Department of Employee Relations

Statewide Audit - Selected Audit Areas
For the Year Ended June 30, 1998

February 1999

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

99-7

Centennial Office Building, Saint Paul, MN 55155 ● 651/296-4708

SUMMARY

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Department of Employee Relations

Statewide Audit
Selected Audit Areas
For the Fiscal Year Ended June 30, 1998

Public Release Date: February 4, 1999 No. 99-7

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 the financial activities within the Department of Employee Relations that were material to the State of Minnesota's Comprehensive Annual Financial Report for fiscal year ended June 30, 1998. Our scope included statewide payroll expenditures, compensated absence liabilities, revenues and expenses of the State Employees Insurance Fund, the Public Employees Insurance Program (PEIP), and the Minnesota Employees Insurance Program (MEIP), and workers' compensation.

We qualified our report, dated December 1, 1998, on the State of Minnesota's Comprehensive Annual Financial Report because insufficient audit evidence exists to support the State of Minnesota's disclosures with respect to the year 2000. Auditing the state's year 2000 compliance efforts was not an objective of this audit. As a result, we do not provide assurance that the Department of Employee Relations is or will be year 2000 ready, that its year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Department of Employee Relations does business will be year 2000 ready.

For the areas audited, the Department of Employee Relations' financial activities were fairly presented in the State of Minnesota's general purpose financial statements for the year ended June 30, 1998. As a result of our procedures, we identified one issue at the Department of Employee Relations involving the reporting of investment balances and activities in accordance with generally accepted accounting principles (GAAP).

The department agreed with the audit report finding and recommendation. They plan to familiarize accounting staff with the necessary financial reporting requirements for investments.

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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
Mike Bzewski	Auditor
Dan Kingsley	Intern

Exit Conference

We discussed the results of the audit at an exit conference with the following Department of Employee Relations staff on January 21, 1999:

Karen Carpenter	Commissioner
Kathy Burek	Assistant Commissioner, Employee Insurance Division
Edmund Anderson	Accounting Director

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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 performed certain audit procedures at the Department of Employee Relations as part of our audit of the financial statements of the State of Minnesota as of and for the year ended June 30, 1998. We also have reviewed certain departmental procedures related to the state's compliance with requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to the department for the year ended June 30, 1998. We emphasize that this has not been a comprehensive audit of the Department of Employee Relations.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Table 1-1 identifies the financial activities within the Department of Employee Relations that were material to the state's financial statements. We performed certain audit procedures on these programs as part of our objective to obtain reasonable assurance about whether the State of Minnesota's financial statements were free of material misstatement.

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Table 1-1
Department of Employee Relations
Programs Material to the State's Financial Statements
Fiscal Year 1998

	Amount
Statewide Payroll Expenditures	$2,270,679,000
Revenue Areas	
Employees Insurance *(internal service fund)*	
Operating revenue	$251,724,000
Investment income	5,790,000
Public Employees Insurance *(enterprise fund)*	
Operating revenue	8,843,000
Investment income	316,000
Minnesota Employees Insurance *(enterprise fund)*	
Operating revenue	4,931,000
Investment income	67,000
Expense Areas	
Employees Insurance *(internal service fund)*	$253,519,000
Public Employees Insurance *(enterprise fund)*	9,057,000
Minnesota Employees Insurance *(enterprise fund)*	4,864,000
Other Areas	
Compensated Absences Liability *(general long-term obligation account group)*	$254,774,000
Compensated Absences Liability *(proprietary funds)*	11,770,000
Workers' Compensation Liability *(general long-term obligation account group)*	113,732,000

Source: State of Minnesota Comprehensive Annual Financial Report and Minnesota Accounting and Procurement System (MAPS) for fiscal year 1998.

Conclusions

We qualified our report dated December 1, 1998, on the State of Minnesota's Comprehensive Annual Financial Report, because of uncertainties about the potentially adverse effect the year 2000 computer issue may have on state operations. Information technology experts believe that many computer applications in private businesses and government may fail as a result of data integrity problems and erroneous calculations beyond December 31, 1999. The state is currently addressing year 2000 issues related to its computer systems and other electronic equipment. During fiscal year 1996, the state established the Minnesota Year 2000 Project Office to develop and monitor the overall statewide effort for executive branch agencies. The project office is tracking over 1,300 mission critical applications owned by state agencies. As of September 1998, the project office believed that 75 percent of the applications were compliant or had completed the necessary modifications. However, because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter.

Department of Employee Relations

Auditing the state's year 2000 compliance efforts was not an objective of this audit. As a result, we do not provide assurance that the Department of Employee Relations is or will be year 2000 ready, that its year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Department of Employee Relations does business will be year 2000 ready.

In accordance with *Government Auditing Standards*, we have also issued our report, dated December 1, 1998, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. At a later date, we will issue our report on compliance with requirements applicable to each major federal program and internal control over compliance in accordance with OMB Circular A-133.

For the areas audited, the Department of Employee Relations' financial activities were fairly presented in the State of Minnesota's general purpose financial statements for the year ended June 30, 1998. As a result of our procedures, we identified no instances of noncompliance with finance-related legal provisions, for the items tested. However, we identified the following weakness in internal control at the Department of Employee Relations:

1. The Department of Employee Relations (DOER) did not report State Employee Insurance Fund investments and investment activities in accordance with generally accepted accounting principles (GAAP).

The DOER Employee Insurance Division is responsible for administering insurance programs that cover state, public, and private employees. The division maintains the State Employee Insurance Fund to account for and provide insurance benefits to state employees. The division offers six health plans, four 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 private insurance carriers and 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. Beginning January 1, 1997, the department also began to self-insure dental claims. Overall, the fund reported annual operating revenue of $252 million and operating expenses of $254 million in its fiscal year 1998 financial statements. In addition, investment income of $5.8 million was earned. The fund accounts for its financial activities using the accrual basis of accounting, similar to private business.

The State Health Plan builds a reserve from premiums to fund current and future health claims. DOER utilized the State Board of Investment to invest approximately $20 million of excess reserves not needed for immediate claims and operations. Beginning in fiscal year 1998, the Governmental Accounting Standards Board (GASB) Statement No. 31 required that investments be recorded at market or 'fair value'. However, DOER continued to record its investments at cost in its financial statements. An audit adjustment of $377,408 was necessary to increase the reported investment balance to fair market value and accrue unrealized investment income.

We also noted that the department did not properly report its investment activities during fiscal year 1998. Interest income of $260,234 was not accrued on the State Employee Insurance Fund investments as of June 30, 1998. In addition, DOER failed to properly identify over $5 million of investment purchases and sales during fiscal year 1998 on its statement of cash flows.

Department of Employee Relations

Recommendation

- *The Department of Employee Relations should ensure its financial statements are prepared in accordance with generally accepted accounting principles. Specifically, the department should:*
  - -- *record investments at market value in accordance with GASB Statement No. 31;*
  - -- *accrue all interest income earned at fiscal year-end; and*
  - -- *properly identify annual investment sales and purchases on the statement of cash flows.*

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Employee Relations. This restriction is not intended to limit the distribution of this report, which was released as a public document on February 4, 1999.

/s/ James R. Nobles	*/s/ Claudia J. Gudvangen*
James R. Nobles Legislative Auditor	Claudia J. Gudvangen Deputy Legislative Auditor

End of Fieldwork: December 1, 1998

Report Signed On: January 29, 1999

Status of Prior Audit Issues
As of December 1, 1998

<u>March 1998, Legislative Audit Report 98-17</u> examined the department's activities and programs material to the State of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1997. The scope included the state's payroll expenditures, state employee insurance fund, public employees insurance fund (PEIP), private employers insurance fund (MEIP), pretax benefits plan, workers' compensation liability, and compensated absences liability.

The audit cited four findings, which the department has resolved. In summary, the department worked with many agencies to minimize incompatible SEMA4 user access. A second issue was raised regarding the inability for MEIP to repay a $2 million outstanding loan. During the 1998 legislative session, a bill was passed which forgave the loan repayment. On another issue, DOER implemented a log to track all incoming insurance collections. Lastly, the department initiated a reduction of a pre-tax administrative fee charged to state agencies for employee enrollment in the program.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on 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*

January 22, 1999

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, 1998. 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,

/s/ Karen L. Carpenter

Karen L. Carpenter
Commissioner

Enclosure

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Department of Employee Relations
Response to Audit Findings and Recommendation's

A. Incorrect Recording of Investment Income in Accordance with GASB Statement 31

Finding #1. The Department of Employee Relations (DOER) did not report State Employee Insurance Fund investments and activities in accordance with generally accepted accounting principles (GAAP).

DOER Response:

The department was unaware of the provisions issued in the Governmental Accounting Standards Board (GASB) Statement No. 31, requiring that external investments pools be recorded at market or fair value. GASB No. 31 was issued for fiscal years beginning after June 15, 1997. Reporting for external investment pools was new to our reporting process and the accounting staff was unfamiliar with the proper reporting procedure. Discussions with the Financial Reporting Unit at the Department of Finance also revealed that they were unaware of the DOER's external investment pool and apologized for not notifying us of this reporting requirement. Also, a letter will be sent to the State Board of Investment to make them aware of our reporting requirement and the documentation needed for future financial statements. Furthermore, additional research will be done to familiarize the accounting staff with the proper entries to record the gains or losses on the sale of external investments and accounting for the accrued investment income realized during the fiscal year.

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