

Office of the Auditor General
Report on Internal Control, Compliance, and Other Matters

Self-Insurers' Security Fund
Workers' Compensation Agency Funds Administration
Department of Licensing and Regulatory Affairs

Calendar Year Ended December 31, 2014

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

Article IV, Section 53 of the Michigan Constitution



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Report Summary

*Report on Internal Control, Compliance, and
Other Matters
Self-Insurers' Security Fund, Workers'
Compensation Agency Funds Administration
Department of Licensing and Regulatory
Affairs
Calendar Year Ended December 31, 2014*

**Report Number:
641-0101-15**

**Released:
October 2015**

Generally accepted government auditing standards require an auditor to report on internal control over financial reporting; compliance with provisions of laws, regulations, contracts, or grant agreements that have a material effect on the financial statements; and other matters coming to the attention of the auditor during the completion of a financial audit. We are issuing this report in conjunction with our independent auditor's report on the Self-Insurers' Security Fund's (SISF's) financial statements dated August 28, 2015.

Findings Related to Internal Control, Compliance, and Other Matters	Material Weakness	Significant Deficiency	Agency Preliminary Response
The Department of Licensing and Regulatory Affairs (LARA) did not have a process to ensure that it provided complete and accurate SISF claim data to the actuary. The SISF actuarially-determined future contingent liability was understated by approximately \$5.6 million (Finding #1).	X		Agrees
LARA did not have a process to ensure that it timely and accurately prepared SISF financial statements. LARA missed the March 31 reporting deadline and delayed the issuance of the 2015 assessments by approximately four months (Finding #2).	X		Agrees
LARA did not have a process to validate assessment revenue submitted by SISF private self-insured employers. As a result, LARA could not ensure that SISF received all assessment revenue that it was entitled to (Finding #3).		X	Agrees

A copy of the full report can be
obtained by calling 517.334.8050
or by visiting our Web site at:
<http://audgen.michigan.gov>

Office of the Auditor General
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Doug A. Ringler, CPA, CIA
Auditor General

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Doug A. Ringler, CPA, CIA
Auditor General

October 30, 2015

Mr. Douglas A. Green, Chair
Board of Trustees for the Funds Administration
and
Mr. Mike Zimmer, Director
Department of Licensing and Regulatory Affairs
Ottawa Building
Lansing, Michigan

Dear Mr. Green and Mr. Zimmer:

We have audited the basic financial statements of the Self-Insurers' Security Fund (SISF), Workers' Compensation Agency Funds Administration, Department of Licensing and Regulatory Affairs, as of and for the calendar year ended December 31, 2014 and have issued a separate report thereon dated August 28, 2015. In planning and performing our audit of the financial statements, we considered SISF's internal control over financial reporting and compliance and other matters. This is our report on internal control, compliance, and other matters of SISF for the calendar year ended December 31, 2014.

Your agency provided preliminary responses to the recommendations at the end of our fieldwork. The *Michigan Compiled Laws* and administrative procedures require an audited agency to develop a plan to comply with the recommendations and submit it within 60 days of the date above to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Doug Ringler
Auditor General

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE



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Doug A. Ringler, CPA, CIA
Auditor General

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters

Mr. Douglas A. Green, Chair
Board of Trustees for the Funds Administration
and
Mr. Mike Zimmer, Director
Department of Licensing and Regulatory Affairs
Ottawa Building
Lansing, Michigan

Dear Mr. Green and Mr. Zimmer:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the basic financial statements of the Self-Insurers' Security Fund, Workers' Compensation Agency Funds Administration, Department of Licensing and Regulatory Affairs, as of and for the calendar year ended December 31, 2014 and the related notes to the basic financial statements and have issued our report thereon dated August 28, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the basic financial statements, we considered the Self-Insurers' Security Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Self-Insurers' Security Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Self-Insurers' Security Fund's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the body of our report, we identified certain deficiencies in internal control that we consider to be material weaknesses and another deficiency that we consider to be a significant deficiency.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's basic financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described in Findings #1 and #2 to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in Finding #3 to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Self-Insurers' Security Fund's basic financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted other noncompliance as described in Finding #2.

Self-Insurers' Security Fund's Response to Findings

The Self-Insurers' Security Fund's preliminary responses to the findings identified in our audit are included in the body of our report. The Self-Insurers' Security Fund's responses were not subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Sincerely,



Doug Ringler
Auditor General
August 28, 2015

**FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES**

FINDING #1

More complete and accurate claim data to the actuary would improve statement accuracy.

The Department of Licensing and Regulatory Affairs (LARA) did not have a process to ensure that it provided complete and accurate Self-Insurers' Security Fund (SISF) claim data to the actuary. SISF's actuarially-determined future contingent liability was understated by approximately \$5.6 million.

Section 418.551(10) of the *Michigan Compiled Laws* (Public Act 236 of 2014) requires LARA to issue an annual financial report of SISF supported by an actuarial review and opinion of future contingent liabilities.

This was the first year that LARA was required to obtain an actuarial review of SISF's future contingent liability. Therefore, LARA had not had sufficient time to fully implement the necessary control procedures and coordinate the exchange of data with the actuary for the calculation of the future contingent liability.

Our review disclosed:

Future contingent liability net understatement of \$5.7 million was subsequently corrected.

- a. LARA did not always provide complete data to the actuary. We tested 43 of SISF's 568 claims and determined that, in 6 (14.0%) instances, the compensation rate used by the actuary did not agree with the compensation rate documented in SISF's supporting claim files. Based on this error rate, we projected that the actuary understated SISF's future contingent liability by approximately \$6.0 million. LARA corrected this misstatement prior to issuing SISF's financial statements.
- b. LARA incorrectly provided three Silicosis, Dust Disease, and Logging Industry Compensation Fund indemnity claims in the data that it provided to the actuary. The actuary included these claims in the SISF future contingent liability calculation, overstating SISF's actuarially-determined future contingent liability by \$82,684.
- c. LARA's actuary double counted payments of one claim, overstating SISF's actuarially-determined future contingent liability by \$271,656. The actuary indicated that the error occurred because of the disorganized, unsorted data provided by LARA. LARA corrected this misstatement prior to issuing SISF's financial statements.

RECOMMENDATION

We recommend that LARA implement a process to ensure that it provides complete and accurate SISF claim data to the actuary.

**AGENCY
PRELIMINARY
RESPONSE**

LARA provided us with the following response:

We agree additional controls are necessary to address any inconsistencies in reporting of the data used to support the claim liability to both the OAG and the actuary. As this is the first year of this audit a great deal of knowledge has been gained through the process and we appreciate the OAG's insight and input. As a result, additional controls are being put in place to address the prior inconsistencies. Further discussions are being held with the actuary to provide a better understanding of the data provided and to gain a better understanding of their needs.

It should be noted that when the SISF takes over claims received from an insolvent self-insurer those claims may not have sufficient data to establish compensation rates or appropriate reserves.

It should be further noted that multiple factors must be considered when placing a proper reserve on a claim and certain data elements that are used to determine reserves were weighted differently by the Funds Administration than by the OAG.

We are currently working:

- 1. To verify the accuracy of claims data entered into FAIS with an internal audit process completed no later than December 31, 2015.*
- 2. To confirm with the actuary the data elements and format necessary for them to timely and accurately complete their report.*
- 3. To develop process controls to eliminate double counting of claims and to identify proper payment sources.*

FINDING #2

Process improvements needed to ensure more timely and accurate financial statements.

The March 31 reporting deadline was missed, and the issuance of the 2015 assessments was delayed.

LARA needs to improve its processes to ensure that it timely and accurately prepares SISF financial statements. LARA missed the March 31 reporting deadline and delayed the issuance of the 2015 assessments by approximately four months.

Section 418.551(10) of the *Michigan Compiled Laws* (Public Act 236 of 2014) requires LARA to issue an annual financial report of SISF in accordance with generally accepted accounting principles* no later than March 31 of the following calendar year.

This was the first year that LARA was required to prepare stand-alone SISF financial statements. Therefore, LARA had limited time to work with the Office of Financial Management, State Budget Office, regarding proper fund classification, to contract with the actuary for the calculation of the future contingent liability, and to fully coordinate the efforts of LARA Funds Administration and LARA Finance for the implementation of the necessary control procedures.

LARA Funds Administration administers SISF. LARA Finance provides financial support services for LARA Funds Administration to ensure compliance with State accounting policies and generally accepted accounting principles.

Although we issued an unmodified opinion* on the SISF financial statements, issued on August 28, 2015, our review of LARA's financial reporting processes disclosed:

- a. Funds Administration did not always substantiate amounts provided to Finance for preparing SISF's financial statement drafts.
- b. Finance did not always ensure that information provided by Funds Administration was relevant, complete, and accurate prior to preparing the financial statement drafts.
- c. Finance did not always ensure that SISF's financial information was appropriately adjusted at year-end to reflect the full accrual basis of accounting for an enterprise fund.
- d. Finance had not developed a methodology to properly format SISF's financial statements based on the account balances in the State's official accounting records.

* See glossary at end of report for definition.

RECOMMENDATION

We recommend that LARA improve its processes to ensure that it timely and accurately prepares SISF financial statements.

**AGENCY
PRELIMINARY
RESPONSE**

LARA provided us with the following response:

We agree. We improved our processes and completed and documented an Enterprise Fund Statement for the first time by putting improvement processes in place to ensure future statements will be prepared timely and accurately.

The Fund is accounted for, and reported, in the State of Michigan Comprehensive Annual Financial Report as a Special Revenue Fund. LARA developed a process to convert the presentation of the fund as an Enterprise fund outside of the State's Accounting system for the first time. This process should ensure that the statements are prepared as an Enterprise Fund in a more timely and accurate manner in the future.

We are currently working to change reporting of the excess reinsurance receipts and receivables as expenditure credits rather than revenue for FY15 and the future.

FINDING #3

Validation of employer-reported assessment revenue may result in additional SISF assessment revenue.

LARA should consider the feasibility of implementing a process to validate assessment revenue submitted by SISF private self-insured employers. Without a validation process, LARA could not ensure that SISF received all assessment revenue that it was entitled to.

Section 418.551(4) of the *Michigan Compiled Laws* allows SISF to make an assessment upon private self-insured employers necessary to keep SISF solvent. Also, Section 18.1485 of the *Michigan Compiled Laws* requires each department to establish an internal accounting and administrative control system. Effective internal control* would include a process to verify the completeness and accuracy of revenue.

Employer-reported assessment revenue of \$6.4 million was not validated for accuracy.

Private self-insured employers determine and submit their current year assessments based on their prior year indemnity payments and the SISF calculated assessment percentage, as determined in accordance with Section 418.551(4) of the *Michigan Compiled Laws*. SISF reported assessment revenue of \$6.4 million for calendar year 2014. LARA did not verify the validity of either the estimated or the actual prior year indemnity payments reported by the private self-insured employers.

LARA indicated that it was in the process of correcting this control weakness.

RECOMMENDATION

We recommend that LARA consider the feasibility of implementing a process to validate assessment revenue submitted by SISF private self-insured employers.

AGENCY PRELIMINARY RESPONSE

LARA provided us with the following response:

We agree. We are currently exploring steps that can be taken to verify that assessments received are based upon accurately reported data. The process we develop must allow verification, yet not be overly intrusive or burdensome to the business environment.

We are currently working to develop a process whereby the Self-Insured Programs Division of the Workers' Compensation Agency completes a random sampling of self-insured employers indemnity payments through contact with and verification by the service companies, approved by the Workers' Compensation Agency, to handle the claims on behalf of the self-insured employers. The sampling process will begin in January and be completed by March 31, of each year. The sampling will be reviewed against the selected employers reporting to LARA Funds Administration.

* See glossary at end of report for definition.

GLOSSARY OF ABBREVIATIONS AND TERMS

deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.
FAIS	Funds Administration Information System.
financial audit	An audit that is designed to provide reasonable assurance about whether the basic financial statements of an audited entity are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.
generally accepted accounting principles	A technical accounting term that encompasses the conventions, rules, guidelines, and procedures necessary to define accepted accounting practice at a particular time; also cited as "accounting principles generally accepted in the United States of America."
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
LARA	Department of Licensing and Regulatory Affairs.
material misstatement	A misstatement in the basic financial statements that causes the statements to not present fairly the financial position or the changes in financial position, and, where applicable, cash flows thereof, in accordance with the applicable financial reporting framework.
material weakness in internal control over financial reporting	A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the basic financial statements will not be prevented, or detected and corrected, on a timely basis.
OAG	Office of the Auditor General.
other noncompliance	Violations of contracts or grant agreements that are not material to the basic financial statements but should be communicated to management in accordance with <i>Government Auditing Standards</i> . Other noncompliance also includes violations of laws, regulations, contracts, or grant agreements; fraud; abuse; or other internal

control deficiencies that may be communicated to management in accordance with *Government Auditing Standards*.

significant deficiency in internal control over financial reporting

A deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

SISF

Self-Insurers' Security Fund.

unmodified opinion

The opinion expressed by the auditor when the auditor, having obtained sufficient appropriate audit evidence, concludes that the basic financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

