State Auditor's Office

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State Auditor

A Financial Review of

The Workers' Compensation Commission

March 18, 2002

Members of the Legislative Audit Committee:

The Legislature and other oversight bodies can rely on the Workers' Compensation Commission's (Commission) financial information. This assurance is based on our testing of the structure of the Commission's financial system and of financial processes in place as of August 2001. The Commission's internal financial system is the primary source of information for all of its financial reports. In addition, the Commission spends appropriated funds in accordance with the General Appropriations Act and other applicable state laws and regulations. Furthermore, expenditures and outcomes are in alignment with Commission goals related to safe and healthy workplaces and dispute resolution. There is no direct relationship between strategy expenditures and all outcomes for the Commission's goal related to benefits and delivery. This is reasonable because strategy expenditures do not directly affect all of the outcomes for this goal.

We also noted some issues the Commission should address even though they do not affect the reliability of its financial information or the appropriateness of its expenditures. The Commission is not referring past-due accounts to the Office of the Attorney General as often as required by statute. In addition, provisions for two business process improvement plan contracts were not sufficient.

This financial review was an extension of work we conducted during fiscal year 2001 at the request of the Senate Finance Committee and the House Appropriations Committee. We reviewed the Commission's financial system and tested selected financial transactions that occurred between September 1, 1997, and August 31, 2001. The attachment to this letter contains additional detail on the results of our work.

We appreciate the Commission's cooperation and responsiveness during this project. The Commission agrees with our observations, and its responses are included in the attachment. If you have any questions, please contact Susan Riley, Audit Manager, at (512) 936-9500.

Sincerely,

Lawrence F. Alwin, CPA
State Auditor

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Attachment

cc: Workers' Compensation Commission
Chair and Commissioners
Mr. Richard F. Reynolds, Executive Director

Objectives, Scope, and Methodology

The project objectives were to:

- Determine whether the Commission's reporting processes enable it to provide legislative budget committees and Commissioners with accurate and consistent financial information.
- Determine whether the Commission is using appropriated funds in accordance with applicable state laws and regulations.
- Determine the relationship between funds expended and outcome results.

To achieve these objectives, we reviewed financial reports, expenditures, revenues, transfers, lapses, and fund balances. We also examined the relationship between expenditures, key strategies, and the expected outcomes for the strategies.

The audit methodology consisted of collecting information, performing selected audit tests and other procedures, and analyzing and evaluating the results against established criteria.

We conducted fieldwork between September and December 2001 and tested transactions that occurred from fiscal year 1998 through fiscal year 2001. This audit was conducted in accordance with generally accepted government auditing standards.

SAO Report No. 02-027

Section 1:

Do the Commission's reporting processes enable it to provide legislative budget committees and Commission management with accurate and consistent financial information?

Overall, the Workers' Compensation Commission (Commission) is providing accurate and consistent financial information to its commissioners and to the Legislature. We noted several aspects of the Commission's financial operations that lead to this conclusion.

We also noted that the Commission is not complying with statutory requirements for referral of delinquent accounts to the Office of the Attorney General. While this issue does not affect the reliability of the Commission's financial information, it reduces the number of accounts that may be eligible for collection.

Section 1-A:

The Commission's Financial Information Is Consistent and Accurate

Several aspects of the Commission's financial operations ensure that its financial information is consistent and accurate.

The Commission reconciles various sources of financial information. The Commission's internal accounting system is the primary source of financial information. This system interfaces with the Uniform Statewide Accounting System (USAS). The Commission reconciles its internal accounting system to USAS on a monthly basis. In addition to this standard reconciliation, the Commission reconciles the General Appropriations Act to its internal operating budget. The Commission also reconciles its internal operating budget to a draft of its annual financial report. We verified all reconciling items by tracing them to supporting documentation.

User access rights to USAS and the Commission's internal accounting system are appropriate. A review of access rights and security levels for USAS and the Commission's internal accounting system revealed that appropriate individuals have access and security levels are consistent with assigned job responsibilities. Appropriate access and security levels help to safeguard financial data and ensure that it cannot be inappropriately changed, deleted, and/or processed.

The Commission has appropriate information systems policies and procedures, and it backs up its financial data. The Commission has policies and procedures that address various components of information systems. Security policies and procedures include controls to help ensure that appropriate access is granted to users, live data and equipment are safeguarded, and information system security policies are monitored on an ongoing basis. The Commission backs up financial data daily and stores tapes at an off-site location.

Fund Balance fluctuations were reasonably explained. We identified and investigated significant fund balance fluctuations for fiscal years 1998, 1999, and 2000. The Commission was able to reasonably explain and support these fluctuations with information included in its financial system.

Section 1-B:

The Commission Does Not Report Past-Due Accounts as Often as Required by Statute

During our review of the Commission's financial reporting processes, we noted that the Commission does not report past-due accounts to the Office of the Attorney General (OAG) as often as required by statute. While this issue does not affect the reliability of the Commission's financial information, it does reduce the number of accounts that may be eligible for collection.

Texas Government Code, Section 2107.004, and the Commission's procedures require the Commission to report uncollected and delinquent obligations to the OAG for further collection efforts 120 days after the date an obligation becomes past due. The Commission is currently referring delinquent accounts in excess of $500 to the OAG once a year because the Commission's manual and automated processes do not support sufficient gathering of relevant documentation. Different divisions within the Commission record the amounts they bill in various internal systems that do not interface with each other or with the Commission's internal accounting system. Because the OAG pursues only accounts that have been delinquent for less than two years, the Commission's infrequent reporting may reduce the number of accounts that are eligible for collection. For fiscal year 2001, the Commission referred 65 accounts totaling approximately $182,000 to the OAG for collection.

<u>Recommendation</u>:

To ensure compliance with statute, the Commission should refer delinquent accounts to the OAG as they fall within the 120-day requirement. Because the OAG does not pursue collection on accounts more than two years old, monthly referrals would be ideal to maximize the number of accounts that will be pursued. However, if monthly referrals are not feasible, the Commission should consult with the OAG to determine an alternative frequency.

<u>Management's Response</u>:

We concur. Prior to the audit, the Commission typically referred delinquent accounts to the OAG on an annual basis. As a result of the auditor's recommendations, a new procedure (effective January 29, 2002) was implemented. This procedure requires referral of delinquent accounts to the OAG no later than 120 days after delinquency has been determined.

Section 2:

Is the Commission using appropriated funds in accordance with applicable state laws and regulations?

The Commission is using funds in accordance with applicable state laws and regulations. We noted several aspects of the Commission's financial processes that lead to this conclusion.

We noted two contracts for the Commission's business process improvement plan (BPI) that did not include sufficient provisions to hold the vendor accountable for quality services. While these contracts did not affect the appropriateness of the Commission's expenditures, they increased the risk that the Commission may not have received services that were required to help meet the objectives of the BPI.

Section 2-A:

The Commission Is Using Funds In Accordance With Applicable State Laws and Regulations

Several aspects of the Commission's financial processes ensure that it uses funds in accordance with state laws and regulations.

Commission expenditures were reasonable and appropriate. A review of Commission expenditures for fiscal years 1998 through 2001 revealed that transactions were appropriate for the Commission's mission, and fourth quarter expenditures did not exceed one-third of the Commission's appropriations as set forth in the General Appropriations Act.

The Commission was able to support and explain significant fluctuations between expenditures for appropriation years 1998 through 2001.

The Commission develops and adheres to reasonable budgets. The Commission is appropriately managing its spending and preparing realistic budgets. The Commission prepares its internal operating budget using historical financial data and input from divisions. Analysis of legislative appropriations requests, internal operating budgets, USAS expenditures, and available budgets revealed that the Commission is not significantly overspending or underspending appropriated funds.

The Commission maintains a budget account in which it includes expenses such as lump sum terminations, tuition reimbursement, legal judgments and settlements, and 10 percent of the travel budget. A review of supporting documentation determined expenditures made out of this account for fiscal years 1999 through 2001 were appropriate. Executive management assesses whether divisions are meeting or exceeding their budgets during quarterly meetings. Divisions that are underspending may have excess money reallocated to this account or another division that is overspending. For fiscal years 1999, 2000, and 2001, this account was initially budgeted at approximately $895,000, $816,000, and $617,000, respectively.

The Commission calculates maintenance tax rates appropriately. Maintenance taxes, which are collected by the Comptroller of Public Accounts and deposited into General Revenue, fund more than 90 percent of the Commission's expenditures. The Commission is responsible for calculating the maintenance tax rate on an annual basis. A review of the Commission's fiscal year 2000 maintenance tax rate calculation revealed that it was calculated in accordance with the Texas Workers' Compensation Act, Section 403.003. For fiscal years 1998 through 2000, annual maintenance tax collections were sufficient to cover Commission expenditures; additional general revenue funding was not required.

To address concerns raised by a recent actuarial analysis regarding the effect of House Bill 2600 (77th Legislature, Regular Session) on the solvency of the Subsequent Injury Fund (SIF), the Commission is considering two possible options:

- Whether to modify the current methodology it uses to calculate the maintenance tax rate.
- Whether to create an additional maintenance tax.

The SIF is currently funded by insurance carrier payments for cases in which a compensable death occurs and no legal beneficiary exists.

The Commission maintains appropriate levels of appropriation transfers and unexpended balance transfers. Three net transfers out for appropriation years 1998 and 1999 exceeded the 25 percent limit set forth in the General Appropriations Act. Two of these transfers resulted from employees moving to the State Office of Risk Management. The third transfer related to a capital budget item and was authorized by Article IX of the General Appropriations Act.

The Commission has unexpended balance authority. All unexpended balances met requirements set forth in the General Appropriations Act.

Encumbrances for fiscal year 2000 were reasonable and were paid within a reasonable amount of time. A review of fiscal year 2000 encumbrance reports and related financial data indicated that the Commission properly classified encumbrances and paid them in fiscal year 2001.

Lapses were reasonable. We reviewed financial information for lapses that occurred in appropriation years 1998 through 2001. The Commission had committed and collected lapses for appropriation years 1998 and 1999. Committed lapses result from the Commission not spending what is authorized by the Legislature. Collected lapses result from the Commission not collecting the amount of revenue it is budgeted to collect. For some of the appropriation year 1998 lapses included in our review, the

Comparison of Original Budget to Committed and Collected Lapses

Appropriation Year	Original Budget	Committed Lapses	Collected Lapses	Total Lapses
1998	$46,194,766	$293,482	$337,309	$630,791
1999	$44,198,767	$257,983	$502,554	$760,537

Commission asserted that FTE[1] turnover resulted in lapsed funds. However, the Commission did not have a supporting analysis that confirmed this assertion. All other lapses were explained reasonably and were supported with documentation. More than half of the dollar value of committed lapses included in our review occurred because of limited responses for prosecuting workers' compensation fraud. A contingency rider allowed the Commission to develop contracts with prosecuting authorities for the prosecution of workers' compensation fraud cases. Although the Commission advertised for these contracts, it received few responses. The majority of the dollar value of collected lapses included in our review occurred because extra hazardous employer inspections decreased. Inspections decreased because a Texas Appellate Court ruled that Occupational Safety and Health Program statutes preempted such inspections.

Section 2-B:

Two Business Process Improvement Plan Contracts Did Not Include Sufficient Provisions

We noted two contracts for the Commission's business process improvement plan (BPI) that did not include sufficient provisions to hold the vendor accountable for quality services. While these contracts did not affect the appropriateness of the Commission's expenditures, they did increase the risk that the Commission may not have received services that were required to help meet the objectives of the BPI (see text box). Both contracts were with the same vendor and totaled $144,000.

Business Process Improvement Plan

The purpose of the Commission's BPI is to streamline, redesign, and automate (as needed) business processes. Commission appropriations were $2.5 million for the 2000-2001 biennium to initiate the BPI. This initial phase served as the foundation for identifying and prioritizing BPI components. The BPI is expected to be complete in fiscal year 2007 for a total cost of approximately $20 million.

The contract provisions did not clearly define the requirements of the contracted party, which put the Commission at risk of losing fiscal year 2001 funding for the BPI. Although the Commission's Legal Services Division recommended stronger provisions for one of the contracts, prior Commission administration did not incorporate these suggestions. The Legal Services Division was not provided an opportunity to review any drafts of the other contract before it was signed and became effective. The Commission's Internal Audit Division also provided suggestions for stronger provisions. In addition to the $144,000 for the startup and development of these contracts, the Commission will be required to pay annual application maintenance fees of $20,400 and annual application hosting charges of $75,000.

[1] FTE: full-time equivalent employee

Recommendation:

To hold vendors accountable for providing quality goods or services, the Legal Services Division should review all contracts and Commission management should carefully consider the Legal Services Division's comments prior to contract approval. In addition, the Commission should consider all recommendations provided by various divisions. The Commission should clearly document all decisions regarding contracts to ensure accountability throughout the agency.

Management's Response:

We concur with the recommendations. Under the current administration, procedures require legal review of all contracts, and input from contributing divisions and offices is obtained and documented prior to final approval.

Section 3:

Is there alignment between funds expended and outcomes?

Expenditures and outcomes are in alignment with the Commission's goals related to safe and healthy workplaces and dispute resolution. Strategy expenditures for these goals remained relatively constant while performance improved. There is no direct relationship between strategy expenditures and all outcomes for the Commission's goal relating to benefits and delivery. This is reasonable because strategy expenditures do not directly affect all of the outcomes for this goal.

Safe and Healthy Work Places. The Commission improved performance with less money. Outcomes improved during fiscal years 1998 through 2001 because incident rates of workers' compensation injuries and illnesses decreased. For the same period, the Commission's expenditures for this goal slightly decreased.

Dispute Resolution. The Commission improved performance during fiscal years 1998 and 1999 because it resolved more cases at a lower level. For fiscal years 2000 and 2001, the Commission met all targeted outcomes. During fiscal years 1998 through 2001, strategy expenditures increased by only 1 percent. Prior to fiscal year 2000, dispute resolution was part of the goal related to benefits and delivery.

Benefits and Delivery. There is no direct relationship between strategy expenditures and two of the three outcomes for this goal. These two outcomes measure the performance of participants in the workers' compensation system rather than the performance of the Commission. The third outcome was under target for fiscal years 1998 and 1999 due to complexities associated with source documentation that included claim information. Expenditures related to this outcome decreased by approximately 3 percent from fiscal year 1998 to 1999. Beginning with fiscal year 2000, this outcome is no longer a key measure for the Commission. The Commission simplified the methodology used to create claim forms, which allowed the Commission to improve performance. A review of the Commission's internal performance measure reports revealed that the Commission improved its performance for this outcome in fiscal year 2000 and met the target in fiscal year 2001.