Department of Employee Relations

Programs Selected For
Fiscal Year 1997 Statewide Audit

March 1998

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

98-17

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STATE OF MINNESOTA
OFFICE OF THE LEGISLATIVE AUDITOR
JAMES R. NOBLES, LEGISLATIVE AUDITOR

Senator Deanna Wiener, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Ms. Karen Carpenter, Commissioner
Department of Employee Relations

We have audited selected areas of the Department of Employee Relations for the fiscal year ended June 30, 1997, 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 1997 financial statements and Single Audit federal compliance audit. The Comprehensive Annual Financial Report for the year ended June 30, 1997, includes our report, issued thereon dated December 8, 1997. The Minnesota Financial and Compliance Report on Federally Assisted Programs for the year ended June 30, 1997, will include our reports on the supplementary information schedule, internal control structure, and compliance with laws and regulations. We anticipate issuing this report in March 1998. 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 *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 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 March 13, 1998.

James R. Nobles
Legislative Auditor

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: December 10, 1997

Report Signed On: March 9, 1998

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SUMMARY

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Department of Employee Relations

Programs Selected For Fiscal Year 1997 Statewide Audit

Public Release Date: March 13, 1998 No. 98-17

Department Background

The Department of Employee Relations (DOER) serves as the central human resource agency, including personnel administration and labor relations, for the executive branch of government. The department manages the State Employee Management (SEMA4) human resource/payroll system in conjunction with the Department of Finance. DOER also operates the insurance and workers' compensation programs for state employees, as well as employee insurance benefit plans for participating public and private employers. Karen Carpenter was appointed department commissioner in October 1997.

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, 1997. We focused our audit on statewide payroll expenditures, year end compensated absences, revenues and expenditures of the State Employees Insurance Fund, the Public Employee Insurance Program (PEIP), the Minnesota Employees Insurance Program (MEIP), and the estimated workers' compensation liability.

We concluded that the state's payroll expenditures and compensated absences were fairly presented in the Minnesota Accounting and Procurement System (MAPS) and the state's financial statements for fiscal year 1997. MAPS payroll expenditures, totaling $2.2 billion, were properly supported by SEMA4 subsystem transactions. In addition, the department designed internal controls to provide reasonable assurance that SEMA4 accurately calculated, paid and reported employee wages, benefits, deductions, and contributions based on information entered by state agencies. However, we found that 22 percent of system users have incompatible access to update both payroll and human resource data.

The department fairly presented the financial activities of the State Employee Insurance Fund, PEIP, and MEIP in the state of Minnesota's financial statements for fiscal year 1997. However, we reported that MEIP will be unable to repay a $2 million outstanding loan. We also concluded that the department designed internal controls to provide reasonable assurance that it enrolled, billed, and collected premiums for enrollees maintained on the state's insurance system. However, the department misplaced a $414,000 check for four months indicating the need for improved controls.

The Workers' Compensation Program manages and controls claims for work-related injuries to state employees. The department fairly estimated the June 30, 1997, workers' compensation liability to be $107 million.

The department agreed with the audit report's findings and recommendations. They plan to work with agencies having incompatible SEMA4 security clearances and will take necessary measures to remedy the insurance issues raised.

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Brad White, CPA, CISA	Audit Manager
Rhonda Regnier, CPA	Auditor-in-Charge
Mark Mathison, CPA	Team Leader
Sonya Hill, CPA	Senior Auditor
Steve Johnson, CPA	Senior Auditor
Jason Stauffenecker	Staff Auditor
Steve Carr	Intern

Exit Conference

We discussed the results of the audit at an exit conference with the following Department of Employee Relations staff on February 26, 1998:

Karen Carpenter	Commissioner
Chris Goodwill	Manager, Administrative Services
Liz Houlding	Manager, Employee Insurance Division
Laurie Hansen	Personnel Servcies Manager
Ed Anderson	Accounting Director, Fiscal Services

Chapter 1. Introduction

The Department of Employee Relations (DOER) is the central human resource agency for the executive branch of state government. Its duties include personnel administration and labor relations. The department manages 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 other human resource issues. In October 1997, the Governor appointed Karen Carpenter as department commissioner.

The department is responsible for the daily operations of the SEMA4 human resource component, 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 3, annual expenses for the State Employees Insurance Program exceeded $236 million for fiscal year 1997. During fiscal year 1997, DOER also administered the Public Employee Insurance Program which provides public employees with insurance benefits and Minnesota Employees Insurance Program which provides insurance benefit plans to private employers.

During fiscal year 1997, the department offered Pre-Tax Benefit Plan accounts to eligible state of Minnesota employees. These accounts allow unreimbursed medical/dental or dependent care expenses to be deducted prior to determining taxable wages. In Chapter 4, we identify that the department deducted and reimbursed over $9 million of participant claims, with an additional $900,000 collected to administer the program.

The department also determines and pays workers' compensation claims for injured state employees. These costs are billed to the employing agencies. As explained in Chapter 5, DOER maintains a computerized system to estimate the state's liability for workers' compensation injuries. As of June 30, 1997, the department estimated that the state had $107 million of workers' compensation liabilities.

Our audit scope for the 1997 fiscal year focused on financial activities that were material to the state's financial statements. This included statewide SEMA4 payroll expenditures recorded in the state's accounting system, as well as the related compensated absence liability amounts. SEMA4 system and user access were reviewed. We also examined the department's revenues and expenditures for the employee insurance funds and the Pre-Tax Benefits Program. In addition, the system and process for determining the estimated workers' compensation liability at fiscal year end was reviewed.

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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 1997. MAPS payroll expenditures, totaling $2.2 billion, were properly supported by SEMA4 subsystem transactions. In addition, the department designed internal controls to provide reasonable assurance that SEMA4 accurately calculated, paid, and reported employee wages, benefits, deductions, and contributions based on information entered by state agencies. However, 22 percent of SEMA4 users have incompatible security profiles allowing broad access to update both payroll and human resource data.

Overview of System and Spending Level

The State Employee Management (SEMA4) system is the state's integrated human resource and payroll system that began on July 1, 1995. The Departments of Employee Relations and Finance are jointly responsible for its operation. State agencies perform the initial input of payroll and human resource 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 1997.

Table 2-1
State of Minnesota
Statewide Payroll Expenditures by Fund
Fiscal Year Ending June 30, 1997

Governmental Fund Type	Total FY 1997 Payroll Expenditures	Percent
General	$1,384,495,735	63.54%
Special Revenue	690,461,069	31.69%
Capital Projects	939,487	0.04%
Enterprise	29,926,326	1.37%
Internal Service	29,806,765	1.37%
Trust and Agency	43,378,721	1.99%
Total Payroll Costs	$2,179,008,103	100.00%

Source: Minnesota Accounting and Procurement System (MAPS), fiscal year 1997, as of September 26, 1997.

Table 2-2 shows the annual payroll expenditures of the largest state agencies for fiscal year 1997.

Table 2-2
State of Minnesota
Annual Payroll Expenditures
Fiscal Year Ending June 30, 1997

Department	Amount	Percent
Minnesota State Colleges and Universities	$620,587,528	28.5%
Human Services	275,788,949	12.7%
Transportation	248,403,122	11.4%
Corrections	160,368,754	7.4%
Natural Resources	122,237,403	5.6%
Public Safety	87,982,914	4.0%
Economic Security	84,951,322	3.9%
Other State Agencies	578,688,111	26.5%
Total Payroll Expenditures	$2,179,008,103	100.0%

Source: Minnesota Accounting and Procurement System (MAPS), fiscal year 1997, as of September 26, 1997.

Most state agencies began using SEMA4 during fiscal year 1996. Most Minnesota State Colleges and Universities (MnSCU) campuses and the central office began using SEMA4 early in fiscal year 1997. SEMA4 incorporated distinct functions of payroll and human resource processes. On entry into SEMA4, payroll and human resource transactions are edited for accuracy and reasonableness with various preventative and detective controls. The Departments of Employee Relations and Finance perform special 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 2-3, the majority of SEMA4 payroll transactions involve earnings codes that relate to the standard 80-hour or biweekly salary amount. Regular, vacation, holiday, and sick leave comprise 95 percent of annual payroll costs. The remaining 5 percent consists of other forms of supplemental or separation pay. Employer contributions for fringe benefits are set by law or the various state bargaining agreements.

Table 2-3
State of Minnesota
SEMA4 Earnings Code Summary
Fiscal Year Ending June 30, 1997

SEMA4 Earnings Code	Salary Amount	Fringe (1)	Total	Percent
Regular	$1,413,144,730	$320,133,618	$1,733,278,348	83.7%
Vacation	98,228,667	21,929,705	120,158,372	5.8%
Holiday	49,748,445	10,931,196	60,679,641	2.9%
Sick	39,814,899	9,073,696	48,888,595	2.4%
Overtime	27,735,740	3,397,604	31,133,344	1.5%
Compensatory Time Taken	9,990,931	2,372,216	12,363,147	.6%
Other Earnings Codes	55,575,429	8,555,841	64,131,270	3.1%
SEMA4 Payroll Expenses	$1,694,238,841	$376,393,877	$2,070,632,718	100.0%

Note: Balances include SEMA4 payroll costs only and exclude amounts transacted in other non-SEMA4 systems.

Department of Employee Relations

Audit Objectives and Methodology

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

- Were state payroll expenditures and related compensated absence liabilities fairly presented in the state of Minnesota's Comprehensive Annual Financial Report for fiscal year 1997?
- Were Minnesota Accounting and Procurement System (MAPS) payroll expenditures and related liabilities properly supported by SEMA4 subsystem transactions?
- Did the department design internal controls to provide reasonable assurance that SEMA4 properly calculates, pays, and reports employee wages. benefits, deductions, and contributions based on information entered by state agencies and in accordance with state bargaining unit agreements?
- Did the department design internal controls to provide reasonable assurance that user access to SEMA4 was limited to functions necessary to meet their job responsibilities?

To achieve these objectives, we interviewed Department of Employee Relations and Department of Finance employees to gain an understanding of the SEMA4 system, how it processes payroll and human resource transactions, and its system integrity controls. We reviewed Department of Finance controls that 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. In addition, we reviewed access controls and security profiles for SEMA4 users.

Conclusions

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 1997. We found that MAPS payroll expenditures, totaling $2.2 billion, were properly supported by SEMA4 and other subsystem transactions. We also determined that the department designed internal controls to provide reasonable assurance that SEMA4 accurately calculated, paid, and reported employee wages, benefits, deductions, and contributions based on information entered by state agencies. However, as explained in Finding 1, we noted that a high percentage of users have ability to update both personnel and payroll data.

1. **PRIOR RECOMMENDATION PARTIALLY IMPLEMENTED: An excessive percentage of SEMA4 system users have incompatible access to payroll and human resource functions.**

The department has not adequately restricted access to SEMA4 by state agency users. SEMA4 was designed with distinct payroll and human resource profiles to separate functional access to the system. However, our review of the SEMA4 security tables revealed many users have been granted access to both payroll and human resource functions. We identified 471 users, or 22 percent of users statewide, who had capability to process both payroll and human resource transactions. With nearly one-fourth of system users with broad access, the state's payroll and personnel transactions are at risk for erroneous data or fraudulent transactions.

We recognize that access to both payroll and human resource functions may be necessary in some small agencies with limited staffing. Effective alternative management oversight procedures could be developed to control these environments. However, we feel that system information is at risk with 22 percent of SEMA4 users having such broad access. Table 2-4 shows the state agencies which assigned incompatible profiles to its SEMA4 users.

Table 2-4
State Employee Management System (SEMA4)
Agency Users Who Can Update Both Payroll and Human Resource Transactions
As of September 1997

Agency	Total Agency Users	Users with Incompatible Profiles	% of Agency Users
Labor & Industry (1)	19	11	57.89%
Transportation	257	130	50.58%
Veterans Home Board	31	15	48.39%
Health	37	14	37.84%
Natural Resources	140	42	30.00%
Corrections	167	41	24.55%
Human Services	281	59	21.00%
Administration	61	11	18.03%
MnSCU	284	23	8.10%
Economic Security	45	3	6.67%
Revenue	128	6	4.69%
Public Safety	105	4	3.81%
Finance	69	2	2.90%
Employee Relations	142	0	0.00%
Other	383	110	28.72%
Totals	**2,149**	**471**	**21.92%**

(1) The Department of Labor and Industry subsequently modified incompatible SEMA4 security clearances for its employees in October 1997.

Source: Auditor analysis of SEMA4 Security Tables as of September 1997.

We first addressed this weakness in our Legislative Audit Report 96-39, released September 27, 1996. In that report, we identified 465 of 1,677 users, or 28 percent, with access to both critical payroll and personnel functions. The Department of Employee Relations responded to our recommendations with a closer review of new access requests. We saw only a slight increase in users with access to incompatible functions out of 472 additional users. However, the department did not embark on a larger challenge, to require changes to users that had previously been granted excessive access.

State agencies are individually responsible for selecting and requesting the appropriate security profiles for each user. However, Minn. Stat. Section 43A.04, Subd. 1, charges the Department of Employee Relations with the responsibility to manage and operate the state's personnel information system. DOER is ultimately responsible for ensuring proper controls are in place. This requires that the department, in coordination with user agencies, ensures that access is restricted to that needed to perform job responsibilities.

Recommendations

- *The Department of Employee Relations should work with state agencies to reduce the number of users with ability to update both SEMA4 payroll and human resource information. The department should require justification from agencies that request incompatible access to both payroll and human resource functions.*

- *The department should develop management oversight and control procedures when incompatible SEMA4 profiles are granted to user agencies.*

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Chapter 3. Employee Insurance Funds

Chapter Conclusions

The Department of Employee Relations (DOER) 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 1997. In addition, the department designed internal controls to provide reasonable assurance of proper enrollment, billing, and collection of premiums for enrollees maintained on the state's insurance system; however, improved financial control is needed over certain collections the department receives. Also, the Minnesota Employees Insurance Program has an outstanding $2.075 million loan which most likely cannot be repaid to the Health Care Access Fund.

The DOER Employee Insurance Division is responsible for administering insurance programs that 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 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. Effective January 1, 1997, the department also began to self-insure dental claims. Overall, the fund reported annual revenue of $225 million and expenses of $236 million in its fiscal year 1997 financial statements.

Public Employee Insurance Program

The Public Employee Insurance Program (PEIP) offers a variety of different insurance plans that were created to give public employers the advantages of large group purchasing including lower costs, stable premiums, and greater health plan choices. The fund reported annual revenues and expenses of nearly $10 million in fiscal year 1997. DOER manages and coordinates the activities of the participating employers and administrative organization. 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 (MEIP) was enacted by statute to facilitate the purchase of health insurance for small, private employer groups located in the state of Minnesota. 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. This fund reported annual revenues and expenses of approximately $8 million in fiscal year 1997.

Financial activities of the three insurance programs for fiscal year 1997 are shown in Table 3-1.

Table 3-1
Department of Employee Relations
Insurance Fund and Programs
Fiscal Year Ending June 30, 1997

Financial Activity	State Employee Insurance Fund	Public Employee Insurance Program	MN Employee Insurance Program
Operating Revenue:			
Insurance Premiums	$222,616,000	$ 9,422,000	$ 7,498,000
Other Income	2,515,000	411,000	358,000
Total Operating Revenues	$225,131,000	$ 9,833,000	$ 7,856,000
Operating Expenses:			
Medical Claims	127,581,000	0	0
Insurance Premiums	91,654,000	9,394,000	6,981,000
Other Administrative Costs	17,214,000	736,000	942,000
Total Operating Expenses	$236,449,000	$10,130,000	$ 7,923,000
Operating Income (Loss)	$ (11,318,000)	$ (297,000)	$ (67,000)
Investment Income	4,709,000	220,000	58,000
Net Income (Loss)	$ (6,609,000)	$ (77,000)	$ (9,000)
Operating Transfer	0	(2,000,000)	0
Increase(Decrease) to Equity	$ (6,609,000)	$ (2,077,000)	$ (9,000)
Fund Equity at 6/30/96	66,255,000	6,226,000	(783,000)
Prior Period Adjustment - Note (1)	0	(658,000)	(542,000)
Fund Equity at 6/30/97	$ 59,646,000	$ 3,491,000	$(1,334,000)

Note (1) DOER initiated prior period adjustments to correct fiscal year 1996 premium distributions paid to the third party administrator which were coded to fiscal year 1997. This change properly matches these expenses with the premium revenue collected from PEIP and MEIP participants in fiscal year 1996.

Source: State of Minnesota Comprehensive Annual Financial Report for fiscal year 1997.

Department of Employee Relations

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, 1997:

- 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 1997?

- Did the department design internal controls over these programs to provide reasonable assurance that they properly enrolled, billed, collected, and paid premiums or medical costs for eligible participants during fiscal year 1997?

To answer these questions, we interviewed DOER employees to gain an understanding of the insurance system and the process to enroll, bill and collect premiums. We 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 reviewed the State Health Plan and Delta Dental administrative and claims costs paid for fiscal year 1997. 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 administrators.

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 1997. However, as disclosed in the state's annual financial report and as explained in Finding 2, it appears unlikely that the Minnesota Employees Insurance Program will be able to repay a $2 million outstanding loan. We found that the department designed internal controls to provide reasonable assurance that enrollment, billing, collection, and disbursement of premiums or medical claims were proper for enrollees maintained on the state's insurance system during fiscal year 1997. However, as explained in Finding 3, the department did not effectively monitor receipt of certain premiums.

2. The Minnesota Employees Insurance Program will be unable to repay a $2.075 million outstanding loan owed to the Health Care Access Fund.

The Minnesota Employees Insurance Program (MEIP) no longer accepts new participants and most likely cannot repay a $2.075 million loan due to the Health Care Access Fund. The department received the loan from the Health Care Access Fund (HCAF) in 1993 for start up administrative funding. However, MEIP experienced a lower enrollment than expected, and effective July 1997, the program no longer accepted new employer groups into the program. The department has decided to discontinue MEIP employer groups' health insurance coverage after September 1998. The lack of enrollment and premium revenue will not allow the program to generate sufficient funding to repay the outstanding loan.

Based on current estimates, it is unlikely that the department will be able to meet its statutory deadline to repay the loan. According to Minn. Stat. Section 43A.17, Subd. 8(b), "Premiums must be established so as to recover and repay within five years after July 1, 1993, any direct appropriations received to provide start up administration costs." Therefore, DOER is required to repay the MEIP start up loan by July 1, 1998. On June 30, 1997, MEIP had a cash balance of $1,394,000 and current obligations of $655,000. It is doubtful that the remaining balance of $739,000, plus excess revenues over expenses for fiscal year 1998, will produce sufficient funds to repay the entire loan.

Recommendation

- *The Department of Employee Relations needs to resolve its outstanding Minnesota Employees Insurance Program loan of $2.075 million owed to the Health Care Access Fund.*

3. The department did not effectively monitor certain receipts for the State Employee Insurance Fund.

The Department of Employee Relation's control procedures over the collection and deposit of certain premium revenue was inadequate. The department received monthly checks from Blue Cross Blue Shield (BCBS) totaling $3.8 million for retirees that pay premiums directly to BCBS. DOER's fiscal services had developed procedures to monitor the monthly receipt of these premiums. However, the monitoring procedure failed and allowed one BCBS check to go undeposited for over four and one half months. As a result, using the invested treasurer's cash (ITC) average rate of return, the fund lost estimated investment income of over $7,500.

The department did not effectively monitor retirees that pay premiums to BCBS directly. Early in fiscal year 1997, Blue Cross Blue Shield discovered that they overpaid the state for certain participants, so both parties agreed to delay subsequent premium payments until a review was completed. On March 25, 1997, a settlement check for $414,000 was sent to the DOER Insurance Division. This check was mistakenly left attached to correspondence and filed. A worksheet used by fiscal services to monitor these premiums did identify the fact that no checks were received for several months, but follow-up was not performed. The check was discovered during audit fieldwork on August 12, 1997, and deposited. The department was clearly aware that the monthly retiree checks from BCBS were suspended and it should have anticipated receipt of the settlement check. In addition, the department should require that all checks be sent directly to fiscal services for processing to ensure that all checks are promptly deposited.

Recommendation

- *The department should improve its monitoring process over insurance premiums for retirees that pay directly to BCBS to ensure that all premiums are collected and deposited.*

Chapter 4. Pre-Tax Benefits Plan

Chapter Conclusions

The Department of Employee Relations properly recorded over $10 million of Pre-Tax Benefits Plan receipts and disbursements in the state's accounting system for fiscal year 1997. In addition, the department designed internal controls to provide reasonable assurance that participants were eligible, deposits were safeguarded, and administrator reimbursements and fees were accurate, timely, and authorized. However, we noted a large fund balance in the Pre-Tax Benefits Plan administrative account.

State of Minnesota employees are eligible to participate in three Pre-Tax Benefit Plan accounts offered by the state:

- Health and Dental Premium Account
- Medical/Dental Expense Account
- Dependent Care Expense Account

The Health and Dental Premium Account allows premiums to be deducted prior to determining taxable wages. Premium revenues and disbursements are recorded in the State Employee Insurance Fund discussed in Chapter 3. The remaining two plans allow participants to pay for certain unreimbursed medical/dental or dependent care expenses with pre-tax dollars. The department has contracted with a third-party administrator to monitor and control participant account balances and reimburse participant claims incurred.

The department collects and safeguards participant pre-tax deposits in the state treasury. Participants file eligible claims with the third-party administrator, who in turn is reimbursed by the department. The department also receives an administrative fee for each account participant, a portion of which is disbursed to the third-party administrator. Table 4-1 shows the financial activity for the Medical/Dental and Dependent Care Expense Accounts for fiscal year 1997.

Table 4-1
State of Minnesota
Pre-Tax Benefit Plan - Financial Activity for the Medical/Dental and Dependent Care Expense Accounts
Fiscal Year Ending June 30, 1997

	Pre-Tax Deposits Account	Pre-Tax Administration Account
Balance Forward In	$ 1,579,261	$ 713,526
Receipts	9,211,135	926,645
Disbursements	(9,107,371)	(654,448)
Outstanding Encumbrances	0	(42,597)
Balance Forward Out	$ 1,683,025	$ 943,126

Source: Minnesota Accounting and Procurement System for fiscal year 1997 as of September 26, 1997.

Department of Employee Relations

We focused on the following objectives during our audit of the Pre-Tax Benefit Plan Medical/Dental and Dependent Care Expense Accounts:

- Did the Department of Employee Relations properly record the Pre-Tax Benefit Plan financial activities in the state's accounting system for fiscal year ending June 30, 1997?
- Did the department design internal controls to provide reasonable assurance that participants were eligible, deposits were safeguarded, and administrator reimbursements and fees were accurate, timely, and authorized?

To address these objectives, we interviewed department staff to gain an understanding of the processing and design of internal controls. We selected a sample of participants to determine whether employees were eligible, pre-tax collections were deposited into the state treasury, and financial activities were properly recorded in the Minnesota Accounting and Procurement System (MAPS). We also reviewed disbursements to the third party administrator for claims reimbursed to participants and administrative costs.

Conclusions

We found that the department properly recorded Pre-Tax Medical/Dental Expense Account and Dependent Care Account receipts and disbursements, totaling approximately $10 million for fiscal year 1997, in the state's accounting system. In addition, the department designed internal controls to provide reasonable assurance that Pre-Tax Benefit Plan participants were eligible, deposits were safeguarded, and administrator reimbursements and fees were accurate, timely, and authorized. However, as explained in Finding 4, we noted a large increase to the administrative account fund balance with no reduction of administrative fee rates charged to state agencies.

4. The fund balance in the Pre-Tax Benefits Plan administrative account continued to increase with no reduction of the fiscal year 1998 administrative fee rates.

The Department of Employee Relations assessed state agencies an administrative fee for employees that participate in the Pre-Tax Benefits Plan. State agencies are charged $4.60 per pay period for each participant. If a participant is enrolled in both the Medical/Dental Expense Account and the Dependent Care Expense Account, the agency is charged $9.20 per pay period. These rates have generated more revenues than were needed to fund administrative costs, allowing the fiscal year-end fund balance to increase from $713,526 to $943,126, or 32 percent.

Department management should review its administrative fees rates for Pre-Tax Benefits Plan. Rates should be structured to generate sufficient revenues to fund administrative costs. The large fund balance indicates the need to reduce administrative rates to a more reasonable level. We noted the fund balance in the Pre-Tax Benefits Plan administrative account is larger than either the Employee Insurance Fund or Workers' Compensation administrative account fund balances. These accounts handle much larger volumes of activity and have greater operating costs.

Recommendation

- *The department should review its administrative fee rates charged to state agencies for Pre-Tax Benefits Plan participants.*

Chapter 5. Workers' Compensation

Chapter Conclusions

The department operates the Workers' Compensation Program to manage and control claim costs for work-related injuries to state employees. Workers' compensation specialists maintain a computerized system to estimate the state's financial liability for injured workers. The department fairly estimated the June 30, 1997, liability of $107 million for workers' compensation claims.

The Workers' Compensation Program is a self-insured program that 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) that 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 5-1 shows the primary state departments comprising the estimated liability for the state's Workers' Compensation Program.

Table 5-1
State of Minnesota
Workers' Compensation Estimated Liabilities for Unpaid Claims
As of June 30, 1997

Department	Liabilities	Percent
Human Services	$ 35,564,361	33.3%
Transportation	16,640,525	15.6%
Corrections	10,673,021	10.0%
Natural Resources	8,554,554	8.0%
Public Safety	5,949,505	5.6%
MN State Colleges and Universities	5,004,642	4.7%
Zoological Board	3,393,459	3.2%
Veterans Home Board	3,360,113	3.1%
Other State Agencies	17,736,808	16.5%
Total	$106,876,988	100.0%

Source: June 30, 1997 GENCOMP System Report.

The calculated liability is an estimate of the state of Minnesota's liability for future payment of workers' compensation claims for injuries incurred as of June 30, 1997. It also acts as a spending budget to control individual claims. At June 30, 1997, the state's estimated liability was $107 million. The department reported this obligation to the Department of Finance for inclusion in the financial statements for the General Long-Term Obligation Account Group.

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.

Conclusion

We found that the department fairly estimated the workers' compensation liability for state employees, totaling $107 million as of June 30, 1997. For the employees tested, we determined that the department properly estimated, in all material respects, the state's financial liability for injured state workers.

Status of Prior Audit Issues
As of December 10, 1997

Most Recent Audits

February 1997, Legislative Audit Report 97-10 covered the fiscal year ending June 30, 1996. The audit scope included the state's payroll expenditures and the associated compensated absence liability. Financial activities of the State Employee Insurance Fund, the Public Employees Insurance Program, and the Minnesota Employees Insurance Program were reviewed. In addition, the audit included a review of the estimated workers' compensation liability for injured state employees.

The audit cited four audit findings. Two findings were resolved while the remaining two findings were nearing resolution and considered substantially implemented. First, the Department of Employee Relations has requested clarification from the Attorney General's Office regarding disposition of prior year cash settlements held in the State Insurance Fund. Second, the department is anticipating the results of an independent review of the Blue Cross Blue Shield claims processing system for the State Health Plan. This should provide assurances regarding controls over State Health Plan participant eligibility and covered claims.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota, any quasi-state organizations, such as the Metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.

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Minnesota
Department of
Employee
Relations

Leadership and partnership in human resource management

March 9, 1998

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

Dear Mr. Nobles:

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

Enclosed is our response to your findings and recommendations from your audit report for the fiscal year ending June 30,1997. We will work toward implementing the recommendations made by your audit as quickly as possible.

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

Sincerely,

Karen L. Carpenter by Chris Goodwill

Karen L. Carpenter
Commissioner

Enclosure

nobles97.doc

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Department of Employee Relations
Response to Audit Findings and Recommendations

A. SEMA4 Human Resource/Payroll

Finding #1: **PRIOR RECOMMENDATION PARTIALLY IMPLEMENTED:** An excessive percentage of SEMA4 system users have incompatible access to payroll and human resource functions.

DOER Response:

The department will identify all SEMA4 users who have an incompatible SEMA4 security profile and work with the agency security administrator to assign those employees to compatible profiles. If an agency must retain an employee in an incompatible profile, DOER will:

1. Require written justification of the need for the incompatible profile.
2. Require documentation of the agency security procedure that ensures controls and minimizes the risks involved with an incompatible profile.

The SEMA4 security policy will be updated. The new policy will reflect a stronger management oversight role by DOER and outline acceptable agency security control procedures for employees with incompatible profiles.

B. Employee Insurance Funds

Finding #2: The Minnesota Employees Insurance Program will be unable to repay a $2.075 million outstanding loan to the Health Care Access Fund.

DOER Response:

The department has recognized for quite some time the possibility that MEIP would have difficulty repaying the loan to the Health Care Access Fund (HCAF) on the scheduled due date of July 1, 1998. Therefore the MEIP staff evaluated future options for the program. Based upon the results of the evaluation, DOER has decided to discontinue the program and address the loan repayment issue.

The department has introduced a budget initiative deleting the language requiring the loan repayment and requiring DOER to repay any remaining funds to the Health Care Access Fund in June 1999.

Finding #3: The department did not effectively monitor certain receipts for the State Employee Insurance Fund.

DOER Response:

Procedures existed for fiscal 1997 that instructed Blue Cross/Blue Shield (BCBS) to forward checks and supporting documentation directly to DOER's Fiscal Services Section. In turn, the documentation supporting these payments by BCBS are forwarded by Fiscal Services to the EID's Financial Analyst who performs a high level analytical review for reasonableness.

The $414,000 check sent by BCBS and received by Employee Insurance Division's (EID) Financial Analyst represented a settlement resulting from a reconciliation process performed on various issues, one of which was related to premiums received from retirees. This was an irregular transaction falling outside the scope of the regular monthly retiree payment of premiums and that Fiscal Services was unaware of. BCBS should have followed established procedures by sending the check and related documentation to DOER's Fiscal Services. However, established procedures were not followed by BCBS. EID's Financial Analyst has sent formal notification to BCBS, as a reminder, to follow established procedures for all types of payments to DOER's Fiscal Services. In addition, EID and Fiscal Services will work to improve the exchange of information regarding program changes that could have a fiscal impact or situations that are exceptions to the norm. Fiscal Services will also increase the review process and monitoring of receipts to minimize or eliminate future occurrences.

C. Pre-Tax Benefits Plan

Finding #4: The fund balance in the Pre-Tax Benefits Plan administrative account continued to increase with no reduction of the fiscal year 1998 administrative fee rates.

DOER Response:

The department is aware of the size of the fund balance in the Pre-Tax Administration Account. DOER is also in the process of analyzing the feasibility of transitioning the administration of this program from an outside contracted service to administering the program internally at DOER. If the study concludes that it is feasible for DOER to administer the program internally , an adequate fund balance will be necessary to cover start-up and implementation costs. Conversely, if the study concludes it is not feasible to administer the program internally, then DOER intends to reduce the administrative fees or implement a premium holiday to state agencies for Pre-Tax Benefits Plan administration fees.