

Department of Employee Relations

Financial Audit

For the Year Ended June 30, 1994

March 1995

*This document can be made available in
alternative formats, such as large print,
Braille, or audio tape, by calling 296-1235.*

**Financial Audit Division
Office of the Legislative Auditor
State of Minnesota**

95-08

SUMMARY

State of Minnesota
Office of the Legislative Auditor
Centennial Office Building • St. Paul, MN 55155
612/296-4708

Department of Employee Relations

Financial Audit For The Year Ended June 30, 1994

Public Release Date: March 17, 1995

No. 95-08

Objectives:

- Review internal control structure: Employee Insurance Fund revenues and expenditures, centralized payroll system, and state employee workers' compensation liability.
- Test compliance with certain finance-related legal provisions.

Conclusions:

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

- The department does not adequately control changes to state employee estimated workers' compensation liabilities.

We found no departures from finance-related legal provisions.

Contact the Financial Audit Division for additional information.
296-1235



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

CENTENNIAL BUILDING, ST. PAUL, MN 55155 • 612/296-4708

JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Phil Riveness, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Bruce Johnson, Commissioner
Department of Employee Relations

Audit Scope

We have completed a financial related audit of the Department of Employee Relations for the year ended June 30, 1994, as outlined below, and as further discussed in the Introduction. We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we consider the internal control structure in order to plan our audit, and that we perform tests of the department's compliance with certain material provisions of laws, regulations, contracts, and grants. However, our objective was not to provide an opinion on the internal control structure or on overall compliance with finance-related legal provisions.

Internal Control Structure

For purposes of this report, we have classified the significant internal control structure policies and procedures to be:

- Employee Insurance Fund revenues and expenditures;
- Centralized payroll system; and
- State employee workers' compensation liability.

For 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.

Management Responsibilities

Management of the Department of Employee Relations is responsible for establishing and maintaining the 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 internal control 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.

Conclusions

Our audit disclosed the conditions discussed in finding 1, 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 that the reportable condition described above is not a material weakness.

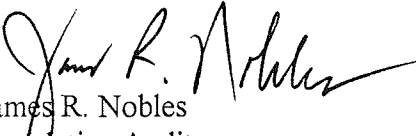
The results of our tests of compliance indicate that, with respect to the items tested, the Department of Employee Relations complied, in all material respects, with the provisions referred to in the audit scope paragraphs. With respect to the items not tested, nothing else came to our attention that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

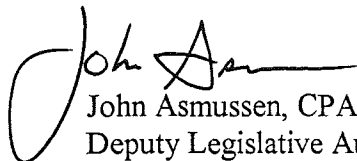
Senator Phil Riveness, Chair
Members of the Legislative Audit Commission
Mr. Bruce Johnson, Commissioner
Page 3

We also noted other matters involving the internal control structure and its operation that we reported to the management of the Department of Employee Relations at the exit conference held on February 1, 1995.

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 17, 1995.

We thank the staff of the Department of Employee Relations for their cooperation during this audit.


James R. Nobles
Legislative Auditor


John Asmussen, CPA
Deputy Legislative Auditor

End Of Fieldwork: November 21, 1994

Report Signed On: March 13, 1995

Department of Employee Relations

Table of Contents

	Page
Introduction	1
Current Finding and Recommendation	3
Agency Response	4

Audit Participation

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

John Asmussen, CPA	Deputy Legislative Auditor
Tom Donahue, CPA	Audit Manager
Brad White, CPA	Auditor-in-Charge
Kari Irber, CPA	Staff Auditor
Laura Puig-White	Staff Auditor
Deanna Hawkins	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 February 1, 1995:

Karen Carpenter	Deputy Commissioner
Chris Goodwill	Administrative Services Director
Sue Gehman	Fiscal Services Director
Elizabeth Houlding	Workers' Compensation Director

Department of Employee Relations

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 workers' compensation programs for state and University of Minnesota employees.

The personnel bureau is responsible for recruiting, classifying, 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 totaling \$8.1 million in fiscal year 1994. An additional \$3.5 million was appropriated for the Health Care Access Fund in fiscal year 1994 but only \$550,000 was used.

DOER negotiates with private insurance companies to underwrite the medical, dental, and life insurance plans offered to employees. The department processes enrollment, collects premiums, and pays insurance companies. DOER relies extensively on the Blue Cross Blue Shield (BCBS) to process and control claims for the state health plan. It also relies on the University of Minnesota and BCBS to submit all premium collections to DOER for deposit into the insurance trust fund account. To minimize the risk of these arrangements, the department has begun plans to hire an internal auditor and contract for audit services. During fiscal year 1994, DOER was also administering a public employee insurance program, which offered insurance coverage to local government and was beginning to implement a private employee plan.

The department determines and pays workers' compensation claims for state employees. These costs are billed to the employer agencies. DOER maintains a computerized system which estimates and tracks exposures on workers' compensation injuries. As of June 30, 1994 the department estimated that the state had \$116 million of workers' compensation liabilities.

DOER serves 132 operating agencies, and approximately 40,000 employees. It also responds to the general public seeking information about employment and organizations involved in human and civil rights issues. Linda Barton served as commissioner of DOER until her resignation in September, 1994. Bruce Johnson was officially appointed commissioner in December, 1994.

Department of Employee Relations

In fiscal year 1994, the department had revenues and expenditures as shown in Table 1.

Table 1
Revenue and Expenditures
Fiscal Year 1994

Revenues:	
Employee Insurance Fund	\$215,342,766
Other Revenue	<u>30,215,472</u>
Total Revenue	<u>\$245,558,238</u>
Expenditures:	
Employee Insurance Fund	\$202,213,207
Other Expenditures	<u>36,939,310</u>
Total Expenditures	<u>\$239,270,517</u>

Source: SWA Allotment Balance and Manager's Financial Report as of September 3, 1994.

Current Finding and Recommendation

1. The department does not adequately control changes to state employee estimated workers' compensation liabilities.

DOER's claim specialists do not document their reasons for making changes to estimated reserve balances for individual workers' compensation accounts. Claim specialists can also override system calculations and payment amounts without approval or explanation. In addition, division management does not prepare and review a summary of individual employee reserve estimates as of June 30.

DOER staff estimate reserves (a liability) required for unpaid compensation, medical expenses, and rehabilitation costs relating to work injuries to state employees. The reserve estimates represent the State of Minnesota's financial liability for workers' compensation claims. The reserves also act as a spending limit on individual claims. At June 30, 1994, the state's estimated liability was \$116 million.

Workers' compensation staff maintain a computerized system to track all individual injuries and reserves necessary to satisfy future claims. Staff are provided a minimum reserve guide for evaluating the initial exposure based on the type and duration of injury. However, staff do not always provide adequate explanation or reason for changes made to initial reserve estimates. Workers' compensation specialists had difficulty reconstructing the rationale behind several reserve changes made during the audit period. We had to rely on much of the verbal reasons and facts provided. These decisions need to be retained and documented in the system as they are made. Although the computer system contains a feature which allows an explanation to be provided, staff have not taken advantage of it.

The computer system restricts the total amount of dollar changes that can be made to reserve limits and payment levels based on staff position and experience. However, claim specialists have the ability to override computer calculations without any explanation or approval. There is no special review or approval when staff override the system calculation. This decreases the reliability on the system to make accurate calculations and ultimately control the workers' compensation liability.

Recommendation

- *The department should improve internal control procedures to document and authorize changes to workers' compensation reserves. This includes:*
 - *Adequate explanation of the reasons and basis for changes to reserves; and*
 - *Proper authorization is obtained to override system calculated benefits.*

Minnesota
Department of
Employee
Relations

*Leadership and partnership in
human resource management*

March 10, 1995

James Nobles
Legislative Auditor
1st Floor, Centennial Building
658 Cedar Street
St. Paul, MN 55155

Dear James Nobles:

Thank you for the opportunity to respond to the audit report for the Department of Employee Relations.

Your recommendation was to improve internal control procedures to document and authorize changes to workers' compensation reserves, including:

- ♦ Adequate explanation of the reasons and basis for changes to reserves; and
- ♦ Proper authorization is obtained to override system calculated benefits.

We have implemented the following changes in our workers' compensation area based on the recommendations of your auditor:

1. *On November 17, 1994, staff were instructed to provide the following explanation when making a reserve change:*
 - a. *Number of weeks for all indemnity categories.*
 - b. *Beginning date for all indemnity reserves.*
 - c. *Offset information and, if known, list social security disability and MSRS amounts separately.*
 - d. *Earning capacity for calculations of temporary partial disability benefits.*
 - e. *Rationale for the reserve change.*

This requirement is now reviewed as part of our self-audit program for compliance.

2. *Account technicians will provide an explanation for any override on payments in the claim notes' section of the computer system. The claims specialists are working within their payment authority level when they make these changes and if the payment exceeds their authority level, supervisory approval is necessary.*

If you would have any questions or need further information, please do not hesitate to contact Chris Goodwill at 296-7956.

Sincerely,

A handwritten signature in cursive script, appearing to read "Karen Carpenter".

Karen Carpenter
Deputy Commissioner

cc: Thomas Donahue, CPA
Audit Manager

KC:dm/l-nobles