

Department of Labor and Industry

Programs Selected For Fiscal Year 1995 Statewide Audit

February 1996

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

96-8



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

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JAMES R. NOBLES, LEGISLATIVE AUDITOR

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Legislative Audit Commission

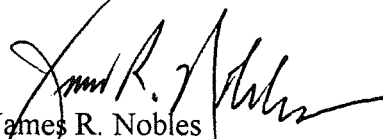
Members of the Legislative Audit Commission


Gary Bastian, Commissioner
Department of Labor and Industry

We have audited selected areas of the Department of Labor and Industry for the fiscal year ended June 30, 1995, as further explained in Chapter 1. The work conducted in the department is part of our Statewide Audit of the State of Minnesota's fiscal year 1995 financial statements. The Comprehensive Annual Financial Report for the year ended June 30, 1995 includes our report, issued thereon dated December 1, 1995. 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 require that we design the audit to provide reasonable assurance that the Department of Labor and Industry complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. Management of the Department of Labor and Industry is responsible for establishing and maintaining the internal control structure and complying with applicable laws, regulations, contracts, and grants.

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 February 16, 1996.


James R. Nobles
Legislative Auditor


John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: November 17, 1995

Report Signed On: February 8, 1996

SUMMARY

State of Minnesota

Office of the Legislative Auditor
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Department of Labor and Industry

Programs Selected for Fiscal Year 1995 Statewide Audit

Public Release Date: February 16, 1996

No. 96-8

Background

The Department of Labor and Industry was responsible for processing and paying about \$100 million of workers' compensation claims in fiscal year 1995. The claims are paid from the Special Compensation Fund that is financed by assessments made on certain insurance companies and employers. Mr. Gary Bastian has served as the Commissioner of Labor and Industry since April 12, 1995.

Selected Audit Areas and Conclusions

Our audit scope focused on department financial activities that were material to the state's fiscal year 1995 financial statements. As a result, we examined Special Compensation Fund assessments collected and workers' compensation claims paid. In addition, we reviewed access controls for the department's computer system.

We concluded that Special Compensation Fund assessments and claims were fairly presented on the state's fiscal year 1995 financial statements in compliance with generally accepted accounting principles.

The internal controls over assessment revenues were generally adequate; however we found some areas where the department could strengthen controls. The department needs to improve the timeliness of certain deposits; must ensure that newly licensed insurance companies are required to file assessment reports; and must maintain adequate supporting documentation for certain accounts receivable.

Our fiscal year 1994 audit cited several findings with the department's processing of workers' compensation claims. In fiscal year 1995, we found that the department was making progress with resolving these problems; however, continued efforts were needed.

Our review of access controls for the department's computer system revealed that, in general, the department is limiting access to sensitive data on its mainframe computer. We found, however, that computer programmers have unfettered and continuous access to all data. We concluded that such extensive access was unnecessary and inappropriate for the programmers and recommended that the department reevaluate its policy of giving unrestricted access to the programmers.

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
Jenny Lee	Auditor

Exit Conference

We discussed the findings and recommendations with the following staff of the Department of Labor and Industry on November 20, 1995:

Gary Bastian	Commissioner
Michael Houliston	Deputy Commissioner
Grethen Maglich	Assistant Commissioner
Brandon Miller	Acting Director, Special Compensation Fund Section
John Kufus	Accounting Officer, Special Compensation Fund Section
Anina Bearrood	Accounting Director
Patrick Sexton	Communications Director
Jean Bortz	Computer Support Supervisor

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 1995 expenditures of the department are shown in Table 1-1.

Table 1-1
Breakdown of Expenditures by Fund
Fiscal Year 1995

	<u>General Fund</u>	<u>Federal Fund</u>	<u>Special Compensation Fund</u>	<u>Other Funds</u>
Workers' Compensation Claims	\$ 0	\$ 0	\$ 99,748,416	\$ 0
Other	<u>3,715,247</u>	<u>3,326,212</u>	<u>22,848,591</u>	<u>1,123,451</u>
Total	<u>\$3,715,247</u>	<u>\$3,326,212</u>	<u>\$122,597,007</u>	<u>\$1,123,451</u>

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 1995. Other expenditures are presented in the Statewide Accounting System Managers' Financial Report as of October 13, 1995.

Our audit scope focused on the Special Compensation Fund assessments collected and workers' compensation claims paid. Both financial activities were material to the state's financial statements.

The primary objective of the Statewide Audit is to render an opinion on the State of Minnesota's financial statements included in its Comprehensive Annual Financial Report for fiscal year 1995. This includes determining whether the financial statements of the state present fairly its financial position, results of operations, and changes in cash flows in conformity with generally accepted accounting principles. As part of our work, we are required to gain an understanding of the internal control structure and ascertain whether the state complied with laws and regulations that may have a material effect on its financial statements.

To address these objectives, we interviewed key department employees, reviewed applicable policies and procedures, and tested representative samples of financial transactions.

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Our work in the Department of Labor and Industry is completed as part of our audit to express an opinion of the state's fiscal year 1995 financial statements. The Comprehensive Annual Financial Report for the year ended June 30, 1995 includes our report, issued thereon dated December 1, 1995. In addition, the compliance section of the Minnesota Financial and Compliance Report on Federally Assisted Programs for the year ended June 30, 1995 will include our reports on the internal control structure and compliance with laws and regulations for the state as a whole. We anticipate issuing that report in June 1996.

In addition to preparing the standard report, we have also developed some audit findings and recommendations. We discuss the results of our work on workers compensation assessments and claims in Chapters 2 and 3, respectively. In addition to the assessment and workers' compensation claims testing, we reviewed the access controls for the department's computer system. We discuss computer access in Chapter 4.

Chapter 2. Workers' Compensation Assessments and Penalties

Chapter Conclusions

The Special Compensation Fund revenues are fairly presented on the financial statements in accordance with generally accepted accounting principles. The internal controls over these revenues are generally adequate; however, we did find some areas where the department needs to strengthen controls. The department needs to improve the timeliness of certain deposits and ensure that newly licensed insurance companies file assessment reports. In addition, controls over the supporting documentation obtained for certain accounts receivable need improvement.

The department receives its major revenue from the Special Compensation Fund. The fund receives 96 percent of the total revenue for the department. In the fund, the revenue consists mainly of assessments, interest, penalties, and fines. The department sends licensed insurance companies assessment reports. The assessment is a self-imposed tax based on the amount of benefits paid out to injured employees.

Fiscal year 1995 receipts of the fund are shown in Table 2-1.

Table 2-1
Workers Compensation Revenue
Fiscal Year 1995

Assessments	\$134,962,960
Interest on Investments	3,879,713
Penalties	1,817,494
Fines	544,377
Other	6,009,653
Total	<u>\$147,214,197</u>

Source: Workers' compensation revenues 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 1995. Also, the Estimated/Actual Receipts Report as of October 13, 1995.

Our objective for examining workers' compensation assessments and penalties was part of our audit of the state's financial statements for fiscal year 1995. Specially, we addressed the following questions:

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

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- Did the Department of Labor and Industry adequately safeguard and document assessment and penalty receipts?

To support our efforts to address our objectives, 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, observed controls, and tested samples of financial transactions.

We found that the department needs to improve controls over receipts. The department needs to adequately safeguard receipts as discussed in Finding 1. Finding 2 discusses that the department should submit assessment reports to every licensed insurance company. In Finding 3, the department needs to obtain adequate documentation in order to support the financial transactions performed.

1. The Department of Labor and Industry did not have adequate controls for certain receipts.

The department did not deposit some checks promptly. For example, we found that the department held a deposit totaling over \$16 million for an extra day. According to Minn. Stat. Section 16A.275, the department must deposit receipts over \$250 on a daily basis. In addition, the department keeps undeposited receipts in a safe that is accessible to several staff. On some occasions, staff did not know in which account to deposit certain receipts. In those cases, the staff put the checks in the department's safe until they determined the appropriate account. Several staff know the combination to this safe. In the Special Compensation Fund, six fund staff can access the safe. Also, computer staff have access to the safe to store backup tapes. With so many staff having access to the safe, accountability over these checks is compromised. Rather than limiting access to one safe, we believe it would be more effective to deposit receipts into a temporary suspense account.

Recommendations

- *The department should deposit receipts in accordance with Minn. Stat. Section 16A.275.*
- *The department should establish a suspense account to hold those receipts for which the proper account is temporarily undetermined.*

2. The department does not send some newly licensed insurance or self-insured companies an assessment report.

The department staff did not send a newly licensed insurance company an assessment report. The department staff determine whether a company should receive an assessment report. Normally, staff wait for a company to be in business at least 30 to 60 days before an assessment report is sent. Minn. Rule 5220.2840, subpart 1, provides that an insurance or self-insured company should make semi-annual assessment payments to the fund based on workers' compensation benefits paid during a specified prior six month period. Assessments are based on benefits paid to

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a claimant for personal injuries. It is possible for a newly licensed company to owe assessments for benefits paid to a claimant. The department could have lost revenue by not sending every licensed company an assessment report.

Recommendation

- *The department should require every company licensed to sell workers' compensation to file an assessment report.*

3. The department does not adequately document certain accounts receivable.

The department processed uninsured accounts receivable transactions without any support of authorization or documentation as to how staff calculated the amount.

We found two occurrences where the department did not adequately authorize the financial transaction. In one case, the former director made an agreement with a court appointed conservator of a company under judicial oversight. The conservator and former director agreed to accept 20¢ on the dollar for a past due assessment. In the other case, an outside attorney working for the department agreed to reduce the amount an uninsured company owed the fund by \$5,000. In this particular example, we did not see any evidence indicating whether the department approved this decision. In both of these examples, the department should have controlled the agreements. One individual should not have the unilateral authority to make these types of agreements.

In addition, we found two accounts receivable amounts that staff did not adequately document. We were unable to determine how staff calculated the accounts receivable. In one case, the staff changed the amount billed to the amount received, resulting in \$70 of less revenue. We were unable to find any documentation to support the change in the receivable amount. Adequate documentation should be on file to support the calculations made on the accounts receivable.

Recommendations

- *The department should develop a procedure on authorizing special agreements.*
- *Adequate documentation should be on file to support all financial transactions.*

Department of Labor and Industry

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Chapter 3. Workers' Compensation Claims and Expenditure Refunds

Chapter Conclusions

The workers' compensation claims are fairly presented on the state's financial statements in accordance with generally accepted accounting principles. In the fiscal year 1994 audit report, we had several findings in this area. The Department of Labor and Industry staff are in the process of implementing our recommendations from the prior audit report. The department is making progress in resolving these problems; however, continued efforts are needed.

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 1995.

Table 3-1
Workers' Compensation Claims
Fiscal Year 1995

Supplemental benefit reimbursements	\$60,650,840
Second injury benefit reimbursements	26,338,314
Uninsured benefits (Note 1)	5,413,476
Insurance company reimbursements	3,128,163
Other	<u>4,217,623</u>
Total	<u>\$99,748,416</u>

Note 1: In accordance with generally accepted accounting principles, the department also recognized a long-term liability of \$45,390,000 for uninsured employees. This liability is presented in the General Long-Term Debt Account Group for the state's fiscal year 1995 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 1995.

Our objective for examining workers' compensation claims was part of our audit of the state's financial statements for fiscal year 1995. 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.

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We found that the Department of Labor and Industry is tightening controls over several aspects of claims processing, as recommended in our prior audit report. We still found some lack of support for both the medical and rehabilitation report for second injury and ongoing supplemental claims. However, these documentation problems found in fiscal year 1995 were not as extensive as in the prior year's audit. In March 1995, the department issued a memorandum to all insurers and self-insurers instructing them to provide acceptable documentation for both medical and rehabilitation reports and ongoing claims.

The department has also partially implemented another prior audit recommendation pertaining to the lack of separation of duties for uninsured lump sum payments of closed files. Currently, the claims specialists approve the lump sum payments, the account clerk processes the payments, and the file is closed. The department still needs to have someone independent of the account clerk review the lump sum payments after they are processed by the account clerk.

Chapter 4. Computer Access Controls

Chapter Conclusions

In general, the Department of Labor and Industry is limiting access to sensitive data on its mainframe computer. However, computer programmers have unfettered and continuous access to all data. We feel that this is unnecessary and inappropriate. The department should reevaluate its policy of giving unrestricted access to its computer programmers.

The Department of Labor and Industry runs Unisys Mapper software on its mainframe computer. The department's programmers use this software to design computerized business systems. One of these computerized systems maintains the detailed accounting records for the Special Compensation Fund.

Unisys Mapper has its own built-in security package. This security package uses unique logon IDs and passwords to control access to the system. All users must enter their logon ID and password to access Mapper. The software denies access to users with unknown logon IDs or incorrect passwords. It also denies access to users with canceled or suspended logon IDs.

We reviewed computer access controls as part of our annual financial audit of the Special Compensation Fund. Specifically, we focused our work on the following question:

- Is the department limiting access to data to only those employees who need access to fulfill their job responsibilities?

To answer this question, we interviewed the department's Mapper system coordinators, programmers, and users. The system coordinators are responsible for managing computer security. We also reviewed various Mapper security reports.

Mapper's security package is not as sophisticated as many other mainframe security products. It does not require passwords to be at least a certain minimum length. Mapper system coordinators can see other users' passwords. In fact, some Mapper security reports even list users' secret passwords. Unauthorized persons with this information could assume the identity of legitimate users and compromise security. These weaknesses are inherent in the Mapper software and we are not aware of a cost efficient method to correct them.

System coordinators are attempting to limit access to sensitive data, except that computer programmers have unfettered and continuous access to all data. As Finding 4 discusses, we do not believe that programmers need this clearance to fulfill their job responsibilities.

Department of Labor and Industry

4. Computer programmers have unlimited and continuous access to all data.

The Department of Labor and Industry gives its computer programmers clearance to read, change, and even delete data. We do not feel that this practice is appropriate or necessary. In fact, we feel that it exposes important and sensitive data to an unnecessary risk of loss or misuse.

Computer programmers do not typically work with actual production data. Rather, they work with test data in a special test environment. On some occasions, programmers need access to production data to perform maintenance functions. However, these occasions are rare and do not merit giving the programmers continuous and unrestricted access. We feel that it would be more appropriate to only give programmers the access they need to perform their normal job duties. The department then could control all other special access requests on a case by case basis.

Recommendation

- *The department should restrict the computer programmers' access to actual production data.*

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February 5, 1996

James R. Nobles
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658 Cedar Street
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Dear Mr. Nobles:

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, 1995 for our Department. This draft report accurately reflects the material that your staff discussed with us at the exit conference on November 20, 1995.

The fiscal year 1995 audit has four findings and six recommendations for actions. We concur with your recommendations for changes within the Department. You state that the internal controls over assessment revenues are generally adequate, however, some areas need further strengthening. Those areas are 1) improving the timeliness of certain deposits; 2) ensuring that all licensed companies that sell workers' compensation insurance file an assessment report; 3) establishing a procedure for Department authorization of special agreements; 4) ensuring that adequate backup documentation is filed for all financial transactions; and 5) establishing more restrictive access to the Department's database. We feel that these findings are reasonable, and we endorse them.

We have enclosed a summary of your recommendations with our action response for each item. **These changes were implemented this year.**

I would like to thank you and your staff for your review of our operations. The annual audit of our Department is an opportunity for operation improvements, and we view it as a healthy learning experience.

Sincerely,



Gary W. Bastian
Commissioner

GWB;GM

Enclosure

FEBRUARY 5, 1996

**SUMMARY OF FINDINGS, RECOMMENDATIONS AND ACTION RESPONSES TO
FISCAL YEAR 1995 FINANCIAL AUDIT OF THE DEPARTMENT OF LABOR AND
INDUSTRY**

CHAPTER 2. WORKERS' COMPENSATION ASSESSMENTS AND PENALTIES

PART 1

Recommendation #1- The Department should deposit receipts in accordance with Minnesota Statutes § 16A.275.

Recommendation #2 - The Department should establish a suspense account to hold those receipts for which the proper account is temporarily undetermined.

Action Response: The Special Compensation Fund currently complies with Minnesota Statutes § 16A.275. Checks are deposited on a daily basis. Checks received in the afternoon mail are stored overnight in a separate safe, accessible only to the Special Compensation Fund's accounting unit and the Special Fund Director. If it cannot be determined that a check correctly belongs to the Fund, or if the check cannot be redirected, the check is returned to the payor no later than the next working day.

All checks are logged upon receipt by a staff member not responsible for deposit. In the situation when a check clearly belongs to the Department, yet the proper account is not immediately evident, the check is deposited into a Department suspense account within one working day. The Department's accounting director was responsible for the establishment of a suspense account.

PART 2

Recommendation #1 - The Department should require every company licensed to sell workers' compensation to file an assessment report.

Action Response: The Department does require all insurers and self-insurers to file an assessment report. Companies are sent assessment reports no matter when they were licensed. This practice has been implemented with the mailing of the last reporting period assessment reports. It should be noted that the situation identified by the auditor which generated this recommendation involved one company. The business had been licensed to sell workers' compensation insurance ten calendar days before the end of the assessment period and inadvertently had not been sent an assessment report to cover those ten days. The current policy will not allow this to happen again. The Special Compensation Fund Director is responsible for this policy.

PART 3

Recommendation #1 - The Department should develop a procedure on authorizing special agreements.

Action Response: Special agreements or settlements on receivables, such as reimbursements from the Workers' Compensation Reinsurance Association (WCRA), Minnesota Insurers' Guaranty Association (MIGA), Self-insured Security Fund (SISF), and other insurance liability sources now must be signed by both the Special Compensation Fund Director and the Department's Accounting Director. The Special Compensation Director is responsible for implementation.

Recommendation #2 - Adequate documentation should be on file to support all financial transactions.

Action Response: Memos and letters substantiating changes to reimbursement agreements are generated by Department employees involved in negotiations. Those recommended changes now must be reviewed and approved by at least one of the following Fund employees: a claims representative, the claims supervisor, or the Director. After the changes are made to the agreement, the accounting staff makes the necessary changes to the accounts receivable. All such documentation will remain in the file. The Special Compensation Director is responsible for this policy implementation.

CHAPTER 4. COMPUTER ACCESS CONTROLS

Recommendation #1 - The Department should restrict the computer programmers' access to actual production data.

Action Response: Access has been restricted under the following outline procedure. Manual updating of the production database will be done only in instances where incorrect data has been entered and must be corrected. Access and the ability to make changes are limited to one Information Technology Services programmer and one Special Compensation Fund supervisor. Each individual event of manual updating will be agreed to and attended by a staff member from the Special Compensation Fund and Information Technology Services. The update will be documented on a department form (see Attachment A) and stored in the programming area. The Special Compensation director and the Information Technology Services supervisor are responsible for implementation.

It should be noted that all six of these changes have been implemented.

ATTACHMENT A

MAPPER C DATABASE CHANGES

DATE OF REQUEST: _____

SCF PERSON REQUESTING CHANGES: _____

CHANGES MADE: _____

REASON FOR CHANGES: _____

MODE: _____ CASE: _____ RID NUMBER: _____

PERSON MAKING CHANGES: _____

WORK LOCATION OF PERSON MAKING CHANGES: SCF ITS (Circle One)

DATE REQUEST COMPLETED: _____

SCF STAFF MEMBER PRESENT DURING CHANGES _____