File

MINNESOTA DEPARTMENT OF LABOR AND INDUSTRY
FINANCIAL AUDIT
FOR THE YEAR ENDED JUNE 30, 1990

MARCH 1991

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

91-14

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

DEPARTMENT OF LABOR AND INDUSTRY

FINANCIAL AUDIT
FOR THE YEAR ENDED JUNE 30, 1990

Public Release Date: March 29, 1991 No. 91-14

OBJECTIVES:

- EVALUATE INTERNAL CONTROL STRUCTURE: Special Workers' Compensation Fund collections and disbursements; fees collected by the Code Enforcement Division, fees and penalties collected by the Labor Standards Division, and administrative disbursements.

- TEST COMPLIANCE WITH CERTAIN FINANCE-RELATED LEGAL PROVISIONS.

CONCLUSIONS:

We found one area where the internal control structure needed improvement:

- The department needs to test the accuracy of Special Workers' Compensation Fund assessments.

We found that the department had not complied with finance-related legal provisions in one area:

- The department overspent its General Fund appropriation by not paying for Attorney General legal fees.

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

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

Representative Dee Long, Acting Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. John Lennes, Commissioner
Minnesota Department of Labor and Industry

Audit Scope

We have conducted a financial related audit of the Minnesota Department of Labor and Industry as of and for the year ended June 30, 1990. Our audit was limited to only that portion of the State of Minnesota financial activities attributable to the Minnesota Department of Labor and Industry, as discussed in the Introduction. We have also made a study and evaluation of the internal control structure at June 30, 1990.

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 Minnesota 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 Minnesota 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.

Management Responsibilities

The management of the Minnesota 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;
- fees collected by the Code Enforcement Division;
- fees and penalties collected by the Labor Standards Division; and
- administrative disbursements.

For the internal control structure categories listed, 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 condition discussed in finding 2 involving the internal control structure of the Minnesota Department of Labor and Industry. We consider this condition to be a reportable condition 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 do not believe the reportable condition described is a material weakness.

We also noted other matters involving the internal control structure that we reported to the management of the Minnesota Department of Labor and Industry at the exit conference held on December 21, 1990. We discussed both findings with Commissioner Lennes after his appointment.

The results of our tests indicate that, except for the issue discussed in finding 1, the Minnesota Department of Labor and Industry 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 Minnesota 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 Minnesota 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 March 29, 1991.

We would like to thank the Minnesota Department of Labor and Industry staff for their cooperation during this audit.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

END OF FIELDWORK: December 12, 1990

REPORT SIGNED ON: March 22, 1991

MINNESOTA 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. L. Jacobson, CPA	Auditor-in-Charge

EXIT CONFERENCE

The findings and recommendations in this report were discussed with the following staff of the Minnesota Department of Labor and Industry on December 21, 1990:

David Abrams	Commissioner
Ann Clayton	Assistant Commissioner, Workers' Compensation Division
Donald Jackman	Acting Assistant Commissioner, Regulation and Enforcement
Anina Bearrood	Accounting Director
Leo Eide	Special Compensation Fund Director
James Berg	Code Enforcement Director
Darlene Hueser	Labor Standards Acting Director

MINNESOTA DEPARTMENT OF LABOR AND INDUSTRY

I. INTRODUCTION

The mission of the Department of Labor and Industry is to help Minnesota work. It is primarily a regulatory agency concerned with protecting the rights of working people in Minnesota. The department consists mainly of three divisions: Workers' Compensation, Regulation and Enforcement, and General Support. Other divisions and sections 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. Kenneth Peterson served as commissioner from October 3, 1988 until his resignation on December 7, 1990. David Abrams served as commissioner from December 10, 1990 to January 7, 1991. Ann Clayton served as acting commissioner until John Lennes was appointed commissioner effective January 31, 1991.

The Department of Labor and Industry is governed generally by Minn. Stat. Sections 175 to 178, 181 to 184 and 326. These sections create the agency and establish the general purposes for its financial transactions. Specifically, Minn. Stat. Section 176 provides legal provisions governing the workers' compensation laws. Minn. Stat. Section 182 establishes the Occupational Safety and Health (OSHA) Program, which is administered through the department and received federal funding of $2.5 million for fiscal year 1990.

Administrative costs of the Department of Labor and Industry are financed primarily through General Fund appropriations and federal grants. Fiscal year 1990 expenditures and obligations of the department totalled $117,435,042. The fund breakdown is shown below.

	General Fund	Federal Fund	Special Workers' Compensation Fund	Other Funds
Personnel Services	$ 3,935,626	$1,104,363	$ 6,966,304	$142,092
Expense & Contractual Services	853,491	980,858	1,822,830	89,821
Workers' Compensation Claims	0	0	99,121,894	0
Supplies & Materials	84,063	33,685	286,320	9,461
Equipment	39,978	22,278	582,844	8,439
Grants	215,000	0	0	0
Other	11,656	299,399	823,090	1,550
TOTAL	$ 5,139,814	$2,440,583	$109,603,282	$251,363

Source: *Managers' Financial Report* as of September 1, 1990.

In addition, the Department of Labor and Industry collected assessment and investment revenue of approximately $115.8 million for the Special Workers' Compensation Fund during fiscal year 1990.

II. CURRENT FINDINGS AND RECOMMENDATIONS

1. The Department of Labor and Industry overspent its General Fund appropriation.

Labor and Industry did not pay some legal fees due to the Attorney General's Office (AGO). The department received legal services from the AGO during fiscal year 1990 totaling $286,658. The department paid legal fees totaling $221,140 from the Special Workers' Compensation Fund and Federal Fund. However, it did not pay for the remaining $65,518 from the General Fund appropriation. The department did not have enough fiscal year 1990 General Fund money remaining to pay for these legal services. At the beginning of the year the department was aware that they would incur these obligations, which were to be paid out of all three funds. Labor and Industry did not pay the General Fund portion even though it received quarterly billings. The department has also failed to pay for some legal services received prior to 1990. As a result, it has accumulted a $190,000 liability against its General Fund appropriations.

Minn. Stat. Section 10.17 states that it is unlawful for any state official to incur indebtedness on behalf of the state in excess of their appropriation. The department has exceeded its General Fund appropriation by incurring an obligation for these legal fees and not having money available to pay the fees.

RECOMMENDATIONS

- **Labor and Industry should resolve its outstanding liability for Attorney General legal fees.**

- **Labor and Industry should follow Minn. Stat. Section 10.17 and only spend available appropriations.**

2. PRIOR FINDING PARTIALLY IMPLEMENTED. The department needs to test the accuracy of Special Workers' Compensation Fund assessments.

Labor and Industry is not exercising reasonable effort to verify the amounts reported on all assessment reports. Minn. Stat. Section 176.129 provides that every employer pay the Special Compensation Fund (SCF) a lump sum amount equal to 31 percent of the total compensation payable. In fiscal year 1990, total receipts generated from these assessments approximated $113 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. The department checks the mathematical accuracy of assessment reports, but does not examine the validity of the amounts reported. Only the self-insurers are required to attach detail of the benefits paid. Without examining the accuracy of the assessments, Labor and Industry may not be collecting all of the money due to the SCF.

Since we first cited this concern last year, the department has taken limited action. Thus, this problem still exists. The department questions assessment reports which contain negative amounts. However, department staff told us it was an infrequent occurrence. The department prepared a schedule comparing the annual amount of assessments paid in to the annual amount of claims paid out for each insurer. However, this schedule is being used for informational purposes and not as a tool for any type of reasonableness testing. In addition, the department has been trying to establish an internal audit function within the SCF area. The former commissioner had set an implementation date of June 1991 for conducting field audits of insurance company reports. We believe the department must implement a reasonable process for examining assessments.

RECOMMENDATION

- The Department of Labor and Industry should improve its procedures for verifying the amounts reported on the semiannual assessment reports submitted by the workers' compensation insurers.

Minnesota
Department of Labor and Industry

443 Lafayette Road
St. Paul, Minnesota 55155
(612) 296-6107

Telecommunication Device
for the Deaf (612) 297-4198

FAX (612) 297-1329

March 19, 1991

James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Veterans Service Building
St. Paul, MN 55155

Dear Mr. Nobles:

Thank you for the opportunity to review and comment on the draft report summarizing the financial-related audit of this Department for the year ended June 30, 1990.

The first finding and recommendation concerns unpaid legal fees due the Attorney General's Office. The conclusion of the audit is that the Department "overspent its General Fund appropriation." The audit further recommends that Labor and Industry "resolve its outstanding liability for Attorney General legal fees."

Frankly, we cannot disagree with the finding of overspending. It is apparent that the previous administration made a calculated decision not to pay the Attorney General fees. That is not a decision that we would have made. Indeed, it is our intent to meet all such expenses incurred since January 6, 1991. However, we reject the notion that we are to be held liable for the actions of our predecessors in this matter, which we can neither justify nor explain. Given our current budget constraints, any attempt to make such compensation would seriously damage Labor and Industry's ability to meet many of its statutory obligations. The overall impact would amount to over a third of a million dollar penalty because we would have to spend almost $200,000 more than the previous administration did just to maintain current levels of legal service even if costs are frozen, plus actually paying another $118,000 in back obligations that we had nothing to do with.

The second finding is really a repeat of one first raised in the 1989 audit, and has to do with the need to test the accuracy of Special Compensation Fund assessments. The inclusion of this finding in the current report comes as a surprise, especially since the Department initiated what it believed to be responsible and timely corrective procedures as a result of the earlier audit.

These procedures were first discussed with your office during the 1989 audit exit interview, and subsequently confirmed in a letter from then-commissioner Ken Peterson (copy enclosed). Then, and in subsequent contacts with your representatives, Department personnel state that they had the clear impression that they were satisfying the concerns raised.

By way of review, the Department's commitment was to begin the process of auditing the reporting procedures and policies of insurers and self-insurers no later than June 30, 1991. By that date we will have actually audited two insurers and one self-insurer. During each subsequent six-month period we intend to check claim details for ten insurers and four self-insureds. From these, full audits will also be conducted on two insurers and one self-insurer. Our long-range goal is to increase our auditing efforts until we are conducting six full audits per six-month period by the end of 1992. (See enclosed memo from Leo M. Eide, Special Compensation Fund Director.)

We hope that the implementation of these measures meet the concerns expressed in the audit, and will serve to improve the operation of the Fund. Your input is appreciated and we look forward to working with you and your staff again in the future.

Yours truly,

John B. Lennes, Jr.
Commissioner

JBL/jak

Enclosures

Minnesota
Department of Labor and Industry

443 Lafayette Road
St. Paul, Minnesota 55155
(612) 296-6107

Telecommunication Device
for the Deaf (612) 297-4198

FAX (612) 297-1329

April 10, 1990

James R. Nobles, Legislative Auditor
John Asmussen, Deputy Legislative Auditor
Office of the Legislative Auditor
Veterans Service Building
St. Paul, MN 55155

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

SF-00006-05 (4/86)

STATE OF MINNESOTA

Office Memorandum

DEPARTMENT : Labor & Industry
Special Compensation Fund

DATE : 3/18/91

TO : Jim Denn, Deputy Commissioner;
Ann Clayton, Assistant Commissioner

FROM : Leo M. Eide, Director

PHONE : 297 4777

SUBJECT : Response to Legislative Auditor

The Special Compensation Fund has previously promised the Legislative Auditor that Fund staff would begin auditing rhe reporting procedures and policies of insurers and self-insurers by June 30, 1991. We remain committed to that plan, and we will have audited three companies by June 30th.

We plan to proceed as follows:

1. We will audit two insurers and one self-insurer before 6/30/91.

   Those audits will include comparisons of claim detail information to assessment reports to verify consistency and plausibility.

   The audits will also compare claim detail information obtained from the insurers and self-insurers with Fund and Division File information, where feasible.

   The audits will test insurer and self-insurer procedures to verify that those procedures adequately capture information required to accurately report and pay assessments. The audits will further verify that the procedures established are being accurately used and that the numbers reported are verifiable by the internal records of the insurers and self-insurers.

2. We will put all insurers on notice that we reserve the right to request claim detail, as currently provided by self-insurers. We will select 10

insurers each six month period and request the claim details.

(During the next reporting period we intend to exclude insurers located in distant cities, to avoid the high cost of field audits. We will also exclude the insurers we have just audited this fiscal year. From the remaining population of insurers we will randomly select 10 companies to request claim details.)

3. Each six month period we will check the claim details of the 10 insurers and 4 self-insurers. We will use a progressive sample method to review the details, continuing to sample as long as we are encountering discrepancies or things we cannot explain.

4. We will select 2 insurers and 1 self-insurer from our examination of the claim details, and we will fully audit their procedures and records, as described in Item # 1.

5. As our staff becomes more experienced and more efficient with the auditing, we will attempt to add companies to be audited. We currently have an objective of reaching 6 full audits each six month period by the period of 7/1/92-12/31/92.