

Department of Employee Relations

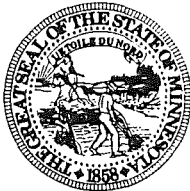
Programs Selected For Fiscal Year 1995 Statewide Audit

April 1996

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

96-17



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Representative Ann H. Rest, Chair
Legislative Audit Commission

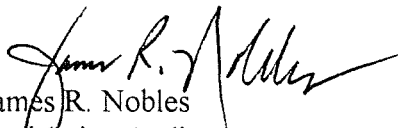
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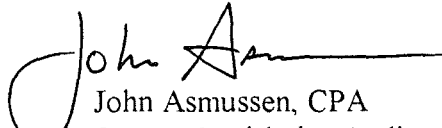
Mr. Wayne Simoneau, Acting Commissioner
Department of Employee Relations

We have audited selected areas of the Department of Employee Relations (DOER) for the fiscal year ended June 30, 1995, as further explained in Chapter 1. The work conducted at DOER is part of our Statewide Audit of the state of Minnesota's fiscal year 1995 financial statements and Single Audit federal compliance audit. The Comprehensive Annual Financial Report for the year ended June 30, 1995, includes our report, issued thereon dated December 1, 1995. The Minnesota Financial and Compliance Report on Federally Assisted Programs for the year ended June 30, 1995, will include our reports on the supplementary information schedule, internal control structure, and compliance with laws and regulations. We anticipate issuing this report in June 1996. Our audit scope also included selected audit areas, as part of our department level work. Therefore, we emphasize that this has not been a complete audit of all financial activities of the Department of Employee Relations. 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 Employee Relations complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. Management of the Department of Employee Relations 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 Employee Relations. This restriction is not intended to limit the distribution of this report, which was released as a public document on April 24, 1996.


James R. Nobles
Legislative Auditor


John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: December 22, 1995

Report Signed On: April 18, 1996

SUMMARY

State of Minnesota

Office of the Legislative Auditor

Centennial Office Building • St. Paul, MN 55155
612/296-4708

Department of Employee Relations

Programs Selected For Fiscal Year 1995 Statewide Audit

Public Release Date: April 24, 1996

No. 96-17

Department Background

The Department of Employee Relations (DOER) is the central human resource agency for the executive branch of state government. Its duties include personnel administration and labor relations. The department operates the insurance and workers' compensation programs for state employees. It also responds to the general public seeking information about employment and organizations involved in human and civil rights issues. DOER administers the Public Employee Insurance Program (PEIP) which provides public employees with insurance benefits. It also administers the Minnesota Employee Insurance Program (MEIP) which provides insurance benefit plans to private employees. Wayne Simoneau is the current acting commissioner, replacing Bruce Johnson in September 1995.

Selected Audit Areas and Conclusions

Our audit scope was limited to those areas material to the State of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1995. We audited the revenues and expenditures of the State Employee Insurance Program, the Public Employee Insurance Program, the Minnesota Employees Insurance Program, and the estimated workers' compensation liability.

The DOER Insurance Division manages several insurance programs which covers state, public, and certain private employees. The division adequately ensures that the enrollment data in the state's insurance system agrees with carrier enrollments. The division properly bills and collects premiums for enrollees maintained on the state's insurance system; however, improved financial control is needed over premiums collected for enrollees not maintained on this system. The Employee Insurance Fund has accumulated significant cash funds averaging over \$79 million daily during fiscal year 1995; however, these funds are not aggressively invested. In addition, the department should take a more active oversight role involving key financial provisions and limits of its State Health Plan under contract with Blue Cross Blue Shield. We also noted concerns with payment invoices missing from fiscal services files and other controls over contract services.

The DOER Workers' Compensation Program manages and controls claims costs for work-related injuries to state employees. Workers' compensation specialists maintain a computerized system to estimate the state's financial exposure to these injuries. However, DOER does not always retain critical information supporting the estimated liability determination.

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
Tom Donahue, CPA	Audit Manager
Brad White, CPA	Auditor-in-Charge
Sonya Hill, CPA	Staff Auditor
Laura Puig-White	Staff Auditor
David Rosoff	Intern

Exit Conference

We discussed the results of the audit at an exit conference with the following DOER staff on April 8, 1996:

Karen Carpenter	Deputy Commissioner
Chris Goodwill	Manager, Administrative Services
Kathy Burek	Director, Employee Insurance
Sue Gehman	Director, Fiscal Services

Chapter 1. Introduction

The Department of Employee Relations (DOER) is the central human resource agency for the executive branch of state government. Its duties include personnel administration and labor relations. The department operates the insurance and workers' compensation programs for state employees. It also responds to the general public seeking information about employment and organizations involved in human and civil rights issues. Wayne Simoneau is the current acting commissioner, replacing Bruce Johnson in September 1995.

DOER's Human Resource Management Division is responsible for recruiting, classifying, and training employees. It also administers the statewide affirmative action program. The labor relations bureau negotiates collective bargaining agreements and develops compensation plans. The department's administrative function operates the personnel system, administers statewide payroll certifications, and provides support services for \$1.8 billion in annual payroll costs for fiscal year 1995. DOER received General Fund appropriations totaling \$7,367,000 in fiscal year 1995.

DOER administers the Public Employee Insurance Program (PEIP) which provides public employees with insurance benefits. DOER also administers the Minnesota Employee Insurance Program (MEIP) which provides insurance benefit plans to private employees. An additional \$1 million was appropriated for the Health Care Access Fund in fiscal year 1995. The \$1 million was set aside and is available to the Minnesota Employees Insurance Program (MEIP) as an operating loan, if needed.

The department also determines and pays workers' compensation claims for state employees. DOER bills these costs to the appropriate employer agencies. As explained in Chapter 3, DOER maintains a computerized system which estimates and tracks exposures on workers' compensation injuries. As of June 30, 1995 the department estimated that the state's liability for workers' compensation claims was \$112 million.

Our audit scope for the 1995 fiscal year focused on the department's employee insurance funds, revenues, and expenditures, as shown in Table 1-1. Our audit scope also included the estimated workers' compensation liability mentioned above. These financial activities were material to the state's financial statements and to the Single Audit objectives.

Department of Employee Relations

Table 1-1
Department of Employee Relations
Employee Insurance Funds Revenues and Expenses
Fiscal Year ending June 30, 1995
(in thousands)

	<u>State Insurance Fund</u>	<u>Public Insurance Fund</u>	<u>Private Insurance Fund</u>
<u>Revenues:</u>			
Insurance Premiums	\$203,684	\$ 8,467	\$4,338
Investment Income	<u>4,216</u>	<u>431</u>	<u>43</u>
Total Revenues	<u>\$207,900</u>	<u>\$ 8,898</u>	<u>\$4,381</u>
<u>Expenses:</u>			
Insurance Premiums	\$101,762	\$ 6,292	\$3,843
Medical Claims	109,605	3,026	0
Other Administrative	<u>2,006</u>	<u>998</u>	<u>649</u>
Total Expenses	<u>\$213,373</u>	<u>\$10,316</u>	<u>\$4,492</u>

Source: 1995 State of Minnesota Comprehensive Annual Financial Report.

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 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 this objective, we interviewed key department employees, reviewed applicable policies and procedures, and tested representative samples of financial transactions.

Our work in the Department of Employee Relations was completed as part of our audit to express an opinion on 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. The Minnesota Financial and Compliance Report on Federally Assisted Programs for the year ended June 30, 1995 will include our reports on the supplementary information schedule, internal control structure, and compliance with laws and regulations. We anticipate issuing this report in June 1996.

We concluded that the amounts shown on Table 1-1 were fairly presented on the state's Comprehensive Annual Financial Report for the year ended June 30, 1995. We discuss, in detail, any internal control issues and other concerns in Chapters 2 and 3 of this report.

Chapter 2. Employee Insurance Funds

Chapter Conclusions

The DOER Insurance Division manages several insurance programs which cover state, public, and certain private employees. The division adequately ensures that enrollment data in the state's insurance system agrees with carrier enrollments. The division properly bills and collects premiums for enrollees maintained on the state's insurance system; however, improved financial control is needed over premiums collected for enrollees not maintained on this system. The Employee Insurance Fund has accumulated significant cash funds averaging over \$79 million daily during fiscal year 1995, however, these funds are not aggressively invested. In addition, the Insurance Division should take a more active oversight role involving key financial provisions and limits of its State Health Plan under contract with Blue Cross Blue Shield. Payment approval should be provided to Fiscal Services and be based on compliance with these contractual provisions and limits. We also noted concerns with payment invoices missing from Fiscal Services files and other controls over contract services.

The DOER Employee Insurance Division is responsible for administering insurance programs which cover state, public, and eligible private employees. The division maintains three separate funds to account for and provide insurance benefits to these employee groups: The State Employee Insurance Fund, the Public Employees Insurance Program (PEIP), and the Minnesota Employees Insurance Program (MEIP).

The State Employee Insurance Fund is the largest fund. It services the component departments and agencies of state government and its employees. Also, certain quasi-state entities, such as the University of Minnesota participate. Through open enrollment, state employees may select from various insurance plans offered by several different insurance companies. These companies negotiate with DOER's Insurance Division to underwrite the medical, dental, and life insurance plans offered to employees. In addition, these plans compete with the State Health Plan administered by the division. Blue Cross Blue Shield is under contract with DOER to properly process and control claims for the State Health Plan. As a result of this managed competition, insurance carriers are encouraged to negotiate the lowest possible premium rates.

The department collects State Employee Insurance Fund premiums from state employees and employers through payroll deductions and transfers the appropriate premiums to the various insurance carrier accounts. State Health Plan premiums collected remain in the state treasury from which claims are paid. The University of Minnesota also collects premiums from its employees and remits them to DOER for deposit into the insurance trust fund account.

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DOER also administers the Public Employee Insurance Program (PEIP) which provides public employees with health, life, and dental insurance programs. The program provides local public employers with the advantages of larger group insurance purchasing, as well as health plan choices to its employees. The program received funds from the Public Employee Retirement Association (PERA) in fiscal years 1993 and 1994 for excess police aid which was deposited into the PEIP program. Minnesota Laws for 1994 directed the department to return \$3,500,000 to the state's General Fund. A transfer was made on December 1, 1994.

The Legislature established the Minnesota Employee Insurance Program (MEIP) on July 1, 1993 as part of its 1992 Minnesota Care legislation. The program provided small employers with the advantages of pooling their health insurance needs and offering their employees a choice of multiple health plan options. MEIP administrative staff negotiate and contract for marketing, advertising, billing, enrollment, consulting, and actuarial services. MEIP borrowed \$2,075,000 from the health care access fund for administrative and startup funding. The loan is scheduled to be repaid by fiscal year 1998.

Financial Accounting and Reporting

The state employee insurance fund is classified as an internal service fund. The local public (PEIP) and private employee (MEIP) funds are classified as separate enterprise funds. DOER Fiscal Services has an annual process to accumulate accounting balances and compile the financial statements for the three insurance funds. All financial activities of the three insurance funds are shown in Table 2-1.

Table 2-1
Department of Employee Relations
State, Public, and Private Employee Insurance Funds
Fiscal Year Ending June 30, 1995

Financial Activity	State Employee Insurance Fund	Public Employee Insurance Fund	Private Employee Insurance Fund
Premium Revenue	\$203,684,000	\$ 8,467,000	\$ 4,338,000
Operating Expenses	<u>213,373,000</u>	<u>10,316,000</u>	<u>4,492,000</u>
Operating Income (Loss)	(9,689,000)	(1,849,000)	(154,000)
Investment Income	<u>4,216,000</u>	<u>431,000</u>	<u>43,000</u>
	(\$ 5,473,000)	(\$1,418,000)	(\$ 111,000)
Transfers Out	<u>0</u>	<u>(3,500,000)</u>	<u>0</u>
Net Income/Loss	(5,473,000)	(4,918,000)	(111,000)
Fund Equity at 6/30/94	81,710,000	0	(861,000)
Change in Reporting Entity	<u>(10,727,000)</u>	<u>10,727,000</u>	<u>0</u>
Fund Equity at 6/30/95	<u>\$ 65,510,000</u>	<u>\$ 5,809,000</u>	<u>(\$ 972,000)</u>

Source: State of Minnesota Comprehensive Annual Financial Report for fiscal year 1995.

Our audit objective was to determine whether the insurance fund financial activities are fairly presented in the State of Minnesota's Comprehensive Annual Financial Report for fiscal year

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1995. Audit work included comparison of financial statement balances reported to assets, revenues, and expenses recorded in the state treasury.

All three insurance funds incurred losses in fiscal year 1995. The department attributes State Employee Insurance Fund losses to employee open enrollment changes to less expensive insurance plans and increases in claims costs due to increasing health care costs and an aging workforce. The department has responded to this loss by offering a new alternative, the State Health Plan Select, to employees for 1996. PEIP losses were attributed to claims runoff costs due to financial exposure when the fund was initially self-insured. MEIP losses were caused by initial administrative and startup costs. The program anticipates cost savings initiatives and expense reductions should improve its financial position in upcoming years.

State Employee Insurance Fund Revenue and Expense

The State Employee Insurance Fund reported annual revenue of \$208 million and expenses of \$213 million in its fiscal year 1995 financial statements. The fund offers six different health plans, four different dental plans, state paid employee life insurance, and a variety of optional insurance benefits. State employees can add or drop plans during an open enrollment period. Providing employees with a choice of plans and options creates competition between the insurance carriers themselves as well as the State Health Plan managed by the department. The State Health Plan is a self-insured health plan and has the largest enrollment in the fund.

Our audit work included analyzing revenue and expense levels for the three insurance funds. Premiums collected were compared to premiums disbursed to insurance carriers. We also reviewed enrollment reconciliations completed by the carriers. For the State Health Plan we selected a sample of employees or dependents which were incurring claims costs, and tested to ensure premiums were accurately paid to the State Health Plan. We also tested a sample of insurance premiums refund transactions. As a result of our work, we noted the following findings.

1. The department is not optimizing investment income for the State Employee Insurance Fund.

The department has not established a cash management and investment strategy, nor pursued investment options that could optimize potential investment income for the State Employee Insurance Fund. As of June 30, 1995, the fund reported a cash balance of \$74,875,295. Throughout fiscal year 1995, the fund's daily cash balance averaged \$79 million. Currently, the fund's cash balances are invested by the State Board of Investment (SBI) as part of the invested treasurer's cash (ITC) pool. However, the department could become more actively involved in the SBI investment process to optimize the fund's investment income. Holding such large levels of cash in ITC does not afford DOER the opportunity to earn a greater return for its employee insurance fund.

Cash in the invested treasurer's cash pool is a liquid, short-term investment which earned 5.34 percent interest for fiscal year 1995. Greater investment returns could have been earned if funds had been separately invested for a longer maturity period. This would require the department to work with SBI to coordinate timing of funds available for investment. SBI will bid and select

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investments with maturity periods that coincide with the cash flow needs of the fund. Upon maturity, cash can be returned to the fund or reinvested.

The department has not established a minimum level of cash needed for fund operations. The level maintained is a cost-benefit decision which must be made by management of the department. The potential for additional investment income must be balanced against the cash liquidity needs of the fund and administrative costs necessary to monitor balances. Ideally, the department should attempt to minimize the amount held in cash, increasing funds available for investment opportunities. A critical consideration in a cash and investment strategy would be the duration of investments and the liquidity needs of the fund.

Recommendation

- *The department should consider working with the State Board of Investment to develop an investment strategy which will optimize investment income and still meet the cash flow needs of the fund.*

2. The department does not monitor and control all premiums due to the State Health Plan.

The Insurance Division lacks control over State Health Plan premiums due from the University of Minnesota and retirees that pay Blue Cross Blue Shield directly. Currently, there is no monitoring procedure in place to ensure that these premiums are collected on a biweekly or monthly cycle, and that the enrollment counts and rates are reasonable. These enrollments are not maintained on the state's insurance system, yet the department makes no effort to analyze enrollment trends and rate details supporting each remittance.

The department routinely collects and deposits insurance collections from the University of Minnesota and Blue Cross Blue Shield without an assurance that each payroll cycle is received. We found that a University of Minnesota premium check received in July 1994, totaling \$553,812, was misplaced and not deposited for 11 months. Using the invested treasurer's cash (ITC) average rate of return for fiscal year 1995, an estimated investment income of \$30,000 was lost. A simple, cost-effective process to ensure premiums were received would include a schedule, listing each premium cycle that could be checked off when the monthly premium check was received.

Both the University of Minnesota and Blue Cross Blue Shield submit supporting enrollment and rate data supporting each remittance received. However, the department did not attempt to analyze this data for reasonableness. Enrollment trends and rates should be fairly stable except during contract rate changes and open enrollment. Without such an analysis, there is no assurance that all premiums are being remitted to the state's employee insurance fund.

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Recommendation

- *The Insurance Division should improve control over State Health Plan premiums by:*
 - *establishing a monitoring process to ensure that biweekly and monthly premiums are collected from the University of Minnesota and Blue Cross Blue Shield for retirees that pay them directly; and*
 - *analyzing enrollment counts and rates supporting each remittance received.*

3. The department lacks control over State Health Plan claims costs.

The department relies on Blue Cross Blue Shield's (BCBS) claims processing systems for payment of eligible State Health Plan claims. DOER disburses over \$100 million annually to BCBS to cover these claims. However, DOER is not actively monitoring certain financial provisions and limits specified in its contract with BCBS. No Insurance Division approval is given to Fiscal Services indicating compliance with these contract provisions and limits. In addition, the department's Insurance Division has not verified the 1994 contract financial settlement of \$2,036,789 returned by BCBS. We noted that BCBS also refunded \$73,976 on May 1, 1995 for prior year runoff credit claims and recoveries which DOER never received. We made the department aware of this and they are pursuing the refund.

The department depends on BCBS systems to control claims processing for the State Health Plan. It pays BCBS to monitor and control eligibility of participants and respective coverages. DOER needs to be assured that the contractors system operates in a controlled and secured environment. The department had initiated a contract for a review of this system, however, the contract was never finalized. Technical guidance is provided in *Statements on Auditing Standards (SAS) #70 Reports on the Processing of Transactions by Service Organizations*. This statement provides guidance for identifying and relying on the internal control structure of external service organizations such as sophisticated computer systems. The department should work with BCBS to initiate a review of its claims processing systems.

The department currently does not oversee a number of important financial provisions contained in its contract with Blue Cross Blue Shield. For example, the Insurance Division does not approve payments made under the contract. In addition, the Insurance Division has not verified other financial incentives, penalty provisions, and performance indicators supporting the \$2 million 1994 contract refund settlement. Fiscal Services does not monitor a monthly cash flow regulator which limits the amount of monthly claims to 125 percent of the monthly expected claims rate. Without adequate controls to monitor key financial provisions and limits and to verify contract settlements, insurance fund disbursements to Blue Cross Blue Shield are not sufficiently controlled. The Insurance Division needs to determine if important contract provisions have been substantially met to support approval of payment under the contract.

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Recommendation

- *The Insurance Division should improve control over State Health Plan claims costs by:*
 - *requesting a review of the BCBS claims processing systems;*
 - *monitoring the contractual provisions and limits of the BCBS contract as a basis for approval of payment; and*
 - *verifying the accuracy and collection of refunds and contract settlements.*

Contractual Services

DOER's various insurance programs utilize consultant, professional, and technical contracts for a variety of services. The department disbursed over \$11 million to contractors through June 30, 1995. The Insurance Division is responsible for most of the contracts which are processed and paid through Fiscal Services. The largest contract exceeds \$7 million for medical claims processing services of the State Health Plan. Other smaller contracts are negotiated for specific needs of the Insurance Division.

4. DOER does not keep all contractor paid invoices and supporting documentation.

Fiscal Services is missing several paid contractor invoices and the appropriate supporting documentation. Payment evidence must be preserved and protected from loss to justify proper use of public funds. Microfilm copies were available at the Department of Finance through June 30, 1995. However, beginning July 1, 1995, the Department of Finance has discontinued microfilming agency disbursement documents. As a result, DOER's Fiscal Services Section now maintains the only official state record. All invoices need to be maintained to validate payment transactions.

Minn. Stat. Section 16A.58 provides that "The commissioner (of finance) or the head of a state agency designated by the commissioner is the custodian of original documents on which money has been or may be paid out of or received in the state treasury." Minn. Stat. Section 15.17, Subd. 1, requires "all officers and agencies of the state to make and preserve all records necessary to a full and accurate knowledge of their official activities." Subdivision 2 further requires that "it shall be the duty of each agency, and of its chief administrative officer, to carefully protect and preserve government records from deterioration, mutilation, loss, or destruction."

The department needs to develop a filing scheme for payment documents and procedures for checkout or removal of records from its files.

Recommendation

- *DOER should ensure that it maintains complete files of all original payment documents and supporting documentation.*

Chapter 3. Workers' Compensation

Chapter Conclusions

The department operates the Workers' Compensation Program to manage and control claims costs for work-related injuries to state employees. Workers' compensation specialists maintain a computerized system to estimate the state's financial exposure to these injuries. However, DOER does not always retain critical information supporting the estimated liability determination.

The Workers' Compensation Program is a self-insured program which administers workers' compensation benefits for injured state employees. It attempts to control and minimize costs for state employee work-related injuries and illnesses. The Workers' Compensation Program staff maintain a computer system (GENCOMP) that monitors estimated and actual medical claims, indemnity benefits, rehabilitation, and legal costs. The staff estimates the financial liability for injuries to state employees. This process allows financial control over individual state employee workers' compensation wage benefits and medical and rehabilitation claims. Workers' compensation costs are accumulated and billed back to the state agency involved.

Our objective was to determine the fair presentation of workers' compensation estimates recorded in the State of Minnesota's Comprehensive Annual Financial Report. We selected a sample of injured employees from various state departments and tested the reasonableness of the workers' compensation estimates. A sample of payments for medical claims and indemnity benefits was also tested to determine its impact on the estimate made. Table 3-1 shows the primary state departments comprising the state's workers' compensation revenue.

Table 3-1
State of Minnesota
Department Workers' Compensation Reserves
As of June 30, 1995

<u>Department</u>	<u>Reserves</u>	<u>Percent</u>
Human Services	\$38,725,052	34.4%
Transportation	18,682,717	16.6%
Corrections	9,858,771	8.8%
Natural Resources	8,259,096	7.3%
State Universities	5,610,088	5.0%
Public Safety	4,837,829	4.3%
Jobs and Training	3,696,876	3.3%
Community Colleges	3,499,933	3.1%
Other State Agencies	19,271,425	17.2%
Total:	<u>\$112,441,937</u>	<u>100.00%</u>

Source: June 30, 1995 GENCOMP System Report.

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The reserve calculations estimate the state of Minnesota's financial liability for workers' compensation claims. The reserve also acts as a spending budget to control individual claims. At June 30, 1995, the state's estimated liability was \$112 million, compared to \$116 million at June 30, 1994.

Effective July 1, 1993, the program contracted with a certified managed care plan to provide a specialized network of participating health care providers, utilization management services, and medical bill payment processing. The contractor provided weekly update of payment information into the GENCOMP system. Workers' Compensation Program staff detected that duplicate payments totaling \$38,880 were made to the contractor. Staff are currently working with the contractor to identify and recover these duplicate payments on a case-by-case basis. An internal review of the managed care contract was initiated by the department and a formal report is pending.

5. PRIOR RECOMMENDATION PARTIALLY IMPLEMENTED: The department does not adequately retain key information used to estimate workers' compensation liabilities.

DOER's workers' compensation claim specialists do not adequately retain critical information supporting the estimated reserve balances for individual workers' compensation accounts. Without this information, the estimates cannot be reconstructed. On November 17, 1994 department management instructed specialists to identify this information in the computer system, but we continue to find insufficient details supporting recent estimates.

DOER staff estimate reserves (a liability) for unpaid compensation, medical expenses, and rehabilitation costs relating to work injuries to state employees. The reserve calculation estimates the state of Minnesota's financial liability for workers' compensation claims. The reserves also act as a spending budget on individual claims. At June 30, 1995, the state's estimated liability was \$112 million.

Workers' compensation specialists staff maintain a computerized system to track all individual injuries and reserves necessary to satisfy future claims. They are provided a minimum reserve guide for evaluating the initial exposure based on the type and duration of injury. However, DOER does not always provide adequate explanation or reason for changes made to initial reserve estimates. Workers' compensation specialists could not reconstruct certain initial estimates or reserve changes made during fiscal year 1995. We had to rely on much of the verbal reasons and facts provided. These decisions need to be retained and documented in the GENCOMP system as they are made. Although the computer system contains a feature which allows an explanation to be provided, the workers' compensation specialists have not taken advantage of it.

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Recommendation

- *The department should improve internal control procedures to retain critical information regarding estimates and changes to workers' compensation reserves, including:*
 - *beginning date and number of weeks for all indemnity categories;*
 - *offset information and identification of other disability benefits;*
 - *earning capacity for calculations of temporary partial disability benefits;*
and
 - *rationale for the reserve change.*

Department of Employee Relations

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Minnesota

Department of

Employee

Relations

*Leadership and partnership in
human resource management*

April 15, 1996

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

Dear Mr. Nobles:

Thank you for the opportunity to respond to the Audit Report for the Department of Employee Relations.

Enclosed is our response to your findings and recommendations from your audit report for the year ending June 30, 1995. We will work toward implementing the recommendations made by your audit as quickly as possible.

I want to thank you and your staff for the cooperation and assistance given to us.

Sincerely,



Wayne Simoneau
Commissioner



Enclosure

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Department of Employee Relations
Response to Audit Findings and Recommendations

A. Employee Insurance Funds

Finding #1: The department is not optimizing investment income for the State Employee Insurance Fund.

DOER Response:

Since the function of cash management and investment strategy is the role of the State Board of Investment (SBI), DOER feels this issue is more appropriately addressed to them. However, for the department to consider becoming more actively involved in the investment strategy process, it would need to identify a level of reserves that could be dedicated to longer term investments. Since enrollment eligibility is subject to legislative action, and other forces beyond our control, there is some risk that we may need the already invested funds and not be able to access them.

A long-term study analyzing benefits and risks to a more aggressive investment strategy would be necessary before we could amend our present procedure. Funds would be invested no less conservatively than pension funds, and we would consult the advice of a trust fund specialist before pursuing alternate investment options.

Finding #2: The department does not monitor and control all premiums due to the State Health Plan.

DOER Response:

Historically, premiums and enrollment counts have been monitored by a health financial analyst position in the division. The individual in this position left and we are in the process of finding a replacement. In the interim, the newly-hired auditor, who begins full-time employment on April 22, will be re-establishing the necessary monitoring mechanisms.

Finding #3: The department lacks control over State Health Plan Claim costs.

DOER Response:

As with the previously-mentioned premium controls, claim costs had been monitored by the currently-vacant health financial analyst position and procedures will again be established to monitor these costs by the newly-hired auditor until the financial analyst position can be filled. In the interim, we have carefully monitored total costs of the program as part of our ongoing rate review with BlueCross BlueShield of Minnesota. While important, the monthly cash flow regulator is merely a vehicle to pay claims and at the same time, prevent potential instability created by any unusually-large claims coming due early in the year. The department retains a discretionary right to exceed the payment cap where necessary.

Finding #4: DOER does not keep all contractor paid invoices and supporting documentation.

DOER Response:

The department has historically maintained complete files of payment documents and supporting documentation. Since the Department of Finance will no longer maintain copies of agency payment documents as of the onset of fiscal year 1996, DOER has begun implementing procedures to provide its own system of backup for all source documents.

As a rule, source documents are prohibited from removal from the Fiscal Services Unit. However, a formalized system has already been implemented to record checkout or removal of documents from its files.

B. Workers' Compensation System

Finding #5: PRIOR RECOMMENDATION PARTIALLY IMPLEMENTED: The department does not adequately retain key information used to estimate workers' compensation liabilities.

DOER Response:

In response to the Legislative Auditor's Fiscal Year 1995 DOER Audit Report, Workers' Compensation Program management has once again specifically advised our claims management staff of the requirements to document reasons for reserve changes, including the number of weeks for all indemnity categories, beginning date for all indemnity reserves, offset information, and the rationale for the reserve change. In addition, we are adding the requirement that our claims managers specifically document earning capacity for calculations of temporary partial disability benefits, as indicated in the report.

Finally, we have made this documentation a required part of our self-audit procedure, which is a continuous review of claim file activity by a supervisor.