**Programs Selected For Fiscal Year 1996 Statewide Audit** 

February 1997

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Financial Audit Division Office of the Legislative Auditor State of Minnesota



### STATE OF MINNESOTA OFFICE OF THE LEGISLATIVE AUDITOR

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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Members of the Legislative Audit Commission

Ms. Karen Carpenter, Acting Commissioner Department of Employee Relations

We have audited selected areas of the Department of Employee Relations for the fiscal year ended June 30, 1996, 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 1996 financial statements and Single Audit federal compliance audit. The Comprehensive Annual Financial Report for the year ended June 30, 1996, includes our report, issued thereon dated December 2, 1996. The Minnesota Financial and Compliance Report on Federally Assisted Programs for the year ended June 30, 1996, 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 1997. 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 Introduction in Chapter 1 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 auditing standards and Governmental Auditing Standards, as issued by the Comptroller of the United States. 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 February 21, 1997.

John Asmussen, CPA

Deputy Legislative Auditor

James R. Nobles Lesislative Auditor

End of Fieldwork: December 10, 1996

Report Signed On: February 14, 1997



State of Minnesota

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#### **Department of Employee Relations**

Programs Selected For Fiscal Year 1996 Statewide Audit

Public Release Date: February 21, 1997

No. 97-10

#### **Department Background**

The Department of Employee Relations (DOER) serves as the central human resource agency for the executive branch of government. Its duties include personnel administration and labor relations. The department operates the State Employee Management (SEMA4) human resource/payroll system in conjunction with the Department of Finance. DOER 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 which provides public employees with insurance benefits. It also administers the Minnesota Employee Insurance Program which provides insurance benefit plans to private employers. Karen Carpenter is the current acting commissioner, replacing Wayne Simoneau in October 1996.

#### 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, 1996. We audited statewide payroll expenditures, 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 state's payroll expenditures were fairly presented in the Minnesota Accounting and Procurement System (MAPS) and the state of Minnesota's Comprehensive Annual Financial Report for fiscal year 1996. MAPS payroll expenditures, totaling \$2.1 billion, were properly supported by SEMA4 and PPS subsystem transactions. In addition, SEMA4 properly and accurately calculated, paid and reported employee wages, benefits, deductions, and contributions based on information entered by state agencies.

The Department of Employee Relations fairly presented the financial activities of the State Employee Insurance Fund, the Public Employees Insurance Program, and the Minnesota Employees Insurance Program in the state of Minnesota's Comprehensive Annual Financial Report for fiscal year 1996. In addition, the Insurance Division did enroll, bill, and collect premiums properly for enrollees maintained on the state's insurance system; however, improved financial control is needed over premiums collected for certain retirees not maintained on this system. Although the Employee Insurance Fund has significant cash funds totaling \$78 million as of June 30, 1996, DOER is not optimizing the fund's investment income. Also, DOER should obtain legal guidance on the disposition of excess cash held in the Delta Dental Trust and State Payroll Clearing Accounts. 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. DOER needs to collect premiums due from participants in the Public Employee Insurance Program in a timely manner.

The DOER Workers' Compensation Program manages and controls claims costs for work-related injuries to state employees. The department fairly estimated the June 30, 1996, workers' compensation liability to be \$101 million.

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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, CISA	Auditor-in-Charge
Susan O'Connell	Staff Auditor
Shane Smeby	Staff Auditor
Scott Tjomsland	Staff Auditor

#### **Exit Conference**

We discussed the results of the audit at an exit conference with the following Department of Employee Relations staff on February 11, 1997:

Karen Carpenter	Acting Commissioner
Chris Goodwill	Manager, Administrative Services
Kathy Burek	Assistant Commissioner for Employee Insurance
Liz Houlding	Acting Manager, Employees Insurance Division
Bill Bausch	Auditor, Employee Insurance Division

#### 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 State Employee Management (SEMA4) human resource/payroll system in conjunction with the Department of Finance. DOER manages 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. In October 1996, the Governor appointed Karen Carpenter to be the acting commissioner of DOER. At that time, the Governor appointed Wayne Simoneau, the former commissioner of DOER, to be the commissioner of Finance.

The Human Resource Management Program is responsible for the daily operations of SEMA4 human resource/payroll system, as well as 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.

DOER negotiates with private insurance companies to underwrite the medical, dental, and life insurance plans offered to employees. The insurance division processes enrollment, collects premiums, and pays insurance companies. As discussed in Chapter 2, annual revenues and expenses for the State Employees Insurance Program exceeded \$230 million for fiscal year 1996. During fiscal year 1996, DOER also administered the Public Employee Insurance Program which provides public employees with insurance benefits and Minnesota Employee Insurance Program which provides insurance benefit plans to private employees.

The department also determines and pays workers compensation claims for state employees. These costs are billed to the employer agencies. As explained in Chapter 3, DOER maintains a computerized system to estimate the state's liability for workers compensation injuries. As of June 30, 1996, the department estimated that the state had \$101 million of workers' compensation liabilities.

Our audit scope for the 1996 fiscal year focused on the SEMA4 payroll expenditures recorded in the state's accounting system, as well as the related compensated absence liability amounts. We also examined 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.

#### Table 1-1 Department of Employee Relations Employee Insurance Funds Revenues and Expenses Fiscal Year Ending June 30, 1996 (in thousands)

	State Employees Insurance Fund	Public Employees Insurance Fund	Private Employees _Insurance Fund_
Revenues: Insurance Premiums	\$227,744	\$ 9,910	\$ 7,207
Investment Income	<u>4,237</u>	318	<u>67</u>
Total Revenues	<u>\$231,981</u>	<u>\$ 10,228</u>	<u>\$ 7,274</u>
Expenses:			
Insurance Premiums	\$116,579	\$ 9,048	\$ 6,252
Medical Claims	102,138	26	0
Other Administrative	<u>12,519</u>	<u>737</u>	<u>834</u>
Total Expenses	<u>\$231,236</u>	<u>\$ 9,811</u>	<u>\$ 7,086</u>
Source: 1996 State of Minnesota Compre	ehensive Annual Financial Report.		

#### Chapter 2. SEMA4 Human Resource/Payroll

#### Chapter Conclusions

The Department of Employee Relations, in conjunction with the Department of Finance, operates the State Employee Management System (SEMA4). The state's payroll expenditures were fairly presented in the Minnesota Accounting and Procurement System (MAPS) and the state of Minnesota's Comprehensive Annual Financial Report for fiscal year 1996. MAPS payroll expenditures, totaling \$2.1 billion, were properly supported by SEMA4 and PPS subsystem transactions. In addition, SEMA4 properly and accurately calculated, paid and reported employee wages, benefits, deductions, and contributions based on information entered by state agencies.

#### Overview of System and Spending Level

On July 1, 1995, the State Employee Management (SEMA4) system, a new integrated human resource and payroll system, went into operation. The Departments of Employee Relations and Finance are jointly responsible for its operation. State agencies perform the initial input of payroll transactions, including biweekly hours worked and pay rates. Ultimately these transactions interface into the state's new accounting system, the Minnesota Accounting and Procurement System (MAPS) and are included in the state's Comprehensive Annual Financial Report. State of Minnesota payroll costs represent a substantial portion of state agency spending. Table 2-1 shows that payroll expenditures exceeded \$2 billion for fiscal year 1996.

# Table 2-1 State of Minnesota Statewide Payroll Expenditures by Fund Fiscal Year Ending June 30, 1996

Governmental Fund	Payroll Costs through June 30, 1996	Salaries Payable as of June 30, 1996	Total FY 1996 Payroll Expenditures
General	\$1,244,561,103	\$103,345,263	\$1,347,906,365
Special Revenue	611,944,538	42,053,268	653,997,895
Capital Projects	825,062	45,524	870,586
Enterprise	27,425,801	1,659,040	29,084,841
Internal Service	26,417,964	1,661,298	28,079,263
Gift and Fiduciary	<u>38,810,902</u>	1,068,393	39,879,295
Total Payroll Costs	<u>\$1,949,985,370</u>	<u>\$149,832,876</u>	<u>\$2,099,818,246</u>

Source: Minnesota Accounting and Procurement System (MAPS), fiscal year 1996, as of September 27, 1996.

Table 2-2 shows the annual payroll expenditures for the largest state agencies recorded in MAPS for fiscal year 1996.

## Table 2-2 State of Minnesota Annual Payroll Expenditures Fiscal Year Ending June 30, 1996

<u>Department</u>	Amount	Percent
Minnesota State Colleges and Universities	\$ 612,894,848	29%
Human Services	273,169,410	13%
Transportation	233,472,831	11%
Corrections	148,846,505	7%
Natural Resources	114,143,524	5%
Public Safety	83,850,265	4%
Economic Security	82,904,587	4%
Other State Agencies	<u>550,536,276</u>	<u>27%</u>
Total Payroll Expenditures	<u>\$2,099,818,246</u>	<u>100.0%</u>

Source: Minnesota Accounting and Procurement System (MAPS), fiscal year 1996, as of September 27, 1996.

State agencies began using SEMA4 during the first half of fiscal year 1996. Minnesota State Colleges and Universities (MnSCU), campuses and the central office, began using SEMA4 from May to August, 1996. Prior to the transition onto SEMA4, executive branch agencies and higher education campuses processed payroll transactions through the state's previous Payroll/Personnel System (PPS). Table 2-3 shows payroll expenditures processed through these systems for fiscal year 1996.

## Table 2-3 State of Minnesota Payroll Expenditures by System Fiscal Year 1996

Payroll System	Payroll costs through June 30, 1996	Salaries Payable as of June 30, 1996	FY 1996 Total	<u>Percent</u>
SEMA4 PPS Other systems	\$ 954,242,672 940,979,792 54,762,906	\$ 91,611,393 52,697,619 	\$1,045,854,065 993,677,411 60,286,770	49.8% 47.3% <u>2.9%</u>
Total Payroll	<u>\$1,949,985,370</u>	<u>\$149,832,876</u>	<u>\$2,099,818,246</u>	<u>100.0%</u>

Source: Minnesota Accounting and Procurement System (MAPS), fiscal year 1996, as of June 30, 1996, and September 27, 1996.

The transition from PPS to the SEMA4 system had a major impact on state agencies payroll responsibilities. SEMA4 incorporated distinct functions of payroll and human resource processes. State agency payroll offices are responsible for initiating biweekly payroll transactions based on time worked and leave taken. On entry into SEMA4, payroll and human resource transactions are edited for accuracy and reasonableness with various preventative and detective controls. We performed a separate audit (Audit Report 96-39) on the MAPS and SEMA4 systems. Our audit report, dated September 19, 1996, concluded that SEMA4 security and data integrity controls were effective at editing and controlling payroll data at the agencies. The Departments of

Employee Relations and Finance also perform ad hoc queries and analysis to isolate problematic transactions.

SEMA4 was designed with numerous features which enable an efficient processing of payroll. The system automates payroll processing of gross to net pay, leave accruals, employer and employee contributions and deductions. SEMA4 payroll transactions are identified with earnings codes that define the calculation and effect on an employee's gross pay. As shown in Table 2-4, the majority of SEMA4 payroll transactions primarily involve earnings codes which add up to the standard 80 hour or biweekly salary amount. Regular, vacation, holiday, and sick leave comprise over 93 percent of annual payroll. Other forms of supplemental, separation or additional pay comprise less than 7 percent of annual payroll costs.

# Table 2-4 State of Minnesota SEMA4 Earnings Code Summary Fiscal Year Ending June 30, 1996 (through PPE June 11, 1996)

SEMA4 Earnings Code	Amount	<u>Percent</u>
Regular	\$763,656,179	80.0%
Vacation	61,346,750	6.5%
Holiday	37,187,733	3.9%
Sick	28,915,790	3.0%
Overtime	18,413,488	1.9%
Compensatory Time Taken	7,308,707	0.8%
Vacation Payoff and Severance	2,340,552	0.2%
Other Earnings Codes	<u>35,073,473</u>	<u>3.7%</u>
SEMA4 Payroll Expenses	<u>\$954,242,672</u>	<u>100.0%</u>

Source: State Employee Management (SEMA4) System, fiscal year 1996, as of June 30, 1996 (through PPE 6/11/96).

Employer contributions are determined from various fringe benefit rate tables in SEMA4. The various state bargaining units and employee payroll plans have a variety of employer contribution rates. As shown in Table 2-5 employer contributions total 22 percent of employee payroll costs for fiscal year 1996.

# Table 2-5 State of Minnesota SEMA4 Employer Contributions Fiscal Year Ending June 30, 1996 (through PPE June 11, 1996)

SEMA4 Payroll Costs	Amount	Percent of Gross Pay
Employee Gross Pay	\$782,201,312	100%
Employer Contributions - Retirement	39, <b>918,094</b>	5%
Employer Contributions - FICA/Medicare	56, <b>991,636</b>	7%
Employer Contributions - Insurance	75,131,630	10%
Total Payroll Expenses	<b>\$954,242,672</b>	

Source: State Employee Management (SEMA4) System, fiscal year 1996, as of June 30, 1996, (through PPE June 11, 1996).

#### **Audit Objectives and Methodology**

We focused on the following objectives during our review of SEMA4 human resource/payroll system:

- Were state payroll expenditures fairly presented in the Minnesota Accounting and Procurement System (MAPS) and the state of Minnesota's Comprehensive Annual Financial Report for fiscal year 1996?
- Were MAPS payroll expenditures properly supported by SEMA4 and PPS subsystem transactions?
- Did SEMA4 properly calculate, pay, and report employee wages, benefits, deductions, and contributions based on information entered by state agencies?

To achieve these objectives, we interviewed Department of Employee Relations and Department of Finance employees to gain an understanding of the SEMA4 system and how it processes payroll and human resource transactions. We reviewed Department of Finance controls which compare SEMA4 transactions to MAPS payroll expenses. We obtained electronic copies of the SEMA4 labor distribution tables which support the MAPS payroll expenditures. Using computer assisted audit techniques, we tested the accuracy of employee transactions, analyzed earnings codes, and compared to bargaining unit criteria. We recalculated payroll using the hours and pay rates in the labor distribution table and tested employer and employee contributions for FICA, retirement, and insurance. We also verified the SEMA4 salary grid tables and tested the propriety and timing of employee pay rate changes.

#### **Conclusions**

Based on our review, we concluded that state payroll expenditures were fairly presented in the Minnesota Accounting and Procurement System (MAPS) and the state of Minnesota's Comprehensive Annual Financial Report for fiscal year 1996. We also determined that MAPS payroll expenditures, totaling \$2.1 billion, were properly supported by SEMA4 and PPS subsystem transactions. We also concluded that SEMA4 properly and accurately calculated, paid and reported employee wages, benefits, deductions, and contributions based on information entered by state agencies.

#### Chapter 3. Employee Insurance Funds

#### Chapter Conclusions

The Department of Employee Relations fairly presented the financial activities of the State Employee Insurance Fund, the Public Employees Insurance Program, and the Minnesota Employees Insurance Program in the state of Minnesota's Comprehensive Annual Financial Report for fiscal year 1996. In addition, the Insurance Division did enroll, bill, and collect premiums properly for enrollees maintained on the state's insurance system; however, improved financial control is needed over premiums collected for certain retirees not maintained on this system. Although the Employee Insurance Fund has significant cash funds totaling \$78 million as of June 30, 1996, DOER is not optimizing the fund's investment income. Also, DOER should obtain legal guidance on the disposition of excess cash held in the Delta Dental Trust and State Payroll Clearing Accounts. 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. DOER needs to collect premiums due from participants in the Public Employee Insurance Program in a timely manner.

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

#### State Employee Insurance Fund

The State Employee Insurance Fund reported annual revenue of \$232 million and expenses of \$231 million in its fiscal year 1996 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 which has the largest enrollment in the fund.

#### **Public Employee Insurance Program**

The Public Employee Insurance Program reported annual revenues and expenses of nearly \$10 million in fiscal year 1996. The Public Employee Insurance Program offers a variety of different insurance plans which are created to give public employers the advantages of large group purchasing including lower costs, stable premiums, and greater health plan choices. DOER manages and coordinates the activities of the participating health plans and administrative organizations. A plan administrator is under contract to handle the enrollment, participant billing, and premium costs passed on to the insurance carriers.

#### Minnesota Employee Insurance Program

The Minnesota Employee Insurance Program reported annual revenue and expense of over \$7 million for fiscal year 1996. The Minnesota Employee Insurance Program offers a variety of different insurance plans to private employers to allow advantages of large group purchasing similar to the Public Employees Insurance Program. DOER manages and coordinates the activities of the participating health plans and administrative organizations. The Minnesota Employee Insurance Program contracts with the same plan administrator as the Public Employee Insurance Program for handling enrollment, participant billing, and premium costs passed on to the insurance carriers.

Financial activities of the three funds for fiscal year 1996 are shown in Table 3-1.

Table 3-1
Department of Employee Relations
State, Public, and Private Employee Insurance Funds
Fiscal Year Ending June 30, 1996

Financial Activity	State Employee	Public Employee	Private Employee
	Insurance Fund	Insurance Fund	Insurance Fund
Premium Revenue Operating Expenses Operating Income (Loss) Investment Income	\$227,744,000	\$9,910,000	\$7,208,000
	231,236,000	9,811,000	7,086,000
	(3,492,000)	99,000	122,000
	4,237,000	<u>318,000</u>	67,000
Net Income (Loss)	\$ 745,000	\$ 417,000	\$ 189,000
Fund Equity at 6/30/95	<u>65,510,000</u>	5,809,000	<u>(972,000)</u>
Fund Equity at 6/30/96	\$ 66,255,000	\$6,226,000	<u>\$ (783,000)</u>

Source: State of Minnesota Comprehensive Annual Financial Report for fiscal year 1996.

The Employee Insurance Division added an internal audit function during fiscal year 1996 to review the accounting and reporting activities of the three funds. During fiscal year 1996, the internal auditor made several adjustments to correct expenses charged or costs allocated between the various insurance programs. In addition, the internal auditor developed a work plan to analyze cash reserves and to improve controls over the State Health Plan's claim processing.

#### **Audit Objectives and Methodology**

We focused on the following objectives during our audit of the financial statements of the State Employee Insurance Fund, the Public Employees Insurance Program, and the Minnesota Employees Insurance Program for the fiscal year ended June 30, 1996:

- Did DOER fairly present the financial activities of the State Employee Insurance Fund, the Public Employees Insurance Program, and the Minnesota Employees Insurance Program in the state of Minnesota's Comprehensive Annual Financial Report for fiscal year 1996?
- Did the Employee Insurance Division properly enroll, charge, and collect premiums for enrollees maintained on the state's insurance system during fiscal year 1996?

To answer these questions, we interviewed DOER employees, analyzed revenue and expense levels for the three insurance funds, traced premiums collected from enrollees to premiums disbursed to insurance carriers, and reviewed enrollment reconciliations completed by the carriers. For the State Employee Insurance Fund revenue we selected a sample of employees from the State Employee Management (SEMA4) system to ensure insurance premium deductions and employer insurance contributions were accurate. We also reviewed the State Health Plan administrative and claims costs paid for fiscal year 1996. For the Public Employees Insurance Program and the Minnesota Employees Insurance Program, we compared monthly premiums collected from participating entities to premiums disbursed to the plan administrator's. We reviewed the internal auditor's working papers regarding financial accountability and balances for all insurance funds.

#### **Conclusions**

We concluded that the Department of Employee Relations fairly presented the financial activities of the State Employee Insurance Fund, the Public Employees Insurance Program, and the Minnesota Employees Insurance Program in the state of Minnesota's Comprehensive Annual Financial Report for fiscal year 1996. In addition, the Employee Insurance Division did enroll, charge, and collect premiums properly for enrollees maintained on the state's insurance system during fiscal year 1996, except as explained in Finding 4 concerning the Public Employees Insurance Program. In addition, we noted Findings 1 through 3 relating to the State Employee Insurance Fund. Findings 1 and 3 are prior findings we identified in our previous audit report. Finding 2 addresses the department's legal authority to use excess cash collected in prior years.

## 1. PRIOR RECOMMENDATION PARTIALLY IMPLEMENTED: The department is not optimizing investment income for the State Employee Insurance Fund.

The department has not pursued investment options to optimize investment income for the State Employee Insurance Fund. Each month lost investment earnings continue to grow as the fund holds large levels of cash in the state treasury. Cash funds have increased by \$3.5 million over the last year to \$78 million as of June 30, 1996. Cash balances remained high throughout fiscal year 1996. The fund's cash balances are invested by the State Board of Investment as part of the invested treasurer's cash (ITC) pool. However, the ITC pool is intended for highly liquid, short-

term cash needs of state agency operations. The State Employee Insurance Fund cash flow stream does not require large amounts of highly liquid available cash. Holding such a large level of cash in ITC has resulted in lost investment opportunities.

Cash held in the invested treasurer's cash pool earned 5.7 percent or over \$4 million of interest for fiscal year 1996. The department could have earned over a million dollars of additional investment income had funds been separately invested for a longer maturity period. This would require the department to work with the State Board of Investment (SBI) to coordinate timing of funds available for investment. SBI will bid and select 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 SBI bond portfolio for the Permanent School Trust Fund earned 7.1 percent for top rated bonds with an average duration of 4.8 years. Using this interest rate the Employee Insurance Fund could have earned an additional \$1 million of investment income this fiscal year. This additional income could aid in reducing participant insurance premium rates.

The DOER internal auditor has been analyzing Employee Insurance Fund cash flows and needed cash reserves for current and prior years. This information should aid the department in establishing 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 work with the State Board of Investment to develop an investment strategy which will optimize investment income and meet the cash flow needs of the fund.

#### 2. The department's legal authority to use excess cash collected in prior years is unclear.

DOER collected cash and excess trust fund monies of over \$6 million for certain prior year financial activities. The legal authority to use this excess cash is unclear, and as a result, there is a risk of unauthorized use. Currently, this excess cash is held in separate state treasury accounts and not needed for operations. Table 3-2 shows the cash balances brought forward each fiscal year for the two accounts involved.

## Table 3-2 Cash Balances Carried Forward

Appropriation Account	Fiscal Year 1995	Fiscal Year 1996	Fiscal Year 1997
Delta Dental Trust	\$4,377,717	\$4,585,979	\$4,820,767
State Payroll Clearing	\$4,108,369	\$2,585,425	\$2,784,793

Source: Fiscal Year 1995 Statewide Accounting (SWA) Summary of Appropriation Balances within Fund Report as of October 13, 1995.

Fiscal Year 1996 Minnesota Accounting and Procurement System (MAPS) Appropriation Balance by Fund Report as of September 27, 1996.

- The Delta Dental Trust account has carried forward a cash balance of \$4.5 million into fiscal year 1996. The account was formerly a self-insured account in which premium collections exceeded claims costs, generating an excess cash balance. However, the Employee Insurance Fund no longer self-insures dental benefits. Investment earnings, totaling \$256,516, was the only financial activity of the account during fiscal year 1996. DOER brought forward a balance of approximately \$4.8 million into fiscal year 1997.
- The State Payroll Clearing account collected \$1.5 million in fiscal year 1993 settlement of \$1.5 million from the Fortis Insurance Company. DOER generally uses this account to temporarily record receipts that cannot be identified or allocated to another account. DOER eventually transfers these receipts into the appropriate accounts, intending no cash to be generated in the clearing account. However, the account has held and carried forward the Fortis cash balance since 1993. DOER carried forward a cash balance of approximately \$2.6 million into fiscal year 1996.

The Department of Employee Relations should seek legal guidance on the disposition and use of the excess cash collected under the circumstances described above. Possible alternatives could include reductions in insurance rates, refunds to insurance subscribers, or funding for administrative purposes.

#### Recommendation

• The department should work with the Attorney General's Office to determine appropriate uses for excess cash held in the Delta Dental Trust and State Payroll Clearing accounts.

## 3. PRIOR RECOMMENDATION PARTIALLY IMPLEMENTED: The Insurance Division lacks control over State Heath Plan claims costs.

The division relies extensively on Blue Cross Blue Shield (BCBS) claims processing systems for payment of eligible State Health Plan claims. DOER disburses approximately \$104 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. Currently, Fiscal Services receives a request directly from BCBS, and an electronic funds transfer is initiated without Insurance Division involvement.

The division depends on BCBS systems to control claims processing for the State Health Plan. It pays BCBS to monitor and control participant eligibility and coverages. DOER needs to be

assured that the contractor's system operates in a controlled and secured environment. The division has contacted BCBS to discuss options regarding a review of its claims processing systems. BCBS has indicated that it will soon be conducting a corporate risk assessment. BCBS plans to have an independent auditor conduct a SAS #70 review or allow user contractors to perform "agreed upon procedures" to gain the necessary assurances. However, at this time, no final decision has been reached.

The division currently does not oversee a number of important financial provisions contained in its contract with BCBS. For example, the Employee Insurance Division does not approve payments made under the contract. Disbursements are initiated by BCBS through Fiscal Services without Employee Insurance Division involvement. The division does not monitor the monthly cash flow regulator, which limits the amount of monthly claims to 125 percent of the monthly expected claims rate. Other financial provisions also exist and go unchecked by DOER. Without adequate controls to monitor key financial provisions and limits, insurance fund disbursements to BCBS 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.

#### Recommendation

- The Insurance Division should improve controls over State Health Plan claims costs by:
  - -- requesting a review of the BCBS claims processing systems; and
  - -- monitoring of contractual provisions and limits as a basis for approval of payment.

## 4. The division allows certain participants in the Public Employee Insurance Program to pay their premiums late.

During fiscal year 1996, the division did not collect premiums due from certain participants in a timely manner. However, the division transferred funds to pay the premium costs owed to the insurance carriers for the employees of these participants. This practice causes a negative cash flow impact on the Public Employee Insurance Program and, if never collected, creates a potential state liability to resolve the uncollected balance. It also increases the extent of administrative effort in monitoring and pursuing collection of these premiums.

The Public Employee Insurance Program premiums are billed in advance and due on the 25th of each month for next month's coverage. A 60 day grace period is allowed before considering the account delinquent and coverage is canceled. To avoid cancellation, DOER pays the premium amount due from the participant to the insurance carriers to keep the participant's coverage in force. The division needs to develop a policy for handling delinquent premiums which does not have negative cash flow implications on the Public Employee Insurance Program.

#### Recommendation

• DOER Employee Insurance Division should collect premiums from all participants in a timely manner. If necessary, division management should develop a policy for handling delinquent premiums.

#### Chapter 4. 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 liability for worker injuries. The department fairly estimated June 30, 1996, workers' compensation liability to be \$101 million.

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. Workers' Compensation Program staff estimate the financial liability for injuries to state employees. Staff maintain a computer system (GENCOMP) which monitors estimated and actual medical claims, indemnity benefits, rehabilitation, and legal costs. This system 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 employing state agency.

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. Table 4-1 shows the primary state departments comprising the estimated liability for the state's workers' compensation program.

# Table 4-1 State of Minnesota Workers' Compensation Estimated Liabilities As of June 30, 1996

<u>Department</u>	Liabilities	Percent
Human Services	\$32,270,054	31.7%
Transportation	18,428,488	18.1%
Corrections	9,233,465	9.1%
Natural Resources	9,029,628	8.9%
MN State Colleges and Universities	5,629,404	5.5%
Economic Security	3,814,831	3.8%
Public Safety	3,172,535	3.1%
Zoological Board	3,153,212	3.1%
Other State Agencies	<u> 16,935,698</u>	<u>16.7%</u>
Total	<u>\$101,667,315</u>	<u>100.0%</u>

Source: June 30, 1996, GENCOMP System Report.

The calculated liability is an estimate of the state of Minnesota's financial liability for potential workers' compensation claims. It also acts as a spending budget to control individual claims. At June 30, 1996, the state's estimated liability was \$101 million.

The program contracts 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 provides weekly update of payment information into the GENCOMP system.



Leadership and partnership in human resource management

February 13, 1997

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

Dear James Nobles:

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

The following is our response:

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

The internal auditor health care financial analyst of DOER is currently in the process of conducting a study to calculate the required reserve by plan type, as well as determining the cash levels necessary for the various operating accounts. The variables affecting this study are numerous, ever-changing and some are beyond the control of DOER. Preliminary results of our study indicate that a portion of the \$78 million in State Employee Insurance Fund cash balances could be placed into longer term investments with the expectation of increasing investment returns. However, it is impossible from an operating cash flow perspective to invest the entire State Employee Insurance Fund's \$78 million of cash balances in longer term investments. This was suggested by the Legislative Auditor as a method to earn additional investment income per year of \$1 million. The internal auditor will meet with representatives of the State Board of Investment (SBI) to discuss our investment objectives and develop an investment strategy that will maximize interest income in relation to the State Employee Insurance Fund's liquidity requirements.

### Finding #2: The department's legal authority to use excess cash collected in prior years is unclear.

A majority of the cash held in the Delta Dental Trust and State Payroll Clearing funds represent dollars collected and investment income earned in excess of the amount of claims paid.

Effective January 1, 1997, the Delta Dental portion of dental care for state employees is transitioning from a fully-insured to a self-insured basis. We are expecting the current cash balance of the Delta Dental Trust to be used to meet the reserve requirements under the newly self-funded arrangement.

The internal auditor will work with the Attorney General's Office to determine appropriate uses for cash held in the State Payroll Clearing account in excess of required levels.

#### Funding #3: The Insurance Division lacks control over State Health Plan claims costs.

A provision has been added to the contract with BCBS effective January 1, 1997 requiring BCBS to furnish the State with a Statement on Auditing Standards, No. 70 Report Type Two, or a substantially similar audit, issued by their independent auditors.

Procedures were implemented, during October of 1996, calling for the health care financial analyst to approve disbursements made to BCBS. In addition, EID staff have also implemented monitoring procedures related to certain provisions of the BCBS contract. However, monitoring procedures have not been implemented for all BCBS contract provisions. Our intention is to implement additional monitoring procedures on a priority basis.

## Finding #4: The division allows certain participants in the Public Employee Issuance Program to pay their premiums late.

The Public Employees Insurance Program (PEIP) did allow certain groups to delay their premium payments beyond the required due date. This delay had the effect of "floating" the premium owed beyond the due date. However, effective in September of 1996, all PEIP groups are subject to a change in policy regarding late payments. Essentially, any group that hasn't remitted premiums by the required due date, and served notification of the consequences, will have their coverage terminated.

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

Sincerely, Natur L. Carpenter

Karen L. Carpenter

Deputy Commissioner/Acting Commissioner

KC:can/1-nobles