Department of Labor and Industry

Financial Audit
For the Fiscal Year Ended June 30, 1996

March 1997

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

97-13

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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Members of the Legislative Audit Commission

Mr. Gary Bastain, 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, 1996, as further explained in the Introduction. The work conducted in the department is part of our Statewide Audit of the state of Minnesota's fiscal year 1996 financial statements. The Comprehensive Annual Financial Report for the year ended June 30, 1996, includes our report, issued thereon dated December 2, 1996. We also expanded our scope to review other receipts collected by the department. The following summary highlights the audit objectives and conclusions.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, as issued by the Comptroller General 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 Labor and Industry complied with provisions of laws, regulations, and contracts 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, and contracts.

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 March 14, 1997.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: December 30, 1996

Report Signed On: March 10, 1997

SUMMARY

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Department of Labor and Industry

Financial Audit
For the Fiscal Year Ended June 30, 1996

Public Release Date: March 14, 1997 No. 97-13

Background

The Department of Labor and Industry is responsible for processing and paying over $100 million of workers' compensation claims each year. The department's liability for these claims results from supplemental benefits, second injury responsibilities, and uninsured employers. The claims are paid from the Special Compensation Fund that is financed by assessments made on employers. The department also collected receipts for various purposes and activities, such as issuing licenses. Mr. Gary Bastian has served as Commissioner of Labor and Industry since April 12, 1995.

Selected Audit Areas and Conclusions

Our initial audit scope focused on workers' compensation claims paid and assessments collected by the Special Compensation Fund for fiscal year 1996. Both financial activities were material to the state's financial statements and examined as part of our annual Statewide Audit. We also expanded our work to examine internal controls over other departmental receipts during fiscal year 1996.

We concluded that Special Compensation Fund assessments and claims were fairly presented on the state's fiscal year 1996 financial statements in compliance with generally accepted accounting principles. However, we found that the department needs to maintain consistency in preparing the reserve for general long-term obligation. For fiscal year 1996, we made a $2.2 million adjustment in the reserve calculation.

We also found that the department needs to adequately safeguard receipts, verify completeness of deposits, and separate duties in the receipt cycle.

Our review of access controls for the department's computer system and the Minnesota Accounting Procurement System (MAPS) revealed that ineffective computer access controls are compounding the separation of duties weaknesses. In addition, people were given access to perform processes not necessary to the employee's regular job responsibilities. Collectively, these control weaknesses are exposing the department's assets to an unnecessary risk of loss or misuse.

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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
Fubara Dapper, CPA	Auditor
Eric Wion	Auditor
Anna Lamin	Intern

Exit Conference

We discussed the findings and recommendations with the following staff of the Department of Labor and Industry on February 26, 1997:

Gary W. Bastian	Commissioner
Michael Houliston	Deputy Commissioner
Gretchen Maglich	Assistant Commissioner, Workers' Compensation Division
Gail Blackstone	Assistant Commissioner, Workplace Services Division
Scott Brener	Assistant Commissioner, Legal Services Division
Brandon Miller	Director, Special Compensation Fund Section
John Kufus	Accounting Officer, Special Compensation Fund Section
Cindy Farrell	Accounting Manager
Anina Bearrood	Former Accounting Manager
Cindy Valentine	Chief Information Officer

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. Gary Bastian became commissioner of the Department of Labor and Industry on April 12, 1995.

The department's primary funding sources are workers' compensation assessments, General Fund appropriations, and federal grants. The majority of the department's receipt collection occurs in the Workers' Compensation Division. The total revenue collected during fiscal year 1996 totaled $129.5 million. Of this amount, the workers' compensation assessments totaled $108.8 million or 84 percent. The other $21 million represents amounts collected for interest on investments, penalties, fines, federal grants, and other revenues. Fiscal year 1996 expenditures of the department are shown in Table 1-1.

Table 1-1
Summary of Expenditures by Fund
Fiscal Year 1996

	General Fund	Federal Fund	Special Compensation Fund	Other Funds
Workers' Compensation Claims	$ 0	$ 0	$ 81,447,519	$ 0
Other	3,340,209	3,053,669	19,237,758	247,988
Total	$3,340,209	$3,053,669	$100,685,277	$247,988

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 1996. Other expenditures are as presented in the Minnesota Accounting and Procurement System as of September 27, 1996.

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. We discuss the results of our work on workers' compensation assessments and claims in Chapter 2 and 3, respectively. We expanded our audit scope to review internal controls over departmental receipts. Chapter 4 will discuss our findings and recommendations from our expanded scope of departmental receipts. We also reviewed the computer access for the department's computer system, as discussed in Chapter 5.

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Chapter 2. Workers' Compensation Assessments

Chapter Conclusions

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, as discussed in Chapter 5, we did find inadequate separation of duties with computer security access to receipt transactions.

The department receives its major revenue through the Special Compensation Fund, or 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 assessment reports to licensed insurance companies. The assessment is a self-imposed tax based on the amount of benefits the insurance company paid out to an injured employee.

Fiscal year 1996 receipts of the fund are shown in Table 2-1.

Table 2-1
Workers' Compensation Revenue
Fiscal Year 1996

Assessments	$109,420,056
Other	16,828,134
Total	$126,248,190

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 1996; Minnesota Accounting and Procurement System reports as of September 27, 1996; and Statewide Accounting System reports as of October 13, 1995.

Our review of workers' compensation assessments was part of our audit of the state's financial statements for fiscal year 1996. Specifically, we addressed the following questions:

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

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

In addressing our objectives, we also examined some 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.

Conclusions

Generally, we found the Department of Labor and Industry properly processed and deposited assessment receipts in all material respects. However, the department needs to improve controls and security over receipts. In Chapter 5, we will discuss our concerns about computer security access to receipt transactions.

Chapter 3. Workers' Compensation Claims

Chapter Conclusions

The workers' compensation claims are fairly presented on the state's financial statements in accordance with generally accepted accounting principles. The department's claim specialists, however, do not follow the policy developed to calculate the general long-term obligation. Each specialist calculates the reserve differently. The inconsistency in calculations caused us to make a material adjustment to the financial statements of the General Long Term Debt Account Group. The internal controls over the claims are generally adequate; however, as discussed in Chapter 5, we did find some areas where the department needs to strengthen its computer access controls over the disbursement processing.

The Department of Labor and Industry processes workers' compensation claims under a variety of circumstances. Payments are made from the Special Compensation Fund. Table 3-1 shows a breakdown of types of claims incurred for fiscal year 1996.

Table 3-1
Workers' Compensation Claims
Fiscal Year 1996

Supplemental benefit reimbursements	$61,105,030
Second injury benefit reimbursements	20,015,248
Uninsured benefits - Note 1	5,890,020
Other	3,459,858
Total	$90,470,156

Note 1: In accordance with generally accepted accounting principles, the department also recognized a long-term liability of $37,779,841 for uninsured employees. This liability is presented in the General Long-Term Debt Account Group for the state's fiscal year 1996 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 1996; and Minnesota Accounting and Procurement System reports as of September 27, 1996.

Our objective for examining workers' compensation claims was part of our audit of the state's financial statements for fiscal year 1996. 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 and properly process them?

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.

Conclusion

Generally, we found that the Department of Labor and Industry staff properly authorized and recorded disbursements in the Minnesota Accounting and Procurement System in all material respects. The department also needs to improve controls of security access over disbursement processing. In Chapter 5, we will discuss our concerns about disbursement computer security and inadequate separation of duties.

As discussed in Finding 1, however, the department staff is calculating the general long-term obligation inconsistently.

1. The Department of Labor and Industry staff each calculate the general-long term obligation differently.

The department must submit to the Department of Finance a reserve calculation for the estimated costs needed to finish a claim of an uninsured company. The department has five claim specialists preparing the reserve calculation. For temporary partial disability, medical, and rehabilitation benefits, specialists based their calculations for the general long-term obligation on judgment and past history. However, for temporary and permanent total disability benefits, each specialist calculated the reserve differently. The department had developed a formula each specialist was to use when calculating the reserve. Even though the department had a policy to calculate the temporary and permanent total disability benefits, at times the specialists did not use the formula to prepare the reserve amount.

During testing, we found that only 8 of 32 items tested were calculated according to the department policy. As a result , an additional $2.2 million had to be added to the General Long-Term Debt Account Group. In order to provide consistency in the presentation of the financial statements, the specialists need to calculate the reserve in accordance with department policy.

Recommendation

- *The department's Special Compensation Fund specialists should follow the policy developed to calculate the reserve for the general long-term obligation.*

Chapter 4. Departmental Receipts

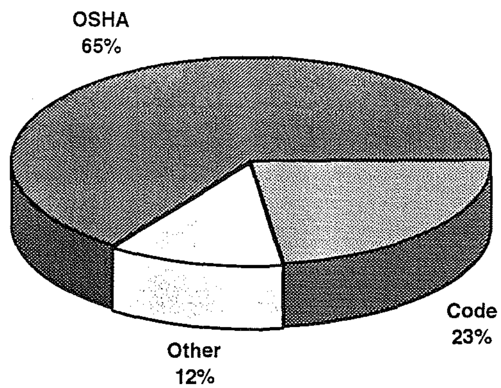
Chapter Conclusions

The Department of Labor and Industry needs to improve controls over departmental receipts. The department did not adequately safeguard receipts in the mailroom or various processing units. It also did not ensure the completeness of transactions recorded in the Minnesota Accounting and Procurement System (MAPS). These problems are further compounded because the department has not adequately separated duties over certain receipts.

During 1995 and 1996 the department experienced a case of employee theft. Our office performed a special review of this fraud. For further details of the fraud, see "Special Review - Employee Theft" (Report 96-46, December 1996). At least 26 checks totaling $3,149 were endorsed with the employee's signature. One check was for the special Compensation Fund and the rest were payments for the Code Division. Because of fraud outside the Workers' Compensation Division, we expanded our scope to review revenue collections in other divisions of the department. We focused our review on receipts that were frequent and in the form of cash or checks which were judged to be the greatest risk associated with the fraud.

Various units of the Department of Labor and Industry collected receipts. The Workers' Compensation Division collected the majority of the receipts, approximately $124 million. The process for collecting and depositing these receipts is the same process as the special compensation assessments. Processing issues for these other receipts collected in the Workers' Compensation Division was the same as the processing issues developed for assessments discussed in Chapter 2. We did not include these receipts in the departmental receipt internal control review. Figure 4-1 shows the different units and percent of amounts deposited, excluding the Workers' Compensation Division. The "other" category in Figure 4-1 includes collections from the following areas: Labor Standards Unit, Information Processing Center, Vocational Rehabilitation Unit, seminars, indirect costs, a federal grant, and miscellaneous items.

Figure 4-1
Department of Labor and Industry
Amounts Deposited (excluding Workers' Compensation Division)
Fiscal Year 1996



Source: Minnesota Accounting and Procurement System reports as of September 27, 1996; and Statewide Accounting System reports as of October 13, 1995.

Our review included the Occupational Safety and Health Enforcement (OSHA), Code Administration and Inspection Services (Code), Vocational Rehabilitation, Information Processing Center, and Labor Standards Units:

-- The OSHA Unit conducts workplace inspections to determine whether employers are complying with OSHA standards and providing a safe and healthful workplace. If an occupational safety and health investigator finds that an employer has violated an OSHA standard, the unit assesses a penalty. The unit bases penalties on the severity and probability of injury that is likely to result from an employee being exposed to a cited hazard. During fiscal year 1996, OSHA received $2.1 million in penalty payments. The other amount, approximately $3 million, represented federal grants. We did not review the receipt handling process of federal grants since the receipts were wire transfers and infrequent. In the OSHA Unit, our internal control review focused on penalty collections.

-- The Code Unit examines and licenses boiler operators, boat pilots, pipe fitters, and pipe fitting contractors. The unit inspects the manufacturing and repair of boilers, boats for hire, and high pressure piping systems. In addition, the unit issues permits for the installation and construction of high pressure piping systems. For the total receipts of $1.8 million, boiler fees represented 74 percent and high pressure piping fees represented 26 percent of the receipts deposited.

-- The Vocational Rehabilitation Unit provides injured workers with claims denied by the employer or insurer and vocational rehabilitation services through qualified rehabilitation counselors. The unit billed insurers and self-insurers for services provided and deposited $223,567 during fiscal year 1996.

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-- The Information Processing Center receives requests to make photo copies of workers' compensation files. Many of the requesting customers are attorneys and have an account within the unit. Customers must pay the photo copy fee prior to receiving the files. The Information Processing center deposited approximately $168,000 in photo copy receipts during fiscal year 1996.

-- The Labor Standards Unit enforces compliance with child labor and payroll record laws and determines back wage collections. In addition, the unit licenses employment agencies. Investigators of the unit assess fines to businesses for the violations of child labor or payroll record laws. The unit bases the violations on the size of the business and gravity of the violation. The Labor Standards Unit deposited $73,833 in license fees, examination fees, wage collections, and fines during fiscal year 1996.

The Accounting Services Section assists in depositing receipts and recording transactions in MAPS for all five units.

Objectives and Methodology

Our objectives for examining the receipts of various units were an expansion of our scope prompted by a special review of employee theft. Specifically, we addressed the following questions:

- For the receipt types we reviewed, did the Department of Labor and Industry design and implement internal controls to provide reasonable assurance that would prevent or detect errors or irregularities in its receipt activities?

- Did the Department of Labor and Industry adequately safeguard receipts and separate duties among individuals handling receipts?

In addressing our objectives, we examined the five units listed above. We interviewed department employees, reviewed its policies and procedures, observed controls, and tested samples to determine whether controls were working as described.

Conclusions

We found that the Department of Labor and Industry needs to improve controls over various receipts. The department did not adequately safeguard receipts in all five units and the Accounting Services Section or separate duties over the processing and handling of receipts in three of the five units. The department could correct a majority of these issues if it would log in and deposit receipts during the initial time the mailroom receives the mail. The mailroom could prepare a receipt log and deposit the receipts. Then, the mailroom could give each unit a list of its receipts deposited. If the mailroom did not know where to credit the receipt, it could deposit the receipt into a suspense account until it determined the appropriate unit. If the department instituted this process, the department could resolve Findings 2 and 3. Short of instituting this overall mailroom process, the department needs to take corrective action on some individual processes in all five units. Findings 2 and 3 will discuss the individual corrective actions over safeguarding assets in four units and separating duties during the receipt process in three units. Finding 4 discusses that the department did not verify the completeness of deposits in four units. Findings 5, 6, and 7 discuss specific issues that need improvement in the Code Unit in addition to the other issues mentioned in Findings 2, 3, and 4. In Chapter 5, we discuss that the Labor Standards and Code Units need to improve computer security access over receipts.

2. The department did not adequately safeguard receipts.

The department did not adequately safeguard receipts in the mailroom or processing units. First, the department did not immediately restrictively endorse receipts nor did the department store the receipts in a safe place. The department had a mailroom that centrally collected all receipts. The mailroom did not log in, restrictively endorse, or deposit these receipts. The main responsibility of the mailroom was to sort the mail and deliver it to the units twice a day. The mailroom staff did not keep the receipts in a secure area. For receipts that were not addressed to a particular unit, mailroom employees had to use judgment on which unit to route the receipt. If the mailroom routed a receipt to an incorrect unit, the unit would send the check to another unit. Neither the mailroom nor the units had a record of these types of receipts, and receipts could go undeposited.

Second, after the mailroom delivered the receipts, three units did not immediately restrictively endorse the checks. The three units were OSHA, Vocational Rehabilitation, and Labor Standards. Generally, the department is more susceptible to theft when the units do not immediately restrictively endorse the checks. In the Labor Standards Unit, the receptionist opened the mail and gave the check and the supporting documentation to the investigator. After the investigator reviewed the documentation, the investigator returned the check to the receptionist to be restrictively endorsed and deposited. The unit gave unnecessary access of receipts to the investigators. The investigators do not need the check in order to perform their job responsibilities.

Third, after obtaining the receipts, the Information Processing Center and the Accounting Services Section did not adequately safeguard the receipts. In the Information Processing Center, after the unit received the mail, staff kept the receipts in an open basket until the receipts were restrictively endorsed and deposited. In the Accounting Services Section, all five units brought receipts for deposit. The accountant kept the receipts in an unsecured basket until she prepared a verification of the receipts to deposits.

Recommendations

- *The department needs to adequately safeguard receipts in the mailroom.*
- *The department needs to develop an overall policy and procedures to control receipts for which the mailroom cannot identify the appropriate processing unit.*
- *OSHA, Vocational Rehabilitation, and Labor Standards Units need to immediately restrictively endorse checks upon opening the mail.*
- *The Labor Standards Unit needs to deposit receipts immediately; investigators should not have access to the receipts.*
- *The Information Processing Center and Accounting Services Section should keep receipts in a secure place until the staff take the receipts for deposit.*

3. The department had inadequate separation of duties over certain receipts.

Three units did not adequately separate duties in the receipt process. For two of the three units, Vocational Rehabilitation and Information Processing Center, one person handled the incoming mail, made deposits, and posted the receipts to unit records. In the Vocational Rehabilitation Unit, the person handling and posting receipts also followed up on outstanding accounts receivable. In the Information Processing Center, the same person handling and posting receipts also requested money when the account balances were low and distributed the photo copies to the customer.

The Code Unit also had a separation of duties problem. One person was responsible for opening mail, preparing deposits, and posting inspections in the unit's data base. Furthermore, during fiscal year 1996, the unit's accounts receivable system did not work. The unit did not follow up on any outstanding accounts receivable.

These processes would not detect errors and irregularities. The units need to separate the duties of collecting and posting from following up on accounts receivable, billing customers, and distributing goods. Also, as discussed in Finding 4, the units were not verifying the completeness of their deposits. This critical reconciliation process must also be performed by someone other than the person responsible for collections and postings.

Recommendations

- *For the Vocational Rehabilitation Unit, the person collecting and posting the receipts should not follow up on accounts receivable or perform the reconciliation.*

- *For the Information Processing Center, the duties between the person collecting and posting receipts should be separate from billing customers and distributing reports and reconciling receipts.*

- *The Code Unit needs to adequately separate the collection of receipts from the posting of the unit's data base.*

4. The department did not ensure the completeness of the deposits.

Four units, OSHA, Vocational Rehabilitation, Labor Standards, and Code Administration and Inspection Services (Code), did not ensure the completeness of deposits. These units did not compare transactions recorded on the internal system to transactions recorded on the Minnesota Accounting and Procurement System (MAPS). As a result, these units could not verify whether transactions recorded in their systems were actually deposited. During testing, we tried to reconcile the unit's records and MAPS records. We were able to reconcile OSHA and Vocational Rehabilitation records without material adjustments. However, we were not able to reconcile Labor Standards and Code Units records. Part of a shortage may be due to fraud. The Labor Standards Unit had $7,300 more posted on its records than recorded in MAPS. The Code Unit had $7,183 less recorded in its record than recorded in MAPS. These four units did not compare their records to MAPS records for fiscal year 1996. Without reconciling the units' records to MAPS records, the department is unsure whether receipts collected were actually deposited.

Recommendations

- *The Labor Standards and Code Units should investigate shortages.*
- *Department units should reconcile their records to MAPS totals on a periodic basis.*

5. The Code Unit had inadequate procedures for processing boiler license examination fees.

The Code Unit needs to improve controls over boiler license examination fees. First, the unit did not control the daily logs or applications because the unit staff did not have applicants taking the boiler examination sign a daily log. Normally, the applicant fills out an application and pays the staff administering the examination, who completes the daily log. An independent person uses the log to enter individual test scores and payments into the unit's system. An applicant who failed the examination could pay for the examination and the receipt might not be recorded or deposited.

Second, the unit staff did not control the sequentially numbered application packets. Staff administering the examination used any applications available. Since the unit does not control these applications, unrecorded receipts could go undetected.

Recommendation

- *The Code Unit should require applicants to complete a daily log prior to obtaining an application. The unit should control applications and account for each application.*

6. The Code Unit needs to improve accounts receivable procedures.

For part of fiscal year 1996, the Code Unit did not follow up on any accounts receivable. The unit had problems interfacing its accounts receivable program with the new version of the department's software. In fiscal year 1997, the unit started following up on accounts receivable. The unit has a policy only to follow up on accounts receivable under 60 days old. As of the beginning of December 1996, the unit had $41,015 accounts receivable older than 60 days. Under the current unit procedure, these receipts would go uncollected.

The unit also did not adequately ensure collection of fees for boilers exempt from state inspections. The unit did not verify the amount billed to companies to the insurance inspection reports. We found discrepancies because the amount billed was not always supported by an inspection report. In addition, we found two files that had inspection reports, but for which the unit did not bill the companies. In order to properly bill companies, the unit needs to compare the bills to the insurance inspection reports.

Recommendations

- *The Code Unit needs to pursue collection on all outstanding accounts receivable.*

- *The Code Unit needs to develop a write-off procedure to delete uncollectible accounts receivable from its data base.*

- *In order to ensure the accuracy of boiler exemption bills, the Code Unit should consider modifying procedures to more accurately bill companies for boiler exemption fees.*

7. The Code Unit exempted some employees from paying the cost of acquiring certain credentials administered by the unit.

The Code Unit's inspectors were not required to pay for the national board examination, a certificate of competency, or A endorsements. According to Minn. Rule 5225.1225, in order to qualify as an authorized inspector, the inspector needs to obtain the credentials mentioned above. The unit has a policy not to reimburse the costs of employees credentials if the qualifications are a condition of employment. An inspector needs to take the national board examination, obtain a certificate of competency, and obtain an A or B endorsement in order to be an inspector. Minn. Rule 5225.8600, subpart 5, sets the fees for these qualifications, which are \$75, \$30 or \$20, and \$30, respectively. The department expects the employee to pay for the national board examination, but waives the cost of the certificate of competency and pays for the A or B endorsement.

Furthermore, the unit is not in compliance with Minn. Stat. Section 43A.38 that states an employee has a conflict of interest if the employee gained a benefit, privilege, exemption, or advantage from the action of a state agency or employee that is not available to the general public.

Recommendations

- *The unit should require employees to pay for the cost of acquiring the certificates of competency.*

- *The unit should study whether the A or B endorsements are necessary and who should pay for them.*

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Chapter 5. The Computing Environment

Chapter Conclusions

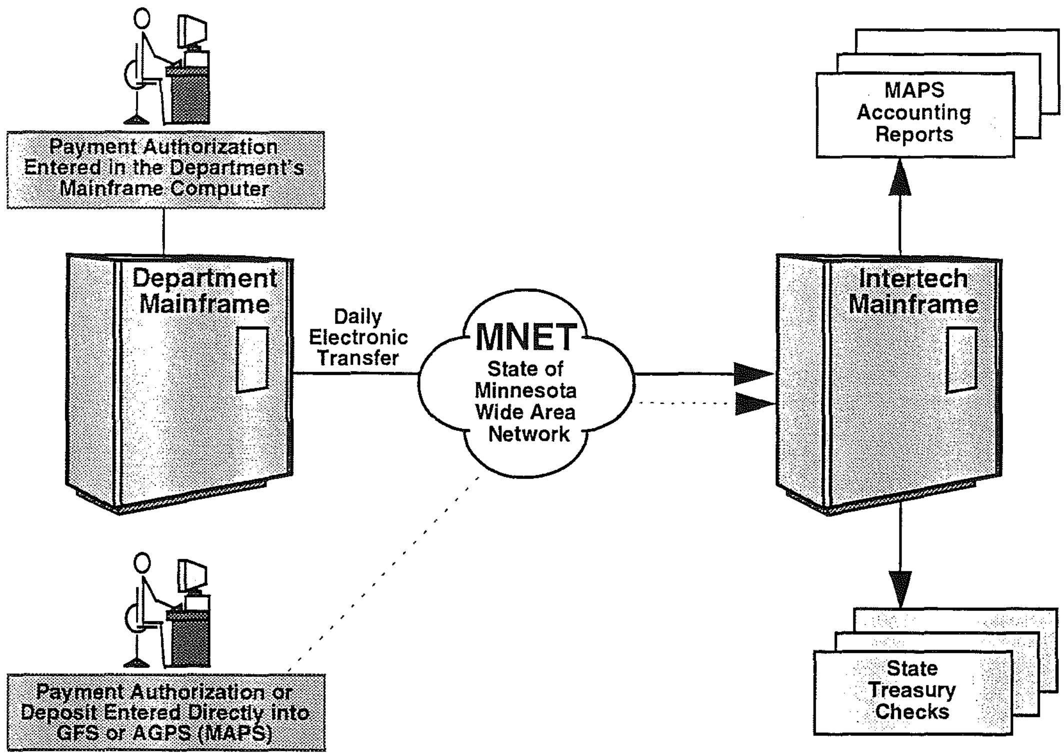
Ineffective computer access controls are compounding the separation of duties weaknesses over receipts and disbursement functions. Many employees have more security clearance than they need to fulfill their job responsibilities. Collectively, these internal control weaknesses are exposing the department's assets to an unnecessary risk of loss or misuse.

The Department of Labor and Industry supports its business operations with a complex computing environment. The department has its own mainframe computer and information systems support staff. The primary function of this mainframe computer is to help employees manage the various aspects of the state's Workers Compensation Program.

The department uses the Minnesota Accounting and Procurement System (MAPS) to account for most of its financial activities. MAPS resides on the state's central mainframe computer center, commonly referred to as InterTech. MAPS consists of two separate computerized applications. Government Financial System (GFS) is the new accounting system, and the Advanced Government Purchasing System (AGPS) is the new purchasing system. These two systems work both interactively and independently to account for most of the state's financial activities. The department enters many transaction directly in GFS and AGPS. However, it also electronically transfers a substantial amount of payment data from its mainframe to MAPS. Figure 5-1 illustrates how MAPS interacts with the department's mainframe.

Controlling access to computer resources and sensitive data is difficult in complex computing environments. To make effective access decisions, the department must determine what computer resources and data every employee needs to access to complete their job responsibilities. The department also must be familiar with the various security software packages that control the access to those computer resources and data. For example, the department runs Unisys MAPPER (Maintain and Prepare Executive Reports) software on its mainframe computer. Unisys MAPPER has its own security module which controls access to the system. The state's central mainframe computers are protected by a different security software package named ACF2. Finally, the GFS and AGPS components of MAPS are each controlled by a software package called CORE. The department needs to understand all of its security options with these software packages.

Figure 5-1
The Department of Labor and Industry's Computing Environment
As of November 1996



Source: Auditor prepared from discussions with department staff.

Audit Scope and Objectives

We reviewed computer access controls as part of our annual financial audit of the Department of Labor and Industry. We focused our work on the business processes of the Special Compensation Fund. However, we also reviewed access controls for the Labor Standards Unit and the Code Unit. Specifically, we attempted to answer the following questions:

- Was the department adequately separating duties through computer access controls for both MAPPER and MAPS transactions?

- Was the department limiting access to computer resources and data to only those employees who need access to fulfill their job responsibilities?

To answer this question, we interviewed the department's Maintain and Prepare Executive Reports (MAPPER) system coordinator, programmers, and users. We also reviewed various MAPPER, MAPS, and ACF2 security reports. Individual units within the Department of Labor and Industry are responsible for making their own MAPPER security decisions. The department's accounting director assigns security clearances for the GFS and AGPS components of MAPS.

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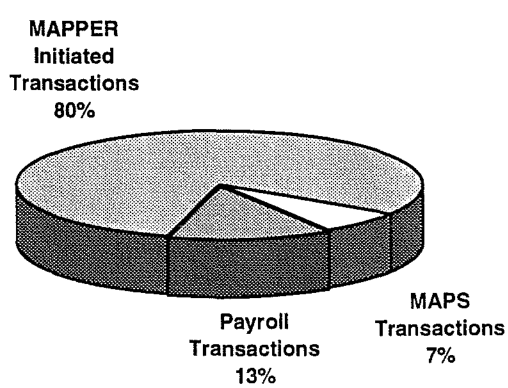
In the next section of this chapter, we discuss our work done and conclusions reached on MAPPER security administration. We also discuss MAPS and ACF2 security administration issues.

Controlling Access to Computerized Resources and Data

This section discusses how the Department of Labor and Industry controls access to computerized resources and data. Special Compensation Fund revenue comes from a variety of sources, including insurance companies, self-insurance companies, and uninsured companies. This revenue totaled approximately $109 million in fiscal year 1996. The department records detailed receipt transactions in MAPPER and deposits all funds in the state treasury. The department also records the total amount of each deposit in MAPS. (See additional information in Chapter 2.)

Special Compensation Fund expenditures consist primarily of annual reimbursements to insurance companies, benefit payments to claimants, and agency payroll costs. These expenditures totaled approximately $102 million in fiscal year 1996. Staff initiate most benefit payment and insurance company reimbursement transactions in MAPPER. The department then electronically transfers these transactions to MAPS, where checks are generated. For certain transactions, the department must enter benefit payment and insurance company reimbursement transactions directly into both MAPPER and MAPS. The state's central payroll system generates checks for employees and posts payroll expenditures to the Special Compensation Fund accounting records in MAPS. As Figure 5-2 illustrates, transactions originating in MAPPER accounted for approximately 80 percent of the Special Compensation Fund expenditures in fiscal year 1996.

Figure 5-2
Fiscal Year 1996 Special Compensation Fund Expenditures By Source of Originating Transaction



Source: Fiscal year 1996 MAPS expenditures.

We found that the Department of Labor and Industry is not limiting access to sensitive computer resources and data. Many employees have more access than they need to fulfill their job responsibilities. However, the department's control weaknesses cannot be remedied by simply modifying security clearances. The department's business processes themselves do not provide for an adequate separation of duties. (See Chapter 4 for findings and recommendations relating to some of these problems.) In fact, some accounting employees routinely perform incompatible functions with little or no independent oversight. Finding 8 discusses our concerns in more detail.

8. The Department of Labor and Industry is not separating incompatible accounting functions or controlling access to sensitive computer resources and data.

Many employees in the Department of Labor and Industry perform, or have the ability to perform, incompatible accounting functions. Many also have security clearances that they do not need to fulfill their job responsibilities. Finally, the department is not protecting sensitive data files from unauthorized access.

The department's receipt and disbursement processing procedures do not provide for an adequate separation of duties. For example, some Special Compensation Fund employees who enter receipt transactions in MAPPER are also responsible for preparing deposits and monitoring outstanding accounts receivable. One of these employees also reconciles the MAPS deposits to the sum of the MAPPER receipt transactions. Chapter 4 discusses similar problems with other receipt types. We also found a large number of employees who can both authorize and process MAPPER and MAPS disbursement transactions with little or no independent oversight. To improve controls, the department needs to separate incompatible accounting functions so that individuals cannot both perpetrate and conceal errors and irregularities.

The department's computer access controls are also weak in several respects. We reviewed MAPPER, MAPS, and ACF2 security reports and found many employees who have inappropriate clearances. For example, some employees have the ability to change MAPPER data even though they only need to view data to fulfill their job responsibilities. We also found many employees with inappropriate access to sensitive MAPPER computer screens. Too many employees were given the ability to process the full cycle of MAPS disbursements without appropriate separation of duties. Finally, we found some employees whose security clearances were not changed after they transferred to different departments.

We also found a large number of unsecured and improperly secured MAPPER data files. Many of these files contain sensitive payment data. The security module in Unisys MAPPER gives the system coordinator an option to password protect critical data files. However, the department did not implement this additional level of security for many critical data files. Therefore, a large number of system users can simply add records to these files or alter existing data. Controls over password protected data files may also be unreliable. The MAPPER system coordinator could not identify which users know the passwords or if multiple users are sharing passwords.

Recommendations

- *In addition to improving controls over the receipt types as addressed in Chapter 4, the department should redesign its receipt and disbursement processing procedures to separate incompatible accounting functions.*
- *The department should assign users security clearances that are consistent with their job responsibilities and monitor those clearances on a continuing basis.*
- *The department should secure sensitive data files both in MAPPER and on Intertech's mainframe.*

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March 7, 1997

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

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, 1996 for our department. This draft report accurately reflects the material that your staff discussed with us at the exit conference on February 26, 1997.

The fiscal year 1996 audit has eight findings and nineteen recommendations for actions. We concur with your recommendations for changes within the department. You state that the Special Compensation Fund assessments and claims were fairly presented on the state's fiscal year 1996 financial statements. There were some other areas of our operations recommended for action. Those areas are: 1) standardizing the calculation of the general-long term obligation; 2) improving internal controls over departmental receipts; and 3) controlling access to computer resources and data. We believe that these findings are reasonable, and will take action to address them.

We have enclosed a summary of your recommendations with our action response for each item. Most of the recommendations have already been implemented. The remainder of the recommendations will be implemented during the current fiscal 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 Bastian

Gary W. Bastian
Commissioner

GWB/jak

Enclosure

SUMMARY OF FINDINGS, RECOMMENDATIONS AND ACTION RESPONSES TO FISCAL YEAR 1996 FINANCIAL AUDIT OF THE DEPARTMENT OF LABOR AND INDUSTRY.

WORKERS' COMPENSATION CLAIMS

Finding 1 - The Department of Labor and Industry staff each calculate the general long-term obligation differently.

Recommendation:

- *The department's Special Compensation Fund specialists should follow the policy developed to calculate the reserve for the general long-term obligation.*

Action Response: In response to a verbal finding in the FY 1995 Legislative Auditor's report, the Special Compensation Fund developed a formula for calculating "reserve." The receipt of the draft FY 1996 report brought to our attention that not all of the reserves were being calculated according to the established formula. That situation has been corrected; all of the claims administrators have been instructed to prepare all future reserves according to the adopted policy. This strict adherence to the reserve policy calculations will appear beginning in FY 1997. Additionally, the Special Claims Section is in the process of purchasing and installing a claims management software package which will mandate files have a set "reserve" when they are entered into the system. The software will automatically calculate the reserve according to a standard formula for all claims and will also keep a cumulative total on remaining "reserves" and future liability for the claims.

It should be noted that the reserve calculation cited serves as a footnote to the agency's annual financial statement. The Special Compensation Fund does not set aside an actual "reserve" of monies to pay the future liability of uninsured claims. Minnesota Statutes § 176.129 dictates the funding mechanism for receipts of assessments and the calculation of the annual assessment rate. The funding formula discourages reserving of monies and by nature trends the annual fund balance towards zero. The funding mechanism is a rolling, pay-as-incurred assessment.

DEPARTMENTAL RECEIPTS

Finding 2 - The department did not adequately safeguard receipts.

Recommendations:

- *Adequately safeguard receipts in the mailroom.*

- *Develop an overall policy and procedures to control receipts for which the mailroom cannot identify the appropriate processing unit.*

- *OSHA, Vocational Rehabilitation, and Labor Standards units immediately restrictively endorse checks upon opening the mail.*

- *The Labor Standards unit needs to deposit receipts immediately; investigators should not have access to the receipts.*

- *The Information Processing Center and Financial Services section should keep receipts in a secure place until the staff take the receipts for deposit.*

Action Response: The mailroom will obtain a locked cabinet to store receipts until they are delivered. Mailroom doors will be locked at the end of the day. The agency is implementing a new procedure requiring that all receipts that cannot be identified to a processing unit be delivered directly to the cash receipts clerk in the Financial Services section. These receipts are deposited into a suspense account until the appropriate unit can be determined by the cash receipts clerk. If a receipt is mistakenly delivered to another unit, that unit will have the receipt deposited into the suspense account. The cash receipts clerk will investigate, notify the appropriate unit of the receipt, and re-distribute the receipt into the appropriate account.

The Information Processing Center and Financial Services section have modified procedures and will require all receipts collected to be stored in a locked cabinet until the deposit is prepared. All units delivering receipts to the Financial Services section are required to hand deliver them to the cash receipts clerk.

The department implemented a procedure in December 1996, whereby the person opening the mail in each unit immediately endorses the checks. Also at this time the Labor Standards unit began to deposit all checks upon initial receipt. Only the supporting documentation is forwarded to the investigators for review.

Finding 3 - The department had inadequate separation of duties over certain receipts.

Recommendations:

- *The Vocational Rehabilitation Unit should separate the person collecting and posting the receipts from the person who follows up on accounts receivable or performs the reconciliation.*

- *The Information Processing Center should separate the duties of collecting and posting receipts from billing customers and distributing reports and reconciling receipts.*

- *The Code unit should separate the collection of receipts from the posting of the unit's data base.*

Action Response: The department is implementing a procedure whereby the Vocational Rehabilitation Unit receipts will be delivered from the mailroom to the cash receipts clerk in the Financial Services section. The cash receipts clerk will prepare the deposit and submit the remittance advices or copies of checks to the Vocational Rehabilitation Unit to update its database and manage its accounts receivable.

The Code unit implemented a procedure in November 1996 that separates the responsibility for preparing the unit's deposit with the responsibility for posting the receipts to the unit's database. The Information Processing Center is implementing a new procedure whereby the person opening the mail and preparing the deposit is not responsible for providing copy services or processing billings. This unit is also beginning a study of its functions to identify business process reengineering opportunities. As processes are revised, this unit will ensure that adequate separation of duties is maintained.

Finding 4 - The department did not ensure completeness of the deposits.

Recommendations:

- *The Labor Standards and Code units should investigate shortages.*

- *Department units should reconcile their records to MAPS totals on a periodic basis.*

Action Response: The department's Financial Services section has provided the Labor Standards and Code units with detailed deposit information from MAPS. With the assistance of the Financial Services section, staff of these units have begun a thorough reconciliation process to identify discrepancies between receipts recorded in MAPS and receipts recorded in the units' databases. It is expected that this reconciliation will be completed by March 31, 1997.

The department's Financial Services section provides monthly receipt reports to all units. This section will assist each unit to develop procedures for monthly reconciliation of MAPS information with unit records. New procedures should be implemented by April 30, 1997.

The agency's Financial Services section will assess the functionality of the MAPS Advanced Receivables module, to determine if it can be used to meet the needs of department units. Where unit needs can be met, their receivable functions will be converted to MAPS July 1, 1997. This will eliminate the need for a reconciliation between MAPS and individual unit systems. It is expected that the assessment will be completed by April 30, 1997.

Finding 5 - The Code unit had inadequate procedures for processing boiler license examination fees.

Recommendation:

- *The Code unit should require applicants to complete a daily log prior to obtaining an application. The unit should control applications and account for each application.*

Action Response: The Code unit is implementing procedures to control the daily log and the sequentially numbered application packets. Applicants are now required to sign the log sheet at the time the examination fee is paid and the application is received. The numerical sequence of each application packet is identified on the log sheet. The log sheets will be independently reviewed and compared to the amount of fees collected.

Finding 6 - The Code unit needs to improve accounts receivable procedures.

Recommendations:

- *The Code unit should pursue collection on all outstanding accounts receivable.*

- *The Code unit needs to develop a write-off procedure to delete uncollectible accounts receivable from its data base.*

- *In order to ensure the accuracy of boiler exemption bills, the Code unit should consider modifying procedures to more accurately bill companies for boiler exemption fees.*

Action Response: The Code unit has begun to pursue the collection of outstanding accounts receivable. All entities with past-due balances were mailed notices of the unpaid invoice(s) in December 1996. The Code unit is in the process of contacting by telephone all companies that continue to have unpaid invoices. The department will develop and implement a procedure for writing off those receivables that are determined to be uncollectible by April 30, 1997.

The Code unit is in the process of redesigning its record-keeping system. It will be creating a new information data base that will account for boiler exemptions more accurately. In addition, as discussed in Finding 5 above, an assessment will be conducted to determine if the Code unit's accounts receivable function can be converted to MAPS beginning July 1, 1997. It is expected that the MAPS system will provide information necessary for the unit to better manage its accounts receivable.

Finding 7 - The Code unit exempted its employees from paying the cost of acquiring certain credentials administered by the unit.

Recommendation:

- *The Code unit should require employees to pay for the cost of acquiring the Certificate of Competency and should study whether the A and B endorsements are necessary for employment and who should pay for them.*

Action Response: The Code unit does not have a policy. The Code unit will conform to and abide by state and department policies. Any potentially inappropriate action will be investigated and if there was a violation of policy, appropriate measures will be taken to collect the examination fee. The Code unit will review all credentialling related to agency boiler inspectors, determine what is required for the job and establish who should pay the costs.

THE COMPUTING ENVIRONMENT

Finding 8 - The Department of Labor and Industry is not separating incompatible accounting functions or controlling access to sensitive computer resources and data.

Recommendations:

- *Redesign receipt and disbursement processing procedures to separate incompatible accounting functions.*

- *Assign users security clearances that are consistent with job responsibilities and monitor those clearances on a continuing basis.*

- *Secure sensitive data files both in MAPPER and on Intertec's mainframe.*

Action Response: The department's new Chief Financial Officer (CFO) has begun to analyze the business processes for accounting for Special Compensation Fund (SCF) receipts and expenditures. With the implementation of new claims management software (Finding 1) and potential conversion of accounts receivable management to MAPS (Finding 4), we anticipate changes to the responsibilities of accounting staff assigned to SCF services. As new responsibilities and procedures are defined, the CFO will provide for the adequate separation of duties. Following the review and realignment of job functions, security clearances for department employees will be appropriately adjusted.

In general, the Information Technology Services unit relies on managers and most often supervisors to determine and monitor security clearances assigned to employees. In 1996 an "Employee Status Change" form was instituted to track employee movement between department units. This has been largely successful. However, because these forms have not always been completed by supervisors, there are instances of employees moving to other units with no attendant change in their computer security clearances. Managers and supervisors will be reminded of the use and importance of this form.

Finally, as was noted in the Exit Conference, the department is on the threshold of redesigning its computing environment and with that change, reengineering the security structure in place. We plan to address the suggestions/concerns listed in the legislative auditor's report as we move forward with this exercise.