGNED ON: April 12, 1990

DEPARTMENT OF LABOR AND INDUSTRY

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AUDIT PARTICIPATION

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

John Asmussen, CPA	Deputy Legislative Auditor
Warren Bartz, CPA	Audit Manager
Mary G. Lentsch	Auditor-in-Charge
Amy Vanderziel	Auditor

EXIT CONFERENCE

The findings and recommendations in this report were discussed with the following staff of the Department of Labor and Industry at an exit conference held on February 8, 1990:

Kenneth B. Peterson	Commissioner
David Abrams	Deputy Commissioner
Ann Clayton	Assistant Commissioner
Linda Finney	Assistant Commissioner
Anina Bearrood	Accounting Director
Gary Norell	Accounting Officer
Charles Curren	Policy Analysis Director
Leo Eide	Special Compensation Fund Director
Gail Keckhafer	Special Compensation Fund Assistant Director
Peter Clark	Occupational Safety and Health Enforcement Division Director
Martha Watson	Human Resources Director
Kathy Novosad	Code Enforcement Office Supervisor

DEPARTMENT OF LABOR AND INDUSTRY

I. INTRODUCTION

The mission of the Department of Labor and Industry is to help Minnesota work. The department is primarily a regulatory agency concerned with protecting the rights of working people in Minnesota. The department consists primarily of three divisions: Workers' Compensation, Regulation and Enforcement, and General Support. There are other divisions and sections which provide advisory services to employers and the general public. The department seeks to preserve the human and material resources of the state by providing safe and healthful working environments, assuring payment of legal compensation for work performed, administering apprenticeship programs, and providing care and benefits for individuals suffering from occupational injuries. The department also provides general protection to the public by licensing and inspecting establishments operating high pressure boilers and steam equipment.

The Department of Labor and Industry is governed generally by Minn. Stat. Chapters 175 to 178, Chapters 181 to 184 and 326. These chapters create the agency and establish the general purposes for its financial transactions. Specifically, Minn. Stat. 176 provides legal provisions governing the workers' compensation laws. Minn. Stat. Chapter 182 establishes the Occupational Safety and Health (OSHA) Program which is administered through the department and received federal funding of $2.25 million for fiscal year 1989.

Administrative costs of the Department of Labor and Industry are financed primarily through General Fund appropriations and federal grants. Fiscal year 1989 expenditures of the department totalled $117,713,238. The fund breakdown is shown below.

	GENERAL FUND	FEDERAL FUND	SPECIAL COMPENSATION FUND	OTHER FUNDS
Personnel Services	$2,421,693	$1,438,332	$ 6,286,513	$1,075,415
Expense & Contractual Services	576,221	340,785	1,237,587	304,656
Workers' Compensation Claims	0	0	102,478,304	0
Supplies & Materials	83,604	67,169	117,110	46,732
Equipment	90,214	47,703	246,683	16,878
Grants	166,624	671,015	0	0
TOTAL	$3,338,356	$2,565,004	$110,366,197	$1,443,681

(Source: Managers' Financial Report as of September 2, 1989.)

In addition, the Department of Labor and Industry collected revenue of approximately $107.9 million for the Special Workers' Compensation Fund during fiscal year 1989.

DEPARTMENT OF LABOR AND INDUSTRY

II. CURRENT FINDINGS AND RECOMMENDATIONS

1. The department needs to verify the accuracy of Special Workers' Compensation Fund assessments.

Labor and Industry is not verifying the amounts reported on all of the assessment reports. Minn. Stat. Section 176.129 provides that every employer pay to the Department of Labor and Industry for the benefit of the Special Compensation Fund (SCF) a lump sum amount equal to 31 percent of the total compensation payable. In fiscal year 1989, total receipts generated from these assessments approximated $104 million. Both workers' compensation self-insurers and workers' compensation insurers are required to file semiannual reports which summarize the workers' compensation benefits paid during the preceding six month period. However, only the self-nsurers are required to attach detail of the benefits paid. Without verifying the accuracy of the assessments, Labor and Industry may not be collecting all of the money due to the SCF.

Labor and Industry staff informed us that insurers were not required to provide this type of detail, because the insurers submitted a similar report to the Department of Commerce. Prior to fiscal year 1989, these reports were compared on a yearly basis for consistency. This practice was discontinued, because many factors made a full reconciliation difficult. We believe the department needs some type of mechanism to verify the validity of the assessment reports. Possible alternatives include reasonableness tests, internal editing, or on-site auditing of insurers' records.

RECOMMENDATION

- **The Department of Labor and Industry should verify the amounts reported on the semiannual assessment reports submitted by the workers' compensation insurers.**

2. Internal controls over some departmental receipts are inadequate.

Labor and Industry does not have adequate separation of duties over some receipts. It does not deposit some receipts timely, does not write off some outstanding accounts properly, and does not restrictively endorse some checks immediately upon receipt. Without adequate separation of duties the chance that errors or irregularities could occur and go undetected increases. The practices of not restrictively endorsing checks immediately nor depositing checks promptly increases the chances of loss or theft. Because Labor and Industry is not writing off outstanding accounts properly, they are in violation of statutory requirements. Below is a discussion of these problems.

Receipt duties are inadequately separated in the photocopy area. Inadequate separation of duties in the this area was first addressed in our audit report for the fiscal year ended June 30, 1985. The department attempted to revise procedures, but we found the problem still exists. One individual is still responsible for almost every aspect of the receipts process in the workers' compensation records area. The workers' compensation record center has a copying machine available for attorneys, insurance companies, or individuals who desire photocopies of documents relating to their individual case. A fee is charged by the records center for the copies made including sales tax and postage charges. For fiscal years 1986, 1987, 1988, and 1989, photocopy receipts totalled $38,747, $47,653, $54,762, and $58,938, respectively. Although the amount of cash receipts for photocopy fees is small compared to total departmental receipts, having one individual involved in most aspects of a cash operation is not desirable.

Both the OSHA Division and the workers' compensation records area also are not consistently depositing receipts promptly. For example, in May 1989, OSHA held $2,800 for eight days before depositing the receipts with the state treasurer. The receipts collected in the workers' compensation records area, which exceed $250 a day, sometimes are deposited on a weekly basis. Minn. Stat. Section 16A.275 requires receipts to be deposited once they accumulate to $250 or more. Without prompt depositing, Labor and Industry is in violation of this statutory requirement.

The OSHA Division is also writing off bad debts up to $200 without going through the Executive Council. While Minn. Stat. Section 10.12 allows agency heads to cancel any draft or account when the amount involved is $100 it specifically states:

> When any draft or account for a sum in excess of $100 due to the state is found to be uncollectible by any department, it shall report such fact to the executive council, and the executive council may cancel such draft or account upon the approval of the attorney general.

Finally, Labor and Industry does not require some divisions to restrictively endorse receipts immediately upon receipt. The divisions involved are: Labor Standards, Rehabilitation and Medical, OSHA, and the workers' compensation records center. Checks are received at the divisions where they are processed and prepared for deposit. The receipts are then sent to the accounting section where they are restrictively endorsed. Without a restrictive endorsement, the possibility of theft increases.

RECOMMENDATIONS

- The Department of Labor and Industry should separate duties in the photocopy area.

- The Department of Labor and Industry should deposit receipts promptly in accordance with Minn. Stat. Section 16A.275.

RECOMMENDATIONS (Continued)

- **The Department of Labor and Industry should write off uncollectible accounts through the Executive Council in accordance with Minn. Stat. Section 10.12.**

- **The Department of Labor and Industry should require all divisions to restrictively endorse checks immediately upon receipt.**

3. <u>The department did not adequately review and edit the Labor and Education Advancement Program (LEAP) 1989 grant payments</u>.

The Department of Labor and Industry did not verify the accuracy of the reports received from the LEAP participants. Without verifying the mathematical accuracy of reported amounts, errors could remain undetected.

LEAP is designed to increase the participation of minorities and women in the labor force of the apprenticing trades. Since 1983, Labor and Industry has been appropriated money to administer LEAP. Participants are required to match a portion of the state funding with nonstate contributions.

Labor and Industry did not adequately review and edit the expenditure reports nor assure that matching requirements were met. The grantees submitted monthly expenditure reports which broke down the costs incurred during the previous month. The reports provided both monthly and cumulative totals. Payments made to the participants were based on these reports. Labor and Industry did not verify the accuracy of the final cumulative totals for fiscal year 1989. Inconsistencies were noted in some of the expenditure reports. It appears there was an overpayment to the Minneapolis Urban League.

For the 1989 fiscal year, the Minneapolis Urban League was paid $135,750 for program activities; however, the final report indicated total program expenditures of only $134,759, or an overpayment of $991. We noted another inconsistency by comparing the monthly reports and summarizing the amounts reported as current expenditures. Our analysis indicated program activities for the year totalled approximately $131,190, or a possible overpayment to the Minneapolis Urban League of $4,600.

The program appears to be growing. Because continuation of state funding is anticipated and the number of participants are increasing, it is important to establish and maintain strong controls. These controls must include ensuring that any matching requirements are met.

RECOMMENDATION

- **Labor and Industry should review the fiscal year 1989 reports and determine whether it overpaid the Minneapolis Urban League. It should recover any overpayment. All future reports should be reviewed to ensure both accuracy and consistency from month to month.**

4. <u>The Department of Labor and Industry does not have procedures for security over the state's fixed assets</u>.

Labor and Industry has not conducted a complete physical inventory of equipment for three years. Because they have not taken a complete physical inventory the accuracy of fixed assets as recorded on the statewide fixed asset records management system (FARMS) has not been verified. The total book value, as shown on FARMS, was $1,810,797 as of March 6, 1990. The net book value after depreciation was $746,310.

The entire department relocated from one building to another during June 1988. A physical inventory was not conducted before the move, nor has one been performed since the move. It is especially important during a complete relocation to ensure that all assets are accounted for. Purchases of equipment have been significant. During fiscal year 1989, Labor and Industry spent $401,478 on equipment, as shown in the Introduction.

RECOMMENDATION

- To improve the accuracy and security of fixed assets, the Department of Labor and Industry should conduct a complete physical inventory of equipment and perform annual spot-checks.

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April 10, 1990

James R. Nobles, Legislative Auditor
John Asmussen, Deputy Legislative Auditor
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Dear Gentlemen:

We appreciate the opportunity to review and comment on the issues addressed in your draft audit report completed on this Department for the four years ending June 30, 1989. Along with the audit, you studied and evaluated the Department's internal control structure in effect as of June 30, 1989.

We agree with the recommendations stated in the report and have taken steps to address them. Each is discussed below.

The first recommendation is that the Department verify the accuracy of the Special Workers' Compensation Fund assessments on insurers and self-insurers. In the past we have verified assessments. However, consistent with your comments, we are now formalizing existing procedures for reasonableness testing and internal editing of the accuracy of assessment reporting. This will be accomplished by June 30, 1990.

In addition, we will be seeking additional information from other agencies and organizations involved in workers' compensation, such as the Minnesota Workers' Compensation Insurers' Association, against which reports may be compared for reasonableness. With that information, we will develop additional reasonableness testing procedures for both insurer reports and self-insurer detailed reports. The Department will develop a pilot test of these new procedures by September 30, 1990. Final implementation of new tests is expected by September 30, 1991. Finally, we intend to conduct field audits of at least two major insurance company reports within the next 18 months and continue to conduct such audits as time goes on.

Your second recommendation deals with inadequate internal controls over certain departmental receipts. The actual recommendations are in four parts. The first is separating duties in the photocopy area. These duties were separated in 1987, however, the reconciliation of the receipt ledger and the accounts receivable did not take place. The records supervisor will reconcile the receipt ledger and the accounts receivable log monthly beginning May 1, 1990.

The second part of this recommendation is that receipts should be promptly deposited in accordance with Minn. Stat. § 16A.275. Those individuals responsible for accounts receivable in OSHA, the Special Compensation Fund, Rehabilitation and Medical Affairs, and the Records copy area are now and will continue to send all receipts to the Department's Accounting unit for deposit on a daily basis.

The third recommendation covers the policy of the OSHA unit of writing off bad debts up to $200 without going to the Executive Council. This policy was arrived at with the approval of the unit's Special Assistant Attorney General. The policy has now been changed to make it in accordance with the law so that in the future uncollectibles of over $100 shall be referred to the Executive Council.

Finally, Labor Standards, OSHA, and Workers' Compensation units are each restrictively endorsing checks immediately upon receipt.

The next recommendation was that the Department should review FY 1989 reports to determine whether the Minneapolis Urban League was overpaid for its Labor Education Advancement Program (LEAP). When your audit was conducted, the Urban League's final report had not been received. Since then, its expenditure report for FY 1989 has been submitted. It certifies total state fund expenditures of $135,750, the amount of the grant, in addition to $56,082 in non-state matching funds. We have reviewed the monthly expenditure reports for FY 1989 and found that no overpayment did occur. However, the expenditure report form has been revised to: facilitate better reporting; provide for more accurate verification; improve the consistency of month-to-month reporting; and improve the documentation of matching non-state funds. We have also implemented internal checks to insure that LEAP grantees are not overpaid.

The fourth recommendation was to conduct a complete physical inventory of equipment and perform annual spot checks. Spot checks have been done on a routine basis since September 1986. However, the report is correct in that there has not been complete physical inventory of equipment conducted for three years. A complete physical inventory was initiated January 1990 which we hope to have completed in the summer of 1990. Every three years thereafter there will be a complete physical inventory conducted.

We expect the implementation of these recommendations to improve the Department's operations. All either have been implemented or are in the process. I appreciate the cooperation of you and your staff during this audit. I sincerely believe that your recommendations will enhance Labor and Industry's effectiveness in serving the public.

Sincerely yours,

Ken Peterson
Commissioner

KP/jk