

Department of Labor and Industry

Financial Audit

For the Fiscal Year Ended June 30, 1994**

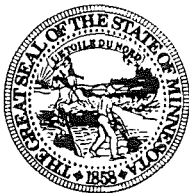
**Extended to fiscal years 1993 and 1995 for certain contractual services

November 1995

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

95-49



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Representative Ann Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Gary Bastian, Commissioner
Minnesota Department of Labor and Industry

We have audited selected aspects of the Department of Labor and Industry for the fiscal year ended June 30, 1994, as further explained in Chapter 1. Our audit scope included two aspects of the Special Compensation Fund (SCF), assessments and claims, as part of our Statewide Audit of the State of Minnesota's fiscal year 1994 financial statements. Also, as explained in Chapter 2, we audited selected aspects of contractual services acquired for the Special Compensation Fund during fiscal years 1993 to 1995. This has not been, however, a complete audit of all financial activities of the Department of Labor and Industry. The following Summary highlights the audit objectives and conclusions. We discuss our concerns more fully in the individual chapters of this report.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we obtain an understanding of management controls relevant to the audit. The standards also require that we design the audit to provide reasonable assurance that the department complied with provisions of laws, regulations, contracts and grants that are significant to the audit.

In accordance with Minn. Stat. Section 3.975, this report will be referred to the Attorney General. Findings 1 and 2 discuss potential overpayments to investigative services firms and potential misconduct by state employees. Minn. Stat. Section 3.975 requires us to report these issues to the Attorney General and the Legislative Audit Commission.

This report is intended for the information of the Legislative Audit Commission and the 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 November 3, 1995.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: December 12, 1994, except for the matter discussed in Finding 2 as to which the date was October 16, 1995.

Report Signed On: October 31, 1995

SUMMARY

State of Minnesota

Office of the Legislative Auditor

Centennial Office Building • St. Paul, MN 55155

612/296-4708

Department of Labor and Industry

Financial Audit

For the Fiscal Year Ended June 30, 1994;

Extended to fiscal years 1993 and 1995 for certain contractual services

Public Release Date: November 3, 1995

No. 95-49

Background

The Department of Labor and Industry is responsible for processing and paying over \$100 million of workers' compensation claims each year. The department's liability for these claims results from supplemental benefits, second injury responsibilities, and uninsured employers. The claims are paid from the Special Compensation Fund that is financed by assessments made on employers. Mr. John Lennes served as Commissioner of Labor and Industry from January 31, 1991, to January 31, 1995. The current commissioner is Mr. Gary Bastian.

Our initial audit scope focused on workers' compensation claims paid and assessments collected by the Special Compensation Fund for fiscal year 1994. Both financial activities were material to the state's financial statements and were examined as part of our 1994 Statewide Audit. We also expanded our work to examine certain contractual services purchased for the Special Compensation Fund during fiscal years 1993 to 1995.

Conclusions

We found that the department made overpayments in excess of \$50,000 to an investigative services firm, Rgnonti & Associates. The overpayments resulted from a combination of weak controls in the department and questionable billing practices by the Rgnonti firm. The Ramsey County Attorney's Office and the U.S. Postal Inspectors also investigated certain aspects of the financial transactions between the department and Rgnonti & Associates. Neither law enforcement agency has filed criminal charges in this matter, however. We have referred our findings to the Attorney General's Office to consider the need for civil and criminal action in regard to the overpayments. The Department of Labor and Industry is also conducting personnel investigations to pursue potential misconduct by some of its employees who had direct responsibility for the contract with Rgnonti & Associates.

We cited several problems with the department's procedures for processing and documenting workers' compensation claims. We also found that the department negotiated a significant settlement with a self-insured employer, but had not established adequate policies or procedures to govern settlements.

Contact the Financial Audit Division for additional information.

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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
Karen Klein, CPA	Auditor-in-Charge
Marla Conroy, CPA	Director of Investigations
Jean Mellett, CPA	Investigator
Laura Puig-White	Auditor

Exit Conference

We discussed the findings and recommendations found in Chapter 3 with the following staff of the Department of Labor and Industry on December 12, 1994:

Gary Bastian	Deputy Commissioner
Kevin Wilkins	Acting Assistant Commissioner, Workers' Compensation Division
Brandon Miller	Acting Director, Special Compensation Fund Section
John A. Kufus	Accounting Officer, Special Compensation Fund Section
Anina Bearrood	Accounting Director
Scott Brener	Assistant to the Commissioner
Greg Frank	Communications Director

We also discussed the findings and recommendations found in Chapter 2 with department representatives on September 21, 1995.

Department of Labor and Industry

Chapter 1. Introduction

The Department of Labor and Industry consists of the following divisions: Workers' Compensation Division, Workplace Services Division, and General Support Division. Minn. Stat. Chapters 175 to 178, 181 to 184, and 326 govern the department. These chapters create the agency and establish the general purposes for its financial transactions. Specifically, Minn. Stat. Chapter 176 provides legal provisions governing the workers' compensation laws. John Lennes served as commissioner from January 31, 1991, to January 31, 1995. The Governor appointed Gary Bastian as acting commissioner and then commissioner on April 12, 1995.

The department's primary funding sources are Special Compensation Fund assessments, General Fund appropriations, and federal grants. Fiscal year 1994 expenditures of the department are shown in Table 1-1.

Table 1-1
Breakdown of Expenditures by Fund
Fiscal Year 1994

	<u>General Fund</u>	<u>Federal Fund</u>	<u>Special Compensation Fund</u>	<u>Other Funds</u>
Workers' Compensation Claims	\$ 0	\$ 0	\$ 108,725,000	\$ 0
Other	<u>3,759,000</u>	<u>3,239,000</u>	<u>21,268,000</u>	<u>293,000</u>
Total	<u>\$3,759,000</u>	<u>\$3,239,000</u>	<u>\$129,993,00</u>	<u>\$293,000</u>

Sources: Workers' Compensation Claims as calculated by the Department of Labor and Industry for presentation in the Comprehensive Annual Financial Report published by the Department of Finance for fiscal year 1994. Other expenditures are as presented in the Statewide Accounting System Managers' Financial Report as of September 2, 1994.

Our initial audit scope focused on workers' compensation claims paid and assessments collected by the Special Compensation Fund. Both financial activities were material to the state's financial statements. We discuss the results of our work on workers compensation claims in Chapter 3. We concluded that Special Compensation Fund assessments were fairly presented as \$134 million for fiscal year 1994. We had no findings or recommendations related to assessment revenues. Finally, as discussed in Chapter 2, we found it necessary to expand our work to examine certain aspects of contractual services purchased by the Special Compensation Fund.

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Chapter 2. Special Compensation Fund - Contractual Services

Chapter Conclusions

The department has not established effective controls over contractual services acquired for the Special Compensation Fund. In particular, the control over investigative services contracts were weak. We found extensive overpayments to one investigative firm. We also question the reasonableness of many medical review services purchased by the department.

The Department of Labor and Industry contracts for certain services to support the Special Compensation Fund Section's claims processing responsibilities. The contracts have been for specialty services, such as investigative and medical review services, that historically could not be provided by the department's in-house staff. The section's use of these contractors grew dramatically in the early 1990's. It has, however, curtailed its use of contractors in the last few years. The department has begun to acquire in-house staff to perform some of these specialty duties. Also, especially in fiscal year 1995, the section has become more selective about delegating claims processing duties to contractors. Table 2-1 summarizes the fund's payments to specialty contractors since 1990.

Table 2-1
Special Compensation Fund
Claims Processing Contract Services
Payments Made in Fiscal Years 1990 to 1995

Fiscal Year	Investigative Services	Medical Review Services	Total Contract Specialists	% Change from Prior Year
1990	\$1,928	\$3,704	\$5,633	
1991	\$109,825	\$247,050	\$356,875	+6255%
1992	\$432,381	\$513,622	\$946,003	+165%
1993	\$497,975	\$336,449	\$834,424	-12%
1994	\$494,463	\$275,030	\$769,493	-8%
1995	\$428,599	\$140,040	\$568,640	-26%

Source: Statewide Accounting System - Payment by Vendor Reports as of June 30 for each respective year.

Our audit on the department for FY 1991 (report 92-10 issued in January 1992) noted the increase in medical review services and recommended that the department execute timely, written contracts for these services. The department initially executed a written contract for its medical review services in December 1991. As discussed in Finding 1, the department did not execute written contracts for investigative services until fiscal year 1994.

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The Special Compensation Fund Section operates in an environment where it often needs specialty services to determine the legitimacy and propriety for the \$100 million in workers compensation claims it processes each year. The department employs several claims specialists who are each assigned a caseload of claims to oversee. Claims specialists have been authorized to acquire investigative or medical review support from contractors upon request. In fiscal year 1994, we observed that 14 different employees had authorized investigative firms to provide services to the department. Four employees accounted for about 80 percent of the investigative services ordered.

During our 1994 audit in the department, we expanded our audit fieldwork to examine contractual services acquired for the Special Compensation Fund. Finding 2 contains an explanation of the reasons for expanding our work in this area. Aside from the overpayments discussed in Finding 2, our primary focus was on contractual services purchased in fiscal year 1994. We addressed the following objectives:

- Did the department establish adequate controls to ensure that contractual services are necessary and appropriate?
- Were payments to Special Compensation Fund contractors made in accordance with contractual terms? For this objective, we conducted an extensive review of the department's investigative services contract with Rgnonti & Associates.

To address these questions, we performed standard audit tests of contractual services, combined with a more extensive investigation of possible contract overpayments and potential misconduct by certain state employees. We issued an administrative subpoena to acquire some personal bank records of a state employee. We also issued some subpoenas to compel certain witnesses to provide us with sworn testimony. We ultimately obtained sworn statements from three state employees and several former and present employees of Rgnonti & Associates. We conducted an extensive examination of state records supporting payments to Rgnonti & Associates. We also examined relevant records maintained by Rgnonti & Associates. Finally, we met with representatives of Rgnonti & Associates and its legal counsel to explain our preliminary findings and to obtain their explanations.

We found several fundamental problems with the contractual services acquired for the Special Compensation Fund. As discussed in Finding 1, the department had inadequate procedures to control the costs associated with investigative services contracts. Finding 2 expands on the consequences of those control deficiencies and cites extensive overpayments to an investigative firm, Rgnonti & Associates. In Finding 3, we question the need for many of the medical review services acquired by the department in fiscal year 1994.

- 1. The Department of Labor and Industry had inadequate controls to ensure that investigative services purchased for the Special Compensation Fund (SCF) were properly authorized and that payments were appropriate.**

The department failed to implement adequate control procedures over the purchase of investigative services. For an extensive period of time, the department acquired investigative

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services without negotiating an appropriate written contract. It ultimately negotiated contracts, but failed to monitor the contractors' adherence to the terms. The contracts also incorporated some questionable compensation terms. Furthermore, the department did not establish clear guidelines for the Special Compensation Fund employees to purchase investigative services. It also did not maintain the documentation necessary to allow the SCF accountants to determine the propriety of investigative billings. These weaknesses in the department's internal control structure contributed to the occurrence of significant overpayments for investigative services, as discussed in Finding 2.

As shown in the Table 2-2, the department purchased a significant amount of investigative services from a variety of firms. Its use of these contractual services grew substantially in fiscal year 1992. Prior to fiscal year 1994, the department did not establish any budgetary control over the amount spent on investigative services. It finally sought competitive bids and negotiated formal contracts with investigative firms for fiscal year 1994. During fiscal years 1992 and 1993, the department paid between \$57 and \$68 per hour for investigative services. After soliciting competitive bids and negotiating contracts in fiscal year 1994, the department reduced hourly costs for investigative services to between \$35 and \$50 per hour.

Table 2-2
Investigative Services Contracts
Payments Made in Fiscal Years 1991 to 1995

Investigative Firm	FY 91	FY 92	FY 93	FY 94	FY 95
Rgnonti & Associates	\$ 63,921	\$195,254	\$286,205	\$187,739	\$ 32,058
Equifax Services Ltd.	44,426	235,685	84,136	54,900	
North Central Adjusters	1,479	1,442	27,616	27,130	
North Reporting Service			83,137		64,898
Probe Investigative			16,881	12,719	
Teleserv Legal Systems				3,689	87,585
Interstate Reporting Co.				57,975	
WC Adjusters Inc.				149,066	165,209
Int'l Claims Specialists				1,246	78,849
Investigative Services	\$109,825	\$432,381	\$497,975	\$494,463	\$428,599

Source: Statewide Accounting System - Payment by Vendor Reports as of June 30 for each respective year.

Although the contracts provided a basis for improving controls over investigative services, some payment terms remained problematic. Some of the contracts provided for mileage reimbursements at an excessive rate. For example, two contracts allowed the investigative firm to be reimbursed at a rate of 35 cents per mile. The mileage rate for state employees was 27 cents per mile at the time. A standard provision of state contracts is to allow expense reimbursements comparable to the amounts provided to state employees. We see no reason why these contractors should be reimbursed at a higher mileage rate than state employees.

We also found that the department did not establish a clear definition of eligible time to be charged by contractors. As shown in Table 2-3, contractors quoted the department various rates for their services. All contracts contained a specific hourly rate for investigative services. It is not clear, however, what constituted investigative services. Nor is it clear whether or not supervisory

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or administrative duties were included. Some contracts had a separate billing rate for secretarial time, while others did not. It is not clear whether these other contractors could bill for secretarial time at \$50 per hour or whether it was included as part of the investigative service rate.

The department did not establish clear lines of authority nor guidelines to control the purchasing of investigative services. The Request for Proposal stipulated that the department "envisioned that files will be assigned to the investigative services contractor with specified parameters and instructions regarding the investigative services required and requested." Many different SCF employees were able to order investigative services from these firms. These services were usually ordered, however, without establishing any specific parameters or instructions. In some cases, we question whether the services were needed. For example, we saw a case where it cost the fund \$686 for an investigation of a one-time \$32 medical claim against an uninsured employer.

Table 2-3
Investigative Contract Terms
Effective for May 1, 1993 to April 30, 1994

Firm	Investigative Service	Travel Time	Secretarial Service	Mileage	Other Expenses
Rgnonti & Associates	\$50/Hour	\$45/Hour		35¢	Actual
Equifax Services Ltd.	\$45/Hour		\$26/Hour	20¢	Actual
Probe Investigative	\$35/Hour		\$15/Hour		Actual
Interstate Reporting	\$40/Hour		\$8.50/page	35¢	Actual
North Central Adjusters	\$36/Hour			34¢	Actual

Source: Investigative services contracts on file in the Department of Labor and Industry.

Note: Only rates or reimbursements cited in specific contracts are listed. Items left blank in the table were not addressed by those contracts.

Special Compensation Fund managers also authorized one of the firms, Rgnonti & Associates, to perform investigative services that were beyond the scope of its contract. The Request for Proposal established the purpose of these contracts as investigating "reports of uninsured/bankrupt self-insured claims to determine workers' compensation liability." In at least two cases, however, fund managers authorized services for different purposes. In one case, the firm was asked to perform a background check on a new department employee. The documentation available indicated Rgnonti & Associates charged \$11,311 for this background check.

In the other case, fund managers arranged for Rgnonti & Associates to help establish a sting operation to "conduct a random statewide investigation of chiropractors and attorneys in an effort to ensure compliance relative to the workers' compensation laws of the State of Minnesota." The SCF director concocted a written agreement to authorize the sting operation. The agreement authorized two Rgnonti & Associates employees to temporarily serve as state employees and work on the project. The agreement further stipulated that Rgnonti & Associates would provide consultative services for this project. The director did not, however, have the authority to enter into this agreement on behalf of the state. Furthermore, the agreement was not subject to the normal contracting approval process and did not establish any limits on compensation. The sting operation was later abandoned without any substantive results. The department incurred

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incremental costs of nearly \$30,000 to conduct this sting operation; about \$23,000 of this amount was paid directly to Rgnonti & Associates.

Fund managers exacerbated the problem with these two special investigative projects by devising a method to cover up the billings. Rgnonti & Associates agreed not to submit a distinct billing for the two projects. Rather, at the direction of the SCF director, the firm inflated the billings for other routine investigative services in order to recoup the value of the two special projects.

The SCF director also overrode fund procedures and intervened so that certain billings for investigative services would be paid. On occasion, the director hand delivered invoices to the department's accounting unit and circumvented existing internal procedures. It was later determined, as discussed in Finding 2, that this practice resulted in some duplicate payments to Rgnonti & Associates.

Finally, the department did not establish adequate procedures or maintain sufficient documentation to ensure that payments for investigative services could be processed effectively. Accounting staff did not retain copies of paid invoices; these documents were submitted to the Department of Finance. As a result, the accountants could not compare services billed on incoming invoices with previous invoices. Such a comparison would have allowed the accountants to discover some of the duplicate payments. Furthermore, the accounting staff did not have copies of the contracts or evidence to show that the services had been properly authorized. Some invoices clearly showed services being billed at rates that were higher than those allowed by the contracts. As discussed in Finding 2, Rgnonti & Associates overcharged the department in a variety of ways, including inflating its rates. We also found another contractor, Interstate Reporting, that had submitted several invoices at an inflated rate, resulting in another \$4,390 of over billings.

Recommendations

- *The department should amend its investigative services contracts to limit mileage reimbursements to reasonable amounts. It must also establish a clear understanding with the contractors about what services may be billed.*
- *The department should establish guidelines for its claims specialist to follow in purchasing investigative services. The guidelines should require the claims specialists to stipulate specific parameters and instructions when purchasing these services.*
- *The department should complete personnel investigations to address the questionable activities authorized by the former SCF director and Assistant Commissioner for the Workers Compensation Division.*
- *The department should improve internal accounting procedures to require the retention of necessary documentation and evidence to adequately support contract payments.*
- *The department should recover the \$4,390 overcharged by Interstate Reporting.*

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2. The department overpaid an investigative services firm more than \$50,000.

The department overpaid Rgnonti & Associates, an investigative services firm, by at least \$54,417. These overpayments were permitted due to the deficiencies in the department's control procedures, as discussed in the previous finding. Rgnonti & Associates also contributed to the problem. It billed for excessive hours, submitted duplicate billings for some services, and in some cases charged more than its contractual rate. We were not able to conduct a thorough review of all department payments to Rgnonti & Associates, however. Therefore, we believe it is likely that the firm may have received a significant amount of additional overpayments.

Table 2-4 summarizes the overpayments to Rgnonti & Associates identified by our analyses.

Table 2-4
Overpayments to Rgnonti & Associates
From July 1992 to September 1994

Cause of Overpayment	4 months from July to Oct. 92 (3)	9 months from Nov. 92 to Aug. 93 (4)	13 months from Sept. 93 to Sept. 94 (5)	Fiscal Years 1993 to 1995
Excess Hours (1)	\$322	\$30,678	\$501	\$31,501
Duplicate Payments	0	13,782	4,636	18,418
Inflated Rates (2)	0	2,998	1,500	4,498
Total Overpayments	\$322	\$47,458	\$6,637	\$54,417

(1) In addition to the amounts shown in this table, Rgnonti & Associates inflated other billings to recoup \$34,500 for services it provided on two special projects. We have not classified the \$34,500 as an overpayment, however, because Rgnonti & Associates apparently provided the services and had not otherwise billed the department.

(2) The department could not enforce a set rate schedule until it executed a written contract with Rgnonti & Associates in May 1993. Rgnonti charged varying rates for its services prior to that time, but we do not cite these amounts as overpayments.

(3) We examined only 4 of 95 invoices paid to Rgnonti & Associates during these four months. The department paid Rgnonti & Associates \$129,557 for services during this four month period.

(4) We examined virtually all transactions occurring during the nine months from November 1992 to August 1993. The department paid Rgnonti & Associates \$244,303 for services during this nine month period.

(5) We were able to examine only about one-third of the amounts paid to Rgnonti & Associates for these 13 months. The department paid Rgnonti & Associates \$132,142 for services during this 13 month period.

Source: Analysis by the Office of the Legislative Auditor.

The owner of Rgnonti & Associates, Mr. Fred Rgnonti, notified the Department of Labor and Industry in June 1994 that he had discovered an unusual billing arrangement between his firm and the department. Mr. Rgnonti presented evidence showing that the SCF director had authorized his firm to conduct two special projects, but had designed a method to cover-up the billings. According to Mr. Rgnonti, his former office manager had agreed to recoup \$34,500 for these two special projects by inflating billings for other routine investigative services provided by his firm.

The department gave Mr. Rgnonti's evidence to both our office and the Ramsey County Attorney's Office in July 1994. In September 1994, the department suspended the SCF director

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from her duties and reassigned the Assistant Commissioner for the Workers Compensation Division. The Ramsey County Attorney's Office began investigating for potential criminal activity. We were interested in determining whether the state had incurred a financial loss resulting from this situation, but initially allowed the criminal investigation to take precedence.

In February 1995, the Ramsey County Attorney's Office requested our assistance in reviewing billing records at Rgnonti & Associates. We discovered evidence of widespread billing discrepancies. In addition to the inflated billings of \$34,500 for the two special projects, we found evidence that excess hours were added to other billings and identified some duplicate billings paid by the department.

We notified the Ramsey County Attorney's Office about the billing discrepancies that we had discovered at Rgnonti & Associates. Initially, they were interested in investigating whether those discrepancies indicated possible criminal activity, but determined that due to venue, the office could not proceed with the investigation. In April 1995, the Ramsey County Attorney's Office referred the case to the U.S. Postal Inspectors for investigation. We cooperated with the Postal Inspectors while they investigated for a possible scheme to commit fraud through the mail. In August 1995, the Postal Inspectors determined that there was insufficient evidence to support criminal charges under federal law and closed its case.

In August 1995, although a final determination had not been made about potential violations of the state criminal code, we decided it was necessary to complete our examination of possible financial losses incurred by the state. We have conducted an extensive review of the relevant financial records maintained by both the state and Rgnonti & Associates.

We encountered several difficulties in examining the financial records. Rgnonti & Associates had few investigator timesheets for the period prior to August 1993. In some cases, we were able to review investigators' journals in lieu of the timesheets. However, journals were not always available to support investigators' time. To the extent possible, we also attempted to use an internal management report generated by Rgnonti & Associates during part of the time period.

We obtained statements under oath from three state employees who had responsibilities for acquiring or overseeing the acquisition of investigative services from Rgnonti & Associates. We also obtained sworn statements from Mr. Fred Rgnonti and several of his present and former employees. The sworn testimony produced conflicting explanations and recollections.

Based on our examination, we concluded that the Department of Labor and Industry overpaid Rgnonti & Associates at least \$54,417 for services provided from September 1992 to August 1994. We were able to examine some documentation supporting 294 of the 468 invoices submitted by Rgnonti & Associates to the department since September 1992. Because of missing financial records and other difficulties, we could not reach a conclusion on the propriety of most investigative billings from Rgnonti & Associates prior to November 1992. Rgnonti & Associates could not provide investigator timesheets for a substantial period of time during the review. One investigator did not maintain a journal until November 1992. Due to these limitations, we reviewed a very limited number of invoices prior to November 1992.

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The majority of evidence available related to investigative services provided during the nine months ending August 1993. During this time period, we reviewed virtually all the invoices submitted by Rgnonti & Associates to the Department of Labor and Industry. We utilized Rgnonti & Associate's Investigator Management Report that reflected actual and billed hours by investigator. We verified actual hours to certain investigator journals and timesheets, when available.

After August 1993, we reviewed less than half of the invoices submitted for payment. Again, we utilized certain investigator's journals and timesheets when they were available. Given the documentation available during this time period, it was not practical to review additional invoices.

We categorized the overbillings into three categories: excess hours, duplicate payments, and inflated rates.

Excess Hours

The largest category of overbillings resulted from excess hours being added to investigative cases. We found excess hours being added to 178 different Rgnonti & Associate invoices paid by the department since September 1992, amounting to \$31,501 of overpayments.

We found several examples of billings including hours of service that were not supported by investigators' timesheets or journals. For example, one invoice totaling \$3,776 included 15.5 hours, billed at \$908, that we could not substantiate. Rgnonti & Associates did not have employee time sheets to support these added hours. We also examined other records available, including Rgnonti & Associates' Investigator Management Report, the investigators' journals and certain case files, but found no evidence to support the added hours. Furthermore, a former bookkeeper for Rgnonti & Associates testified that she systematically added hours to the billings at the direction of Mr. Rgnonti. Mr. Rgnonti testified that he believed these added hours represented his time for reviewing case files and overseeing office operations. Mr. Rgnonti could not produce any evidence that showed he had worked on these cases. Furthermore, other employees of Rgnonti & Associates testified that Mr. Rgnonti did not have an active role on the investigations for the Department of Labor and Industry. We also observed that the practice of adding these extra hours to the invoices diminished after the former bookkeeper left Mr. Rgnonti's employment in September 1993. Finally, we believe it would be inappropriate for Rgnonti & Associates to add hours for administrative functions. The contract stipulates payment for investigative services, not administrative or management services. Presumably the contract rate of \$50 per hour included a sufficient component to cover administrative and management overhead costs.

Duplicate payments

The next largest category of overbillings resulted from duplicate payments. We found duplicate payments for services on 58 different Rgnonti & Associates invoices paid by the department since September 1992, amounting to \$18,418 of overpayments. For example, one invoice totaling \$1,186 included 8.5 hours, billed at \$453, that Rgnonti & Associates had previously billed to the department three months earlier. The rebilled hours were commingled with other legitimate hours

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on the second invoice. As a result, the duplicate billing was not apparent to the department and it paid both invoices, resulting in the overpayment.

In two other cases, the department initially paid for investigative work based on detailed original invoices. It later paid for these same services a second time based on a summary or reminder invoice. These two instances resulted in overpayments to Rgnonti & Associates of \$6,652.

Inflated Rates

Finally, we found that some overbillings resulted from Rgnonti & Associates charging an inflated rate for their services. The contracts stipulated that Rgnonti & Associates was entitled to \$50 per hour for investigative services from May 1, 1993, to April 30, 1994. However, we found instances on 58 invoices where Rgnonti & Associates billed its services at \$55 per hour.

Rgnonti & Associates admitted that it had inadvertently billed at the higher rate. Former Rgnonti & Associate employees told us that the billing system automatically billed investigative hours at \$55. When preparing invoices for the Department of Labor and Industry, the bookkeeper had to manually enter a rate of \$50 per hour. The bookkeeper sometimes forgot to make the manual adjustment, resulting in the department being billed at the higher rate.

We also found that Rgnonti & Associates charged additional fees for overhead expenses. The department's contract with Rgnonti & Associates did not, however, permit payment for these overhead charges. For a certain period of time, Rgnonti & Associates charged an initial \$62 case opening fee. We cited four invoices in fiscal years 1994 and 1995 that included case opening expenses totaling \$264. In July 1994, Rgnonti & Associates started charging the department for office expense instead of the case opening fee. Current Rgnonti & Associates employees told us the office expense represents ten percent of the investigative hours billed. We cited 16 invoices containing office expense in fiscal year 1995 totaling \$1,102. We consider the entire \$1,366 billed as overhead expenses to be an overpayment resulting from Rgnonti & Associates charging more than allowed by its contract.

We took a sworn statement from Mr. Rgnonti on August 9, 1995. We also met with Mr. Rgnonti, along with some of his employees and attorney on October 3, 1995. We explained the process used to determine the amount of overpayments. In addition, we provided specific information regarding certain transactions. As of this date, Mr. Rgnonti has not provided any supplemental documentation substantiating the amount in question.

Pursuant to Minn. Stat. Section 3.975, we shall refer this finding concerning overbilling to the Attorney General. The Attorney General is responsible for negotiating financial recoveries on behalf of the state and referring potential criminal matters to the appropriate county attorney.

Recommendation

- *The department should work with the Attorney General's Office to obtain recovery of the amounts overpaid to Rgnonti & Associates.*

Department of Labor and Industry

3. The Special Compensation Fund Section did not adequately monitor case files referred to a medical review services contractor, resulting in unnecessary costs to the fund.

Claims specialists often unnecessarily referred cases to a medical services review contractor, Compcost Inc. As a result, the fund incurred costs that could have been avoided.

The department has a contract with Compcost, Inc. to assist its staff with conducting medical reviews of claim files. Compcost Inc. provides the medical expertise necessary to help the Special Compensation Fund employees determine the legitimacy and propriety of costs incurred by claimants. As shown, in Table 2-5, the department has contracted for medical review services for the past several years. In fiscal year 1994, Compcost Inc. charged a fee of \$850 per file for the first year of service and \$350 for each subsequent year of service.

Table 2-5
Medical Review Services Contracts
Payments Made in Fiscal Years 1991 to 1995

Investigative Firm	FY 91	FY 92	FY 93	FY 94	FY 95
Compcost Inc.	\$130,675	\$489,955	\$336,449	\$275,030	\$ 140,040
Med Trac Inc.	116,375	23,667			
Medical Review Services	\$247,050	\$513,622	\$336,449	\$275,030	\$140,040

Source: Statewide Accounting System - Payment by Vendor Reports as of June 30 for each respective year.

The claims specialists were authorized to order medical review services for their assigned cases. To determine whether the department wished to renew service for a case, within 60 days of the case anniversary date Compcost, Inc. notified the department that the case was subject to renewal. Claims specialists were responsible for responding to these notices in order to cancel service for a file.

We found that claims specialists would often allow medical review services to be renewed for cases that no longer seemed to merit the service. For example, we cited cases where the fund's liability had ceased, such as when a claimant had died or a court order had relieved the fund of further responsibility, yet the claims specialists had allowed the medical review services to be renewed. These questionable renewals occurred because the claims specialists did not take the time to reconsider the need for these services. Claims specialists also told us that fund managers ordered them to send as much business as possible to Compcost when the fund first began acquiring its services in 1991. These same employees told us that more recently, however, they have not felt pressure to send cases to Compcost.

Recommendation

- *The Special Compensation Fund Section should monitor case files to prevent unnecessary medical review service costs.*

Chapter 3. Workers Compensation Claims

Chapter Conclusions

The Department of Labor and Industry needs to tighten its controls over several aspects of processing and documenting workers compensation claims. Also, we found that the department had negotiated a significant settlement with a self-insured employer, but had not established adequate policies or procedures to govern settlements.

The Department of Labor and Industry processes workers' compensation claims under a variety of circumstances. Table 3-1 shows a breakdown of types of claims incurred for fiscal year 1994.

Table 3-1
Workers Compensation Claims
Fiscal Year 1994

Supplemental benefit reimbursements	\$58,250,000
Second injury benefit reimbursements	32,798,000
Uninsured benefits ¹	7,923,000
Insurance company reimbursements	6,718,000
Other	<u>3,036,000</u>
Total	<u>\$108,725,000</u>

Note 1: In accordance with generally accepted accounting principles, the department also recognized a long-term liability of \$56,494,000 for uninsured employees. This liability is presented in the General Long-Term Debt Account Group for the state's fiscal year 1994 financial statements.

Source: Workers' Compensation Claims as calculated by the Department of Labor and Industry for presentation in the Comprehensive Annual Financial Report published by the Department of Finance for fiscal year 1994.

Our objective for examining workers compensation claims was part of our audit of the state's financial statements for fiscal year 1994. Specifically, we addressed the following question:

- Did the Department of Labor and Industry, in conjunction with the Department of Finance, measure workers compensation claims payable from the Special Compensation Fund in accordance with generally accepted accounting principles?

To support our effort to address this primary objective, we also examined certain aspects of the department's internal control structure and its compliance with finance related legal provisions. We interviewed department employees, reviewed its policies and procedures, and tested samples of financial transactions. Although it was not our objective to express an opinion on either internal controls or legal compliance, our examination did identify relevant concerns that are reported in this chapter.

Department of Labor and Industry

We found that the Department of Labor and Industry needs to tighten its controls over several aspects of processing and documenting workers compensation claims, as discussed in Findings 5-10. Also, we found that the department had negotiated a significant settlement with a self-insured employer, but had not established adequate policies or procedures to govern settlements. This settlement is discussed in Finding 4.

4. The department paid a settlement of \$4.8 million to a self-insured employer, but did not have policies and procedures governing second injury settlement agreements.

The department has not established policies and procedures governing second injury settlements. The department paid a self insured employer \$4.8 million in a group settlement involving 22 employees. There was no precedent for such a settlement and the department had no guidelines to follow. The settlement amount included a provision for some administrative costs that the department would not normally pay to an employer. Also, the department did not ensure that the 22 employees received copies of the settlement.

The Special Compensation Fund reimburses the employer or insurer for second injury and supplemental benefits paid to an employee. The Legislature repealed the second injury benefits effective July 1, 1992. The Special Compensation Fund continues to reimburse employers for subsequent injuries occurring prior to July 1, 1992. However, any subsequent injuries occurring after that date would not be subject to reimbursement by the fund. The Special Compensation Fund had future liability associated with these 22 employees since their subsequent injuries occurred prior to July 1, 1992.

The department did not have policies or procedures to guide staff in the settlement process. On January 28, 1994, the department, the self-insured employer, and the special compensation judge approved the settlement and the department processed a check. This was not the general practice of the department. The department needs to formalize the settlement process and procedures to ensure equitable treatment of employers and insurers.

The settlement agreement provided for payment of the fund's present value of future benefits and settlement of future medical expenses and administrative costs. It is not the general practice of the department to reimburse self-insured employers for administrative costs. Department of Labor and Industry personnel explained that the administrative costs were to satisfy the self-insured employer's bonding requirements as stated in Minn. Stat. Section 176.181. Nonetheless, the department would not normally reimburse employers for such costs. The value of these administrative costs added \$71,610 to the settlement. The department needs to establish policies and procedures to clarify the allowable components and parameters considered in settlement negotiations.

The department did not ensure that the 22 employees named in the settlement received copies of the settlement document. In addition, the department records for these employees did not contain information regarding the settlement agreement. Minn. Stat. Section 176.281 states "...the commissioner, or the office of administrative hearings or the workers' compensation court of appeals shall immediately service a copy upon every party in interest together with a notification

Department of Labor and Industry

of the date the order was filed." The department needs to ensure the proper filing of documents in accordance with applicable statutes, and maintain complete departmental records.

Recommendation

- *The department should establish definitive guidelines regarding settlements. These guidelines should specify the benefits or components to be included in any settlement agreement. In addition, the Special Compensation Fund staff should apply these guidelines to every situation as to avoid an appearance of preferential treatment.*
- *The department should ensure that documents are filed with all interested parties to a settlement. The department should ensure copies of the settlement agreements are included in the department files.*

5. The Special Compensation Fund staff are processing claims without properly separating duties and setting an acceptable level of mathematical errors.

The same accounting staff member had the ability both to perform adjustments to claims and approve payments of uninsured claims. The accounting staff could make unauthorized changes to claims and process the payment. Unauthorized changes would go undetected. Adequate separation of duties must exist between the adjustment and approval of payments.

Management has a verbal policy which permits staff to process claims that are within \$100 of the actual claim amount. The division needs to review this policy and determine whether the amount selected is reasonable. Without effective guidelines for mathematical errors, the fund could consistently overpay or underpay claims.

Recommendations

- *Management should adequately separate duties between making adjustments and approving payments of uninsured claims.*
- *Management should develop written policies or procedures to outline an acceptable level of mathematical errors in processing claims.*

6. The Special Compensation Fund Section needs to improve controls over assessment report extensions and penalties.

The Workers' Compensation Division did not require insurers to submit written requests indicating reasons for extensions. We found that the section did not request the insurer to submit a written reason as to why the fund should grant an extension in five of six extension requests tested. The assessment reports are due twice a year, August 15 and March 1. During fiscal year 1994, the fund granted 49 assessment report extensions.

Minn. Rule Section 5220.2840, Subpart 2, states that a penalty will be assessed when written certification that the assessment report and payment will not be made by the due date because of

Department of Labor and Industry

reasons beyond the control of the insurer, is not received by the Special Compensation Fund on or before the due date.

The fund could be losing revenue by not assessing penalties. In order for the division to grant extensions, the insurers need to provide the reasons that they are unable to submit the assessment report to the fund by the due date.

Recommendation

- *The division should require insurers to submit a written extension request indicating the reason the report is late. In addition, the division should develop guidelines for acceptable reasons for extensions.*

7. The department is not requiring proper medical documentation or verifying deductible for second injury claims.

Fund administrators reimburse claims to insurers without proper medical documentation. Six out of 20 sample items did not have a medical report documenting the relationship of the injury to the expenditures.

Minn. Rule Section 5220.2680, Subd. 6, states that the application must be supported by medical reports showing the nature and extent of disability and relationship to the injury and physical impairment for which reimbursement is claimed.

Without adequate documentation, the fund could be reimbursing medical costs for a nonrelated medical injury. The fund could be making inappropriate reimbursements. The reimbursement specialists do not always request medical reports, because other documentation that supports the injury sometimes is in the department files.

The section also is not verifying the deductibles for second injury temporary partial disability benefits. According to Minn. Stat. Section 176.131, Subd. 1, for injuries occurring prior to July 1, 1992, the employer or insurer shall be reimbursed from the Special Compensation Fund all compensation paid in excess of 52 weeks of monetary benefits and \$2,000 in medical expenses. By not verifying the deductibles, the fund could reimburse the employer or insurer without reaching the deductibles.

Recommendations

- *The department should either require medical reports before reimbursing any claims or the department should change Minn. Rule Section 5220.2680 to require acceptable medical documentation rather than medical reports.*
- *The department should develop written policies or procedures to determine whether 52 weeks of compensation is paid and the \$2,000 medical cost deductible is met for partial disability benefits.*

Department of Labor and Industry

8. The Special Compensation Fund staff did not adequately monitor and record uninsured accounts receivable balances.

The department needs to strengthen the monitoring and recording of uninsured reimbursement accounts receivable. The department may recover compensation it has paid to claimants from uninsured employers. Personnel from the Special Compensation Fund Section negotiate the amount of reimbursement with the uninsured employer based on the costs incurred by the fund. On the basis of the documents reviewed, these costs may include lost wages, medical expenses, and in some cases, administrative costs such as outside medical consultant fees and investigative services. The department negotiates the final amount due based on the employer's ability to pay. After both parties agree on the amount of reimbursement, the department establishes an account receivable. The uninsured employers generally pay the fund on an installment basis. The total accounts receivable reported as of June 30, 1994, was \$600,346.

During our review, we found several weaknesses in the accounts receivable process. First, the department does not adequately pursue collection of outstanding accounts receivable. There were several instances where the department did not actively pursue the collection of outstanding balances. In some cases the department did refer cases to private law firms to pursue collection efforts. The department needs to implement recovery procedures for accounts receivable, including notification letters, referrals to collection agencies, and revenue recapture.

Next, the Special Compensation Fund staff were inconsistent in determining which costs were subject to employer reimbursement. Minn. Stat. Section 176.183, Subd. 4, states the Commissioner of Labor and Industry has a cause of action against the employer to recover compensation paid by the special fund. Statutes define compensation as all benefits provided under workers' compensation laws as a result of injury or death. We found cases where the department sought reimbursement for wages and medical expenses paid as well as fees associated with the department's outside medical consultants and investigative services. The department personnel responsible for reimbursement negotiations expressed different understandings of which costs are allowable for reimbursement. The department needs to establish guidelines specifying the costs the employers are responsible for to ensure consistency in negotiations. The department may also seek statutory clarification of the current law if needed.

Finally, the Special Compensation Fund staff did not accurately record the accounts receivable activity. Some reimbursement agreements require that the employer pay interest on the outstanding balance due. During our review, we found some cases where the agreement stipulated interest, but the department did not calculate the interest and applied all payments to principal. This practice was not in compliance with the reimbursement agreement. In addition, the department recorded the incorrect account receivable balances in two cases. One case resulted in an account receivable understatement of \$76,400. The department must ensure compliance with reimbursement agreement provisions, including total amount due and interest computations.

Department of Labor and Industry

Recommendation

- *The department should establish collection procedures for outstanding accounts receivable. The department should consider using revenue recapture as a means of recovering funds.*
- *The department should define the costs incurred by the Special Compensation Fund that are subject to recovery by the uninsured employer. The department should seek to clarify the statutory language, if needed. The department should be consistent in determining the costs subject to reimbursement by the uninsured employers.*
- *The department should ensure the accurate recording of accounts receivable interest and principal.*

9. The department is inadequately monitoring changes in computer access.

The department has inadequate procedures to take terminated employees' computer access promptly off the system and to follow up on deprogramming the key card access into the building. In our test of 15 sample items, we also found that two employees were taken off the system without adequate supporting documentation.

Terminated employees who retain access to a computer system increase the risk of unauthorized entries after they have left their positions in the department. The risk of improper use of private data also is increased when the key card access to the building is not deleted immediately for terminated employees. The risk of adding current employees who should not have access to the computer system is increased if proper documentation of authorization is not maintained. We were told verbal authorization was given in some cases, but nothing was on file to support the authorization.

Recommendations

- *The department should take terminated employees' computer and key card access off the system immediately upon the employees' leaving employment.*
- *The department should maintain documentation supporting the deprogramming of an unneeded key card.*
- *The department should keep documentation on file to support the addition or removal of employee access to the computer system.*

Department of Labor and Industry

10. PRIOR FINDING NOT RESOLVED: The Special Compensation Fund Section needs to identify formally the documentation it is willing to accept in processing supplemental benefit reimbursements.

Currently, the Special Compensation Fund Section does not require adequate documentation for ongoing permanent disability claims. The claim form states that the insurer must attach a copy of the most recent medical report, rehabilitation report, or other evidence to the claim to document that the claim is valid and ongoing. The insurance companies or self-insured businesses pay supplemental benefits to permanently totally disabled employees. The insurer submits an annual claim to the Special Compensation Fund Section stating the amount of supplemental benefits paid for the year.

The section needs to identify what type of support is adequate to determine whether the permanently disabled person still exists. Without adequate documentation, the staff could process payments to the insurer for nonexistent disabled people.

Recommendations

- *The section should develop written policies or procedures to determine acceptable documentation for ongoing permanent disability claims.*
- *The section should not reimburse insurers for supplemental benefits without documentation that the claim is valid and ongoing.*

Department of Labor and Industry

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Department of Labor and Industry

Auditors' Note Concerning Responses

We have included two responses in this report, one from the Department of Labor and Industry and another from Mr. Fred Rgnonti, the owner of Rgnonti & Associates. Normally, we only include an agency response in a report. In this case, however, we agreed to include a response from Mr. Rgnonti. We regret that Mr. Rgnonti's letter contains personal attacks on individuals, and we strongly disassociate ourselves from his statements.

Department of Labor and Industry

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October 31, 1995

James R. Nobles, Legislative Auditor
John Asmussen, Deputy Legislative Auditor
Office of the Legislative Auditor
Centennial Office Building
658 Cedar Street
St. Paul, Minnesota 55155

HAND DELIVERED

Dear Mr. Nobles and Mr. Asmussen:

Thank you for the opportunity to review and comment on the findings addressed in the draft of your audit for the fiscal year ending June 30, 1994 and fiscal years 1993 and 1995 for certain contractual services.

It should be noted that many of the findings and resulting recommendations that are presented in your draft report are a direct result of our own research and determination that contractual services and a settlement within the Special Compensation Fund (SCF) were questionable in nature. As stated in our letter dated November 29, 1993, regarding the audit for fiscal year 1993, the department had no knowledge of any fraud, malfeasance, or misfeasance. However, as soon as we became aware of questionable events, we immediately notified the proper authorities which included your agency.

In reviewing the findings of the four previous fiscal annual audits of our department, none of the fiscal management problems or controls which were identified in this audit (FY 94) were reported. You first reported some of these findings at the initial exit conference on December 12, 1994. However, it was at our request that your office went on to study how the SCF acquired, utilized and reimbursed contractors providing professional/technical services before developing a final report. We believed this to be a critical element in developing a full picture of the fiscal management of the SCF.

The Department of Labor and Industry takes its responsibility of managing the SCF very seriously. Being charged and entrusted with the duty to effectively and ethically manage the SCF led us to ask your office to research areas which had previously not been identified or examined in depth.

This audit has 10 principal findings with 22 recommendations for action. We agree with the recommendations stated in the report. All 14 of the recommendations for improved policies, procedures and controls in the management of the SCF have been completed. The suggestion that we clarify statutory language allowing the department to recover benefit and administrative costs associated with claims from uninsured employers was completed with an amendment to M.S. § 176.183, subd. 2, effective July 1, 1995.

Mr. James R. Nobles
John Asmussen
October 31, 1995
Page 2

Five recommendations suggested clarification in our contracts for investigative services and improved controls and documentation for computer access and accounts receivable. These are targeted for completion by December 1, 1995. We have partially completed the two findings recommending collection of overpayments to contractors. With the assistance of the Attorney General, we will recoup the monies overpaid. When the fact-finding process is completed for the personnel investigations, the department will act swiftly and fairly.


It is important for the department to classify the 10 principal findings in another way. Findings 1, 2, 3, and 4 all deal with decisions, settlements, actions, and authorizations made by the previous director of the SCF under the former Workers' Compensation Assistant Commissioner. The investigation of any questionable activities is being vigorously pursued.

We have attached a summary of your recommendations with our action response for each. This includes reference materials documenting some of our actions to date. Where practical, we have included four elements in each action response: a) development of business process (policy procedure or action); b) communication of the business process to staff and customers; c) training for staff and customers to assure understanding; and d) regular evaluation for adherence to the new process.

We have made organizational changes that your audit findings would seem to support. The accounting staff of the SCF have been reassigned to our Accounting Director. The SCF's investigators now report to the Director of the Investigative Services Unit. The managers of these units will provide professional leadership and direction to the staff.

I would like to thank you and your staff for your review of our operations. You have provided us with sound suggestions for improving the management of the SCF and for the department.

Sincerely,



Gary W. Bastian
Commissioner

GWB/mh

Attachments

FINDINGS, RECOMMENDATIONS & ACTION RESPONSES
for
FINANCIAL AUDIT
DEPARTMENT OF LABOR AND INDUSTRY
November 3, 1995

FINDING 1

The Department of Labor and Industry had inadequate controls to ensure that investigative services purchased for the Special Compensation Fund (SCF) were properly authorized and that payments were appropriate.

Recommendation 1: Amend investigative service contracts to limit mileage reimbursements and to establish a clear understanding with contractors about what services may be billed.

Action Response: The department is working with the Office of the Attorney General to amend the current investigative contracts by December 1, 1995.

The SCF, after consultation with the Investigative Services Unit, will establish a list of which services will be uniformly reimbursed. These reimbursement guidelines will be mailed to the contractors, reviewed at their quarterly meetings, and be implemented in training with the claims managers of the SCF. Follow-up and compliance will be ensured through the accounting reimbursement function (see attachment #1).

Recommendation 2: Establish guidelines for purchasing investigative services which require claims specialists to stipulate specific parameters and instructions when purchasing these services.

Action Response: Investigative services are only assigned to cases where it is anticipated that the employee will suffer lost work time. Upon assignment, investigative firms are required to provide a transcribed statement from both the alleged employer and employee. We also require medical records and wage records. Additional services (such as surveillance and asset checks) require pre-approval from the claims managers. Claims must be accepted or denied within 14 days of the initial notice of injury. Investigators call whenever an issue arises that might require them to take unusual measures.

The SCF initiated investigative services in Fiscal Year 1991 after being criticized for accepting claims without proper investigation.

Recommendation 3: Complete personnel investigations to address questionable activities authorized by the former SCF director and Assistant Commissioner for the Workers' Compensation Division.

Action Response: The department, with the advice and counsel of the Department of Employee Relations, will continue to investigate. We will act swiftly and fairly when the facts have been gathered.

Recommendation 4: Improve internal accounting procedures to require the retention of necessary documentation and evidence to adequately support contract payments.

Action Response: The SCF accounting staff have implemented this effective April 21, 1995. The original rehabilitation and investigator invoices are retained in a separate filing area within the SCF. They are filed alphabetically by vendor. The current fiscal year and prior fiscal year invoices are retained in this filing area as well. Older invoices are forwarded to the claimant's file.

All accounting staff have been trained. Annual performance reviews will ensure continued compliance with this procedural change.

Recommendation 5: The department should recover the \$4,390.00 overcharge by a vendor.

Action Response: The SCF was provided documentation indicating overpayments of \$964.25 from Interstate Reporting. These monies were received in March, 1995. Upon receipt of overpayment details from the Office of the Legislative Auditors, the SCF will collect the remaining \$3,425.75 from Interstate Reporting (see attachment #2).

FINDING 2

The department overpaid an investigative services firm more than \$50,000.

Recommendation 1: Work with the Attorney General's Office to recover amounts overpaid to Rgnonti & Associates.

Action Response: The SCF was provided documentation indicating significant overpayments from Rgnonti invoices.

The SCF consulted with the Offices of the Legislative Auditor and the Ramsey County Attorney. To date, the SCF requested and received reimbursement of \$777.44 from invoices which were not part of the ongoing criminal investigation.

Upon receipt of additional overpayment details from the Office of the Legislative Auditor, the SCF will work with the Office of the Attorney General to collect the remaining overpaid amounts (see attachment #3).

FINDING 3

The SCF did not adequately monitor case files referred to a medical review services contractor, resulting in unnecessary costs to the SCF.

Recommendation 1: The SCF should monitor case files to prevent unnecessary medical review service costs.

Action Response: The SCF has made significant strides in this area. As table 2-5 indicates, we have reduced costs 50 percent in the last fiscal year. This has been achieved by close monthly monitoring of file status.

Monthly status reports are sent to all claims managers directly from the medical review services contractor, CompCost. Under the new contract between the SCF and CompCost, the

contractor will be billed monthly rather than annually, which will generate more cost control for these vendor services.

Implementation of the procedure to monitor file status and follow-up will be coordinated through monthly staff meetings and performance review plans.

FINDING 4

The Department paid a settlement of \$4.8 million to a self-insured employer, but did not have policies and procedures governing second injury settlement agreements.

Recommendation 1: The department should establish definitive settlement guidelines specifying the benefits or components to be included in any agreement to avoid an appearance of professional treatment.

Action Response: The SCF has implemented guidelines for both reimbursement and special claims files. All claims managers and attorneys have been instructed to complete the settlement worksheets prior to settlement negotiations. Factors include benefit rates, life expectancy, retirement and social security contribution.

Ongoing training will be provided as needed. Follow-up for compliance with this policy will occur at annual performance reviews and during random file audits (see attachment #4).

Recommendation 2: Ensure documents are filed with all interested parties to a settlement and are included in the department files.

Action Response: This is the standard operating procedure for the Workers' Compensation Division. This was the only case settled without participation and knowledge of the affected employees. Copies and SCF files have been copied with the Stipulation for Settlement for this case (see attachment #5).

It is the responsibility of the Judicial Services unit to serve and file any awards on stipulations it issues to the appropriate parties. In this case, since individual claimants were not party to the Stipulation for Settlement, and since there was never a petition filed, there may not have been a formal Award on Stipulation served to any party. Both the SCF and the self-insured employer were delivered copies of the documents by hand on the day of the award.

The previous director of the SCF and workers' compensation assistant commissioner represented the department on the majority of settlement negotiations.

We do not anticipate future group settlements of this nature.

FINDING 5

The SCF is processing reimbursement claims without properly separating duties and setting an acceptable level of mathematical errors.

Recommendation 1: Separate adjustment and payment duties.

Action Response: The separation of duties exists for the reimbursement processes. Claims managers now must review and initial changes in rates or amounts made by the accounting staff before final payment is made. Accounting and claims staff have been trained in these review and initialing procedures, and annual performance reviews will ensure compliance with this procedure.

Recommendation 2: Develop written policies and procedures to outline an acceptable level of mathematical errors in processing the reimbursement claims.

Action Response: A policy was implemented in 1994 requiring adjustment of reimbursements regardless of the size of error. Letters are sent to insurers indicating adjustments made.

Claims managers' position descriptions state they must process claims within a 98 percent accuracy rate. Ongoing training and file review will ensure the policy change is adequately followed.

FINDING 6

The SCF needs to improve controls over assessment report extensions and penalties.

Recommendation 1: Require insurers to submit written request stating why report is late; establish a list of acceptable reasons for extensions.

Action Response: This was implemented by the SCF and was used during the past reporting period. Verbal notification is to be followed by written notice (FAX or mail) and must be received by the due date. Phone calls from insurers requesting extensions are directed to the Accounting Officers who work with the SCF, or the SCF Director in their absence. Parties are told they will be assessed a minimum penalty of \$1,000.00 per Minnesota Rules Part 5220.2840 if the written request is not received on due date. Additionally, the postmarked envelope is retained to defend the lack of timeliness if needed for filing of penalties.

FINDING 7

The department is not requiring proper medical documentation or verifying deductible for second injury claims.

Recommendation 1: Require either medical reports before reimbursing any claims or change Minn. Rules, Part 5220.2680 to require acceptable medical documentation rather than medical reports.

Action Response: Ongoing medical reports are requested from the insurer or obtained from the division file. This will establish that ongoing reimbursements are related to the appropriate injury. This procedure has been updated in the Reimbursement Team procedure manual. The staff has been trained on the new procedure.

The SCF mailed a 5-page memorandum of instructions on how to complete annual claims on March 27, 1995 to all insurers and self-insured employers. This memorandum was also published in the February, 1995 edition of *CompAct*. The SCF will require medical bills reflecting

CPT medical procedure codes on all first claims in order to verify the deductible. The claims managers will check the medical procedure codes on the computerized file detailing these codes.

Recommendation 2: The Department should develop written policies or procedures to determine whether 52 weeks of compensation is paid and the \$2,000 medical cost deductible is met for partial disability benefits.

Action Response: The SCF has instituted this policy. When verifying indemnity deductibles for Temporary Total Disability (TTD) and Permanent Total Disability (PTD) benefits, an Interim Status Report must be attached to the annual claim showing dates and rates paid. For Temporary Partial Disability (TPD) benefits, if the employee's first 26 or 52 weeks of benefits paid is TPD, or if TPD is paid at all within the deductible time period, insurers must submit legible copies of check stubs and a TPD worksheet showing the employee's average weekly wage.

This policy has been distributed to insurers, self-insured employers and staff. A random check of the case files will be conducted by the supervisor of the SCF to assure that the policy is implemented.

FINDING 8

The SCF staff did not adequately monitor and record uninsured accounts receivable balances.

Recommendation 1: Establish collection procedures for outstanding accounts receivables.

Action Response: Outstanding accounts receivable are being referred to either the Office of the Attorney General Collection Division or The Minnesota Collection Enterprise. The SCF entered into a contract with The Minnesota Collection Enterprise in August, 1995. These entities will notify the SCF when accounts are collected, or when they should be written off as bad debt pursuant to the Minnesota Department of Finance guidelines.

The SCF is working with the Office of the Attorney General to develop a Petition for Reimbursement against uninsured employers. The SCF will require this petition be filed to initiate recovery proceedings, prior to the accounting section issuing initial payment. This will ensure early and efficient recoveries. The SCF Director and Accounting Director will review the effectiveness of these activities on a semi-annual basis.

Recommendation 2: Define the costs incurred by the SCF that are subject to recovery by the uninsured employer and seek to clarify statutory language, if needed. Be consistent in determining the costs subject to reimbursement by uninsured employers.

Action Response: Minnesota Statutes, § 176.183, subd. 2 was amended effective July 1, 1995, allowing the Department to recover benefit and administrative costs associated with the claim from uninsured employers.

Recommendation 3: The department should ensure the accurate recording of accounts receivable interest and principal.

Action Response: The Accounting Director will work with the accounting officers who work with the SCF to comply with this recommendation in all applicable cases by December 1, 1995.

FINDING 9

The department is inadequately monitoring changes in computer access.

Recommendation 1: Take terminated employees' computer and key card access off the system immediately upon the employees' leaving employment.

Action Response: By December 1, 1995, the Human Resources and Information Technology Services Divisions will develop a procedure for identifying and referring the names of employees to immediately deactivate their computer access.

Staff of these divisions will perform a post audit to determine whether this process is effective.

Recommendation 2: Maintain documentation supporting the deprogramming of an unneeded key card.

Action Response: Employees are asked to surrender their key cards on termination. If the employee does not have the card or indicates that s/he has lost it, the Human Resources Division asks the landlord to render the card invalid immediately. The department will develop a system by which the record of deprogrammed key cards is confirmed in writing by the landlord and maintained in the Human Resources Division by December 1, 1995. The Human Resources Division will review landlord performance and effectiveness of the documentation system quarterly.

Recommendation 3: Keep documentation on file to support the addition or removal of employee access to the computer system.

Action Response: The Information Technology Services Division will develop a system to document addition and removal of employee access to the computer system by December 1, 1995.

FINDING 10

PRIOR FINDING NOT RESOLVED: The SCF needs to identify formally the documentation it is willing to accept in processing supplemental benefit reimbursements.

Recommendation 1: Develop written policies or procedures to determine acceptable documentation for ongoing permanent disability claims.

Action Response: The SCF mailed a five-page instructional memorandum on how to complete annual claims on March 27, 1995 to all insurers and self-insureds. This memorandum was also published in the February, 1995 edition of *CompAct*. The instructional memorandum also identified acceptable supporting documentation. On-site instructional seminars will also be performed at the initiation of the insurer.

Staff of the SCF will perform a biennial random check of permanent disability claims to determine whether the policies for documentation are followed and corrective action taken to assure compliance.

Recommendation 2: The Division should not reimburse insurers for supplemental benefits without documentation that the claim is valid and ongoing.

Response: During Fiscal Years 1994 and 1995 the SCF pulled all supplementary benefit annual claims that lacked supporting documentation. Staff mailed letters to insurers requesting supporting documentation on these claims. The claims were held until the documentation was received or voided after 60 days of no response.

The definition of appropriate supporting documentation was established. Insurers were notified that acceptable documentation was as follows: activity check report, medical report, rehabilitation report, or letter dated and signed by the employee. All reports or documentation must have been dated during (or after) the time period being claimed. Unacceptable documentation was also established as: a copy of a letter from the insurer to employee or prescription receipts.

The Reimbursement Team procedure manual was revised to include a section on appropriate and required supporting documentation. Compliance with this procedure will be monitored through the employee performance evaluation process.

Auditors' Note on Attachments to Response

The Department of Labor and Industry's response contained 23 pages of attachments that are not included in this report. These attachments are on file in the Office of the Legislative Auditor and are available upon request.

Rgnonti & Associates, Inc.

FRED W. RGNONTI

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October 31, 1995

Mr. James R. Nobles
Legislative Auditor
Office of the Legislative Auditor
Centennial Building
St. Paul, MN 55155

**Re: Audit of the Department of Labor and Industry,
including the results of your "review of the Department
of Labor & Industry's Investigative Services Contract
with Rgnonti & Associates"**

Dear Mr. Nobles:

The following is my response to that part of your office's audit of the Department of Labor and Industry dealing with my company.

As you know, it was over a year ago that I brought to the attention of the Department of Labor and Industry and the State of Minnesota the fact that a portion of the Special Compensation Fund had been mishandled by the director of that fund, Deborah Cordes. I was quite concerned that Ms. Cordes had undertaken unauthorized investigations and, more importantly, incurred substantial sums for work performed by my firm in these unauthorized investigations. I learned and informed the State that Ms. Cordes, through the assistance of a former employee of Rgnonti & Associates, put together a scheme or device to compensate my company for work actually performed in a fashion that was not authorized by the State and, in fact, constituted fraud and misrepresentation upon the State of Minnesota and Ms. Cordes' employer, the Special Compensation Fund.

Following this disclosure, I was advised that your office was performing an audit of the Department of Labor and Industry and that you needed access to my billing records with respect to the State of Minnesota. I opened my doors to your staff in late February or early March of 1995. At that time, one of your investigators spent 2½ to 3 weeks reviewing records at my business. My accountant, Brian Kelly, made every document and every file available to your investigator for her review.

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At the time of your initial investigation into my billing records, I, as well as my staff, made repeated statements to your investigator, Ms. Mellett, that two former disgruntled employees had substantial motivation to fabricate lies about my business and that, in fact, they had destroyed or altered records. Craig Larson, who actually schemed with Ms. Cordes to cover up her unauthorized activities, was in the process of negotiating a \$1 Million dollar contract through the Department of Labor and Industry for future investigative services for a company he was in the process of forming. Mr. Larson, apart from having significant business motivation for making me look bad, also was in default on a personal loan I made to him for an amount in excess of \$13,000.

It is my understanding that part of your conclusions are based upon Mr. Larson's testimony with respect to my billing operations. I cannot believe that your office, or anyone, would put any credence into the testimony of this gentleman.

You make specific reference in your audit report that *"a former bookkeeper for Rgnonti & Associates testified that she systematically added hours to the billings at the direction of Mr. Rgnonti."*

As you know, this former bookkeeper, Jodie Billings, stole and/or borrowed money from my company, a sum in excess of \$22,000, as well as giving herself case expenses of \$5,200 that were totally unauthorized. Unbeknownst to me, Craig Larson convinced the Dakota County prosecutor not to proceed against Ms. Billings criminally for her theft against my company. From that point on, Ms. Billings was indebted to Craig Larson. Apart from Ms. Billings' self motivation to assist Mr. Larson in his desire to destroy my business, Ms. Billings was a very inept and negligent bookkeeper. I have previously provided your office with copies of memos from my staff, including Craig Larson, wherein they detail in great length her inabilities as a bookkeeper.

I acknowledge that part of your audit is accurate. I did not purposely alter any billing statements to the State of Minnesota. As you may have been advised by one of your investigators, my accountant, Brian Kelly, discovered and brought to the attention of your office the fact that Ms. Billings had failed to program my billing package so as to reflect that the State was to be charged at a lower hourly rate than other clients. I do agree with that part of your report that states: *"The bookkeeper sometimes forgot to make the manual adjustment, resulting in the department being billed at the higher rate."*

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I accept full responsibility for this error. Additionally, my accountant informs me that duplicate payments were received by my company and that the amounts claimed by your department in that regard are accurate. I have in the past and do now acknowledge that I must reimburse the State of Minnesota for these oversights. However, I disagree vigorously with your allegations that \$31,501 should be repaid to the State as it represents excess hours not actually performed by my company.

I have spent my professional life as an investigator. First with the Scott County Sheriff's Office and, secondly with this business which I have built by myself. I am not only the owner and manager of the business, but I am also actively involved in all parts of the investigations handled by my personnel. I had substantial hands-on involvement with a great number of the State files. The \$31,501 in question I believe represents actual time spent by myself in the completion of the investigation assignments received from the State of Minnesota. I object to your reporting that I have provided you with no evidence that showed I worked on these cases. You have my sworn testimony detailing my involvement in these investigations. I would put my word and my reputation against that of Jodie Billings and Craig Larson anytime. I certainly would expect the State of Minnesota to acknowledge my forthrightness in this investigation and remember that I was the person who brought to the attention of the Department of Labor and Industry the irregularities in the billing process devised by Deborah Cordes.

I also disagree with your report's summary of the history of this investigation. I did not destroy records nor create documents. I made everything in my possession available to your office. I have provided documentation in affidavit form to your office to support my belief that Mr. Larson destroyed records and/or directed Jodie Billings to destroy records. This was done to destroy my reputation and/or to cover-up their financial wrongdoings within Rgnonti & Associates.

In your report, you state that the Ramsey County Attorney's Office elected not to proceed with this matter due to venue concerns. My attorney, Thomas Hunziker, had a telephone conversation with Assistant Ramsey County Attorney Charles Balck wherein Mr. Balck confirmed that neither Mr. Rgnonti nor his company were a target of any criminal investigation nor would be in the future. This conversation was confirmed in writing by Mr. Hunziker.

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When this matter was turned over to the Postal Inspectors for criminal investigation, I cooperated fully. I met with Gloria Faust, a special investigator for that US agency, and at the conclusion of her investigation, she stated that she found no evidence to support a criminal charge of fraud. Her conclusion was quite different from your report wherein you state that the Postal Inspectors *"determined that there was insufficient evidence to support criminal charges under federal law and closed its case."*

I think the old proverb that people who live in glass houses should not throw stones applies to the Department of Labor and Industry and its billing practices. Duplicate payments and overpayments could not have occurred but for the fact that I had a very negligent bookkeeper and the State of Minnesota's own accounting practices were apparently inadequate.

The saddest part of this tale for me is that I did my civic duty. I called the attention of the State of Minnesota to what I perceived to be a very irregular billing practice devised by Deborah Cordes. I then learned that Ms. Cordes hand-carried and kept in her desk a contract worth more than \$1 Million dollars in favor of Craig Larson, my then office manager, to do work in the future. I believe that part of the motivation for the audit of my billing procedures is to draw attention away from Deborah Cordes and her clear violation of State regulations. Because of all the adverse publicity that this matter has caused, my company's gross revenues are down by more than 50 percent (50%) and I am led to believe that Ms. Cordes has not missed a day's worth of wages.

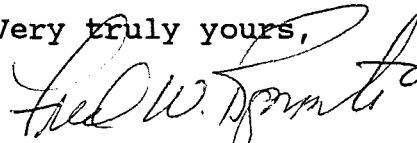
My lay understanding of an auditor's job is to state the facts, and only the facts. I do not understand why your office would make a reckless statement such as *"THEREFORE, WE BELIEVE IT IS LIKELY THAT THE FIRM MAY HAVE RECEIVED A SIGNIFICANT AMOUNT OF ADDITIONAL OVERPAYMENTS"* when you readily acknowledge in your report that there is no evidence to support this contention other than a suspicion. For this reason alone, from an auditor's standpoint, your report should be disregarded.

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RECOMMENDATIONS

- I meet with the appropriate person at the Department of Labor and Industry and we negotiate a settlement of the monies actually owed.
- That the activities of Deborah Cordes and Craig Larson be referred to the Attorney General for referral to the appropriate County Attorney.

Very truly yours,



Fred W. Rgnonti

FWR/sl