PERFORMANCE AUDIT REPORT

Workforce Safety & Insurance

October 26, 2006

Report No. 3024

October 26, 2006

Honorable John Hoeven, Governor

Members of the North Dakota Legislative Assembly

Transmitted herewith is the performance audit report on aspects of Workforce Safety & Insurance. This report contains the results of our review of the adequacy of the organization's procurement system, the organization's human resource management system, and policies and procedures related to leadership and accountability.

The audit was conducted pursuant to and under the authority of North Dakota Century Code Chapter 54-10. Included in the report are the goals and scope, findings and recommendations, conclusions, and management responses.

Sincerely,

Robert R. Peterson
State Auditor

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Results and Findings

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Procurement System

We determined Workforce Safety & Insurance (WSI) does not have an adequate procurement system. WSI has not established sufficient controls necessary to have an adequate procurement system. One area of concern relates to executive management apparently circumventing controls which had been established. We also noted a significant lack of adequate policies, and implementation of those policies which have been established.

Human Resource Management System

We determined WSI has not established an adequate human resource management system. We noted a number of areas of concern related to aspects of human resources including hiring of employees, evaluating employees, conducting investigations involving employees, using a pay for performance system, making payments to employees, and establishing adequate policies. Due to the lack of an adequate system, we noted inconsistencies, inappropriate actions being taken, and apparent preferential treatment taking place.

WSI Management

We determined WSI management has not established adequate policies and procedures to provide appropriate leadership and accountability for the organization. We noted a number of areas of concern related to the organization's personnel system, the organization's procurement system, strategic planning, and actions, or lack of actions, taken by the Executive Director.

Board of Directors

We determined the WSI Board of Directors has not established adequate policies and procedures to provide appropriate leadership and accountability for the organization. We noted a number of areas where improvement could be made relating to the Board's governance of the organization as well as compliance with its adopted governance model.

Procurement System

Introduction

A goal of this performance audit was to answer the following question:

> "Has Workforce Safety & Insurance established an adequate procurement system?"

We determined Workforce Safety & Insurance (WSI) does not have an adequate procurement system. WSI has not established sufficient controls necessary to have an adequate procurement system. One area of concern relates to executive management apparently circumventing controls which had been established. We also noted a significant lack of adequate policies, and implementation of those policies which have been established. Significant improvements needed with WSI's procurement system are included in this chapter. Improvements of less significance were communicated to WSI management in a separate letter.

To determine whether WSI had established an adequate procurement system, we:

- Reviewed WSI's procurement policies and procedures;
- Reviewed selected contracts and related procurement documentation;
- Reviewed support for selected expenditures; and
- Interviewed selected staff.

Improving Procurement Policies and Procedures

We reviewed 53 contracts to determine if WSI complied with State procurement laws, administrative rules, Office of Management and Budget (OMB) policies, and WSI policies and procedures. We identified noncompliance issues in a number of procurement areas. We identified WSI did not consistently adhere to procurement requirements, criteria, or guidelines in:

- Using selection criteria for awarding contracts;
- Following printing requirements;
- Obtaining legal department approval of contracts;
- Using the Attorney General's contract guidance;
- Following "Guidelines to Managing Contractual Risk;"
- Including insurance requirements in solicitations;
- Obtaining appropriate insurance documentation;
- Using vendors who are registered with the Secretary of State;
- Using informal bids versus informal proposals;
- Using Service Requisitions; and
- Using Service Evaluations.

WSI was in noncompliance with procurement requirements.

Three contracts were awarded using inappropriate selection criteria. North Dakota Administrative Code Section 4-12-11-01 requires contracts to be awarded to the responsible vendor with the lowest responsive bid. WSI was not aware of this NDAC requirement regarding two of these contracts. For the third contract, WSI was unable to explain why the contract was not awarded to the lowest bid.

State procurement requirements for printing were not followed for two printing jobs. The first involved the printing of an instruction sheet for the "First Report of Injury" form and the "First Report of Injury" form itself. The vendor considered this one "job" of 100,000 copies (same print stock, font color, and electronic media source). WSI considered this to be two "jobs" of 50,000 copies each. This project was just over $2,500, the level at which state law requires the printing to be done by OMB or contracted by OMB. The second print "job" was approximately $7,000. In review of information, we noted the entire project appeared to be poorly planned as the printing was rushed and WSI concluded there was not enough time to comply with state law relating to printing.

WSI policy states certain contracts are required to be approved by their legal department. Of the 53 contracts reviewed, 6 contracts (11%) were not approved as required by WSI policy.

North Dakota Century Code requires agencies to follow OMB purchasing guidelines. These guidelines require the use of the Attorney General's Office's sample contract contained in the "Contract and Review Manual." Of the 53 contracts reviewed, 26 did not follow the Attorney General's sample contract.

State agencies are required to follow OMB's "Guidelines to Managing Contractual Risk." These guidelines require a risk analysis for all contracts and appropriate insurance provisions be included in state contracts. WSI personnel were not familiar with these guidelines and 34 of the contracts reviewed did not appear to have adequate risk analysis. These same guidelines require agencies to obtain certain insurance certificates or endorsements as applicable. Of the 53 contracts reviewed, 30 contracts did not contain, or contained inadequate, insurance documentation.

OMB guidelines require most vendors be registered with the Secretary of State. WSI contracted with six vendors that should have been registered with the Secretary of State but were not.

OMB guidelines provide guidance regarding when to use informal bids versus informal proposals, including oral versus written solicitations. WSI used informal bids for six contracts when informal proposals would have been preferable. Informal proposals would allow WSI to consider additional qualitative factors when evaluating proposals.

WSI's policies require the use of Service Requisitions and Service Evaluations. Due to poor communication of policies and lack of implementation of these policies, 35 of 53 contracts reviewed did not have service requisitions and 21 did not have service evaluations.

Recommendation 1-1

We recommend Workforce Safety & Insurance take appropriate action to formally establish an adequate procurement system. The organization should, at a minimum:

a) Ensure purchasing policies are thoroughly documented, communicated to appropriate employees, and implemented;
b) Centralize recordkeeping of procurement information; and
c) Establish an adequate monitoring process to monitor compliance with laws, Office of Management and Budget guidelines, and the organization's policies.

In establishing a formal procurement system, the organization should ensure changes are made to address all areas identified in the report as requiring improvement, including compliance issues.

Management's Response

CONCUR: WSI has been and continues to be committed to ensuring that it has an adequate procurement system. See Appendix B for the remainder of WSI's response.

State Auditor's Concluding Remarks

See Appendix B for the State Auditor's concluding remarks.

Using WSI Procurement Office

In review of contracts awarded by WSI, certain contracts did not properly involve WSI's Procurement Office from the beginning of the process. Instead, executive management started procurement processes which, in effect, circumvented established controls. Two contractors, involving multiple procurement transactions, were identified and information related to each is below.

When the Procurement Office was not properly involved, problems with the processes used were noted.

1. Contractor was paid $47,500 during our audit period and was used for three WSI procurements. Two of the procurements related to the same purpose – to provide a training seminar for WSI. Information related to the two purposes for selecting this contractor follows:
   - WSI bid out the books needed for a training seminar separately from the actual training. The training books cost $10,500 while the training was purchased for $16,000. When these two are properly combined, the $26,500 procurement would have required WSI to use a formal request for proposal. North Dakota Administrative Code (NDAC) Section 4-12-04-08 prohibits the splitting of bids. WSI was unable to identify another vendor who would sell the books without the training course being included.
   - WSI selected the contractor to facilitate a planning meeting ($21,000). The contractor appears to be selected prior to phone bids being solicited from other vendors. There is communication with this vendor, via email, indicating the vendor had early notice and participated in extensive discussions with WSI prior to other vendors being notified. This results in noncompliance with NDAC Section 4-12-04-03 which prohibits furnishing information to a prospective bidder that

might give the prospective bidder an unfair advantage. After the discussions are held with this contractor, WSI then obtains phone bids from other vendors. None of the vendors contacted are registered with the State's Procurement Office, one is out-of-state (New York) and one is out of country (Ontario). One of the bids obtained is for $84,000 – four times the winning bid.

2. Contractor was paid approximately $19,000 during our audit period and was used for three procurements which are identified below.
   - The vendor appears to have been selected before competitive bids were requested. We reviewed documentation indicating a contract was negotiated with the vendor prior to competitive bids being requested. Once bids were requested, WSI did not select the lowest bid received and instead awarded the contract to the vendor it had previously negotiated with. NDAC Section 4-12-11-01 requires contracts to be awarded to the lowest responsible bidder which does not appear to have happened.
   - The vendor appears to have been selected before competitive bids were obtained. We reviewed documentation indicating this vendor had early notice and participated in extensive discussions with WSI prior to other vendors being notified. This results in noncompliance with NDAC Section 4-12-04-03 which prohibits furnishing information to a prospective bidder that might give the prospective bidder an unfair advantage. The bid from the selected vendor appeared incomplete and not comparable to the other bids received. The selected vendor's bid excluded four of the eight specifications asked for in the request for a bid. The other two bidders submitted a bid for all eight specifications. Rather than disqualifying the vendor for being unresponsive, WSI awards the contract to this vendor. The vendor selected had a phone quote of $14,400 while the other two bids obtained were $60,000 and $204,000. The contract awarded to the vendor was suspended for violating WSI's harassment policy (conclusion of WSI's own investigation) so the full amount has yet to be paid.
   - The vendor also received payments of approximately $6,800 for services which were not included as part of a contract. These services should have been awarded following a competitive process in accordance with state procurement requirements. The majority of the payments (approximately $5,600) are for the vendor to facilitate a retreat in Medora.

WSI's Procurement Office was not properly involved in the above procurements involving the two contractors. We also noted other instances in which WSI's Procurement Office was not properly included in the procurement process. For example, we noted noncompliance issues regarding printing projects which did not involve WSI's Procurement Office (discussed in the section entitled "Improving Procurement Policies and Procedures").

The apparent override of procurement processes and procedures raises concerns related to executive management. Such behavior sets a negative tone at the top regarding compliance with laws and established policies and procedures. Not only does such behavior set a negative tone at the top, but such instances also require the information to be used in assessing the potential for fraud. As indicated by *Government Auditing Standards* and other professional guidance (such as SAS No. 99), when management is willing to override internal controls, the risk of fraud is higher.

Recommendation 1-2

We recommend the Workforce Safety & Insurance Procurement Office be involved at the beginning of all competitive, limited competitive, noncompetitive, and negotiated purchases.

Management's Response

CONCUR: Management is aware that this recommendation does not include noncompetitive purchases under $2,500 with a purchasing card. The Procurement Officer is a critically important element of WSI's organizational structure. WSI has continually expected that the Procurement Officer be involved from the start of each applicable purchase. In support of this expectation, after a concern was raised by the Procurement Officer that they were not being involved in contracts until the end, a managers meeting was held in June of 2005 to present a procurement overview and outline the need to involve the Procurement Officer as soon as possible in the procurement process. See Appendix B for the remainder of WSI's response.

State Auditor's Concluding Remarks

WSI states it has continually expected the Procurement Officer to be involved from the start of applicable purchases and held a meeting in June 2005 to present information. This meeting was either missed by certain managers, information was misunderstood by managers, or managers chose to ignore information as WSI continued to fail to properly include the Procurement Officer as soon as possible in the procurement process. See Appendix B for the remainder of the State Auditor's concluding remarks.

Improving the Use of Public Funds

We identified expenditures appearing to result in noncompliance with constitutional provisions, state law, and OMB policy. While individually not for significant amounts, we did identify expenditures totaling approximately $18,300. Examples of expenditures include:

Public funds appear to have been used for purposes which do not relate directly to the agency's statutory responsibilities.

- Gift certificates/cards purchased from various restaurants, a gas station, shopping mall, and movie theaters (we did identify $3,500 of certificates/cards were purchased in the last 2 ½ months of the biennium and were distributed/used in the next biennium);
- Beverages and lunches;
- Carnations and balloons;
- Paying for legislators to attend insurance conventions;
- WSI inviting a legislative committee to lunch to present its 2005 legislative bills and paying for the meal;

- Decorations and costume rental; and
- Ornaments/trinkets.

Public funds should be spent efficiently and only expended to pay for expenditures that are directly related to the purpose of the agency and within the agency's statutory responsibilities. As required by the Constitution of North Dakota and in accordance with a 1993 Attorney General's Opinion, an agency may expend public funds only for public purposes.

Recommendation 1-3

We recommend Workforce Safety & Insurance make improvements with how public funds are used. The organization should, at a minimum:

a) Ensure expenditures comply with constitutional provisions, North Dakota Century Code requirements, and OMB Policies; and
b) Ensure expenditures are for necessary and reasonable purposes.

Management's Response

CONCUR: However, WSI does not concur that it has been noncompliant. WSI is focused on assuring the agency follows the law and conducts itself appropriately and believes it has predominantly obeyed all applicable laws and OMB guidance under NDCC 65-02-01.2 and OMB Policy 207. See Appendix B for the remainder of WSI's response.

State Auditor's Concluding Remarks

WSI states it does not concur it has been noncompliant. Based on management's response to this recommendation and the previous two recommendations, we are concerned with management's unwillingness to take responsibility for actions it has taken. For example, in their response to the first recommendation, WSI makes references to and attempts to place blame on the Procurement Officer for the findings. However, it was WSI management who failed to properly include the Procurement Officer in the problem areas we noted. In regards to this recommendation, this is the second review which concludes WSI has not appropriately expended public funds. A private CPA firm selected by the Risk Management Division of OMB to review procurement areas also concluded WSI was not spending moneys as it should. See Appendix B for the remainder of the State Auditor's concluding remarks.

Using Established Evaluation Methodology

In review of WSI's process for awarding a contract in excess of $500,000, we identified WSI inappropriately changed the evaluation methodology after proposals were received. There were two evaluations used in the procurement process – one to evaluate the proposal and one to evaluate a demonstration by the vendors. While the proposal evaluation was scored consistently with other WSI evaluations we reviewed, the demonstration evaluation was not. WSI removed the high and low scores of the employees' evaluations and then averaged evaluation scores. If the high and low scores were not excluded, it appears a different vendor would have been selected.

Methodology for evaluating vendor demonstrations was changed after the demonstrations.

Both NDAC and OMB policies require evaluation methodologies to be established and consistently followed. When such changes do occur, there are concerns regarding bid manipulation and related liability issues. WSI management believed members of the evaluation team may not have been acting in good faith and thus, required the change to occur. Rather than making such a change, WSI should have considered dismissing members of the evaluation team and replacing them with members management believed would have looked out for the interests of the organization as a whole.

Recommendation 1-4

We recommend Workforce Safety & Insurance use the established evaluation and selection methodology to ensure fairness in awarding contracts.

Management's Response

CONCUR: WSI has, and will continue to, utilize the evaluation and selection methodology in accordance with the guidelines established by the State of North Dakota Procurement Office. See Appendix B for the remainder of WSI's response.

State Auditor's Concluding Remarks

See Appendix B for the State Auditor's concluding remarks.

Ensuring Contracts are Established

In review of contracts and payments made for services, we identified WSI had paid for services prior to contracts being finalized. WSI allowed one of its largest vendors (paid over $3 million during the audit period) to conduct work and be paid for services for one month without a contract being established. This appears to have occurred when WSI did not enter into a six month contract extension in a timely manner. We also identified a vendor was allowed to incur expenses of $16,000 before the contract was signed. WSI noted this was an oversight as the contract was provided to the vendor five months before but was not returned. Allowing work to be performed not pursuant to written agreements increases risk in a number of areas including unexpected liabilities, actual payments to be made, what services are to be provided, etc.

Recommendation 1-5

We recommend Workforce Safety & Insurance ensure contracts are in place before work commences or continues on an expired contract.

Management's Response

CONCUR: The two instances noted are rare and in the future WSI will ensure contracts are signed before vendors are authorized to begin working. WSI acknowledges the second instance was an oversight and took the necessary corrective action once the error was identified.

Improving Payments for Contracted Services

In review of contract payments, we identified WSI making four payments to contractors which appear to be pre-payments. One pre-payment ($35,000) was for a 12 month contract. Another payment identified in the amount of $12,500 allowed WSI to use a prior biennium's appropriation. While the other two pre-payments are for minimal amounts ($1,200 and $750), WSI did have to suspend one contract which resulted in additional resource being used to recover the amount.

When advance payments are made, there is a risk that the goods or services will not be received or required specifications will not be met. Withholding payment until satisfactory performance has been accomplished is one way to ensure the state receives goods or services in compliance with contract terms.

Recommendation 1-6

We recommend Workforce Safety & Insurance ensure contracts are not paid until the services have been performed to the organization's satisfaction.

Management's Response

CONCUR: Advance or pre-payments are extremely rare and WSI acknowledges that they should be provided in only extremely limited circumstances. In reference to the four instances in the narrative. The first was a May of 2003 contract for services required by law in Minnesota in order to continue to establish its subsidiary insurance company in the state. The second item was a follow-up review to a recommendation within the 2004 Performance Evaluation in which WSI agreed to pay one-half ($12,500) up front to cover expenses (travel, lodging, etc…) and work started in June of 2005. On-site work for this review commenced on June 28, 2005. Given the circumstances of the two instances outlined above, WSI exercised its discretion and determined the payments in these two instances were appropriate. As for the remaining two items ($1,200 and $750), WSI acknowledges that they were inadvertent and should not have occurred.

Analyzing Contractor versus Temporary Employee Relationships

In review of information, employees identified as temporary employees by WSI appear to be independent contractors. From July 1, 2003 to March 31, 2006, one of these contractors was paid $72,000 while the other was paid approximately $68,000. Hiring contractors as temporary employees allows a state entity to select who they want without having to follow the necessary laws and policies related to procurement of services.

Recommendation 1-7

We recommend Workforce Safety & Insurance formally analyze potential temporary employee relationships to ensure contractors are not hired as temporary employees.

Management's Response

CONCUR: Whether to structure a business relationship as an independent contractor or an employee is not always a "black and white" determination. At the time of hire, those who reviewed the circumstances considered both individuals to be appropriate temporary employees and that a temporary employee relationship was in the best interest of the State. WSI does concur that in future determinations documentation of such an analysis should be placed in the employee's record.

Improving Reimbursements to Executive Director

When the Board of Directors approved the hiring of the current Executive Director, the minutes identify an amount of a base salary "with a housing/business expense allowance of $18,000." In review of expenditure information, we noted the Executive Director being reimbursed for items which a typical business expense allowance would appear to cover. We noted the Executive Director being reimbursed approximately $660 for various items, $7,600 for travel related areas, and WSI also pays $12,000 in membership dues of a CEO membership organization. This could result in WSI effectively paying twice for expenses (expense allowance paid and again when vouchers are submitted). A recommendation in Chapter 4 is made to the Board of Directors to clarify how the expense allowance is to be used (section entitled "Clarifying the Executive Director's Expense Allowance").

The Executive Secretary prepares and approves most of the Executive Director's vouchers for reimbursement. WSI noted the former Finance Director would approve the coding of expenditures which apparently was including a review of the support for reimbursements as well. This appears to have been an informal process as no documentation exists regarding the Finance Director's review or approval of support.

Recommendation 1-8

We recommend Workforce Safety & Insurance make improvements related to reimbursements to the Executive Director. The organization should, at a minimum:

a) Require the Executive Director to use his business expense allowance;
b) Ensure the person preparing the Executive Director's voucher is not the person approving the voucher and is not a person reporting directly to the Executive Director; and
c) Ensure the person approving the reimbursements has sufficient knowledge of the Board of Directors' intent relating to the Executive Director's business expense allowance.

Management's Response

a) DO NOT CONCUR: As part of the Executive Director's most recent annual performance, this issue was addressed. The Executive Performance Committee recommended to the Board of Directors that the expense account provision be eliminated and that the $18,000 be considered as salary. The Board accepted and voted in support of the Executive Performance Committee's recommendation(s) at its November 9, 2006 meeting.
b) CONCUR: WSI will require the Director of Finance to sign off on Executive Director vouchers.
c) DO NOT CONCUR: See management's response to Recommendation 1-8 (a).

State Auditor's Concluding Remarks

WSI states it does not concur the Executive Director should use his business expense allowance as intended. This statement concerns us considering the Board of Directors had specifically provided such an allowance to the Executive Director with little or no guidance. The fact the Board decided to eliminate this account and include the amount as salary is irrelevant as this occurred after the concerns regarding the expense allowance were brought to management's and the Board's attention. We did not state such an allowance should not have been provided but noted clarification was needed.

Improving the Reimbursement of Taxes

When the Executive Director and the Chief of Employer Services were hired, each received a letter from WSI identifying relevant employment information including extending relocation concessions (reimbursements for moving expenses incurred). The letter states portions of the reimbursement may be taxable and reported on a federal W2 tax form. A year after the Executive Director was reimbursed for moving expenses, the Chair of the Board of Directors, at the request of the Executive Director, notified the Finance Director to reimburse the Executive Director and the Chief of Employer Services for their income tax liability related to the taxable portion of the moving expense reimbursement. WSI reimbursed both individuals for their tax liability (total approximately $1,350). We identified no information provided to the employees which indicated WSI would pay for the tax due on the taxable portion of the reimbursement.

Recommendation 1-9

We recommend Workforce Safety & Insurance make improvements with reimbursing employees for taxes already paid by employees. The organization should, at a minimum:

a) Ensure tax reimbursement payments are reasonable and done in accordance with established agreements;
b) Attempt to recover the amounts improperly paid to employees; and
c) Ensure requests made to the Chair of the Board of Directors are reasonable.

Management's Response

a) CONCUR: This authorization was given based on a verbal commitment made by the Chair during the hiring negotiations with the Executive Director. Both parties understood there would be no cost to the Executive Director for moving expenses. This same representation was made by the Executive Director to the Chief of Employer Services during employment negotiations and was based on the Executive Director's understanding that taxes would be reimbursed as part of the compensation package.
b) DO NOT CONCUR
c) CONCUR: The Board Chair considered this request to be reasonable.

Applying Expenditures to the Appropriate Biennium

In review of expenditure information, we identified approximately $24,600 being applied to the incorrect biennium. This results in noncompliance with legislative intent related to appropriation laws as well as OMB policy. In review of information, we were concerned with the fact that WSI appears to have applied purchases to a biennium inappropriately because funding was available. For example, WSI admitted they arranged for an expenditure of $10,500 to be applied to the 2003-2005 appropriation because the funding was available. Also, we noted a payment of $12,500 to a vendor in a biennium which allowed WSI to use a prior biennium's appropriation.

Recommendation 1-10

We recommend Workforce Safety & Insurance comply with legislative intent and apply expenditures to the appropriate biennium.

Management's Response

CONCUR: However, WSI does not concur with the description in the narrative "that WSI apparently applied purchases to a biennium inappropriately because funding was available." WSI followed the Office of Management and Budget's Expenditure and Revenue Policy 200 (Financial Statement – Fiscal Year Cutoff). See Appendix B for the remainder of WSI's response.

State Auditor's Concluding Remarks

See Appendix B for the State Auditor's concluding remarks.

Human Resource Management System

Introduction

A goal of this performance audit was to answer the following question:

> "Has Workforce Safety & Insurance established an adequate human resource management system?"

We determined Workforce Safety & Insurance (WSI) has not established an adequate human resource management system. We noted a number of areas of concern related to various aspects of human resources including hiring of employees, evaluating employees, conducting investigations involving employees, using a pay for performance system, making payments to employees, and establishing adequate policies. Due to the lack of an adequate system, we noted inconsistencies, inappropriate actions being taken, and apparent preferential treatment taking place. Significant improvements needed within WSI's human resource management system are included in this chapter. Improvements of less significance were communicated to management in a separate letter.

To determine whether WSI had established an adequate human resource management system, we:

- Reviewed WSI's personnel and classification system;
- Reviewed applicable laws, policies, and procedures;
- Reviewed applicable management controls; and
- Interviewed selected staff.

WSI Personnel System and Salary Information

The 1995 Legislature removed WSI from the state's classified system and allowed the organization to establish its own personnel system. Prior to January 1, 2006, WSI used a pure market classification system in which salary ranges for positions were determined by using one national and two local positions for comparison purposes. Beginning January 1, 2006, WSI implemented a new classification system based on the results of a review conducted by an outside consultant (Hay Group).

WSI's classification system is, for the most part, the same classification system used for other state agencies.

WSI's current classification system is, for the most part, the same classification system administered by Human Resource Management Services. Under both systems, positions are evaluated based on the same eight factors, points are assigned to these factors, and the total points relate to a pay grade. Each pay grade is assigned a salary range. The significant difference noted in the two systems is the salary ranges of WSI are significantly higher than HRMS. For example, WSI has two pay grades with a higher minimum amount than all pay grade minimums used by HRMS. In comparison of similar job titles from one system to the other, WSI's pay grades assigned are significantly higher.

When WSI implemented the new system, increases were given to ensure employee salaries were brought up to the new minimum level of the assigned pay grade or to provide an increase based on the number of years the employee was in their position (termed "XYZ" increase, maximum of 3.5%). WSI's calculation for implementing the new ranges identified salary increases ranging from 0% to 27%. WSI estimated the new system would result in an additional $600,000 being expended in the 2005-2007 biennium and would require an additional $800,000 for the next biennium. As identified later in this chapter, with additional raises provided to employees, the 2007-2009 biennium will require over $2 million more for salaries compared to the current biennium amount.

Making Improvements with the Performance Appraisal Process

Based on a review of information regarding performance appraisals of WSI employees, we noted significant improvements are needed. As the organization's pay for performance system relies on the performance appraisal process, we also determined the pay for performance system has not operated effectively. In addition, we identified noncompliance with a state law requirement to obtain an employee's signature on documentation within employee personnel files.

Improving Appraisals and Pay for Performance

WSI policy requires a performance appraisal of employees to be completed annually. Our review noted the following:

- All employees were not receiving performance appraisals annually as required by policy.
- One raise, apparently based on a performance appraisal, was given prior to the performance appraisal being completed.
- A new performance management plan was implemented in November 2005. Based on a review of information and limited discussions with supervisors, there was confusion as to what forms are required to be completed, which are optional, and what forms are to be provided to the Human Resources Department.
- Documentation related to employees' goals and objectives for the evaluation period does not appear to be completed prior to the beginning of the period under review. Evaluation criteria should be developed and communicated to employees at the beginning of the appraisal period.
- The performance appraisal process involved only supervisors conducting appraisals of those they supervise. No evaluations were being conducted of the supervisors by those they supervised.

WSI's pay for performance system has not operated effectively due to problems with the performance appraisal process.

WSI uses a pay for performance system. Thus, the performance appraisals not only help identify employee performance and determine an employee's potential for advancement, but also provide the information necessary for making salary adjustments. We question the effectiveness of the pay for performance system due to the problems we identified with the performance appraisal process.

We noted the vast majority of employees had received raises and we question whether there was an actual pay for performance system in place. We noted approximately 94% of all employees working throughout the 2004 calendar year received a raise and approximately 94% received a raise in calendar year 2005. The majority of employees received 3% raises in each of the two years. The scale for raises ranges from 0% to 5% and is based on the score of the performance appraisal. When discussing implementing the new classification system to the Board of Directors in August 2005, the Executive Director stated the Board had asked that the pay for performance system be looked at as it never really developed to what they hoped it would be. The effectiveness of the pay for performance system will continue to be questioned unless significant changes are made.

Recommendation 2-1

We recommend Workforce Safety & Insurance improve the employee performance appraisal process and ensure the pay for performance system operates in an effective manner. The organization should, at a minimum:

a) Ensure the performance appraisal process is adequately monitored for compliance with policies including appraisals being completed annually;
b) Establish the criteria to be used for measuring performance at the beginning of an appraisal period;
c) Update performance appraisal policies in a timely manner;
d) Have supervisors evaluated by those they supervise; and
e) Provide training to employees related to properly completing performance appraisals.

Management's Response

CONCUR (a, b, c, e) and DO NOT CONCUR (d). See Appendix C for the remainder of WSI's response.

Obtaining Employee Signatures on Appraisals

North Dakota Century Code Section 54-06-21 states documents addressing an employee's performance may not be placed in their personnel file unless the employee has had the opportunity to read the material. The employee must acknowledge they have read the material by signing the copy to be filed or an attachment to the copy to be filed. In our review of 29 employees receiving annual performance appraisals, we noted 2 employees had unsigned performance appraisals in their personnel file.

Recommendation 2-2

We recommend Workforce Safety & Insurance comply with North Dakota Century Code Section 54-06-21 and ensure performance appraisal forms are signed by employees before placing them in personnel files.

Management's Response

CONCUR: Regarding the two employees noted with unsigned performance appraisals: the first was an employee in WSI's Fargo office and their review was conducted over the phone and the reviewer forgot to gather the signature; the second employee had signed the appraisal form but the supervisor accidentally kept the signed copy and turned in an unsigned copy. Both issues were immediately rectified and procedures have been put in place to avoid this issue in the future. As noted in management's response to Recommendation 2-1, WSI implemented a new Employee Performance Management system which requires an electronic signature in order for the evaluation to be formally filed.

Making Improvements with Hiring Employees

In a review of information regarding how employees of WSI are hired, we noted significant improvements are needed. WSI did not have a uniform, consistent hiring process and had not established adequate policies and procedures. We noted noncompliance issues with veterans' preference requirements and identified employees being hired without a competitive hiring process.

Establishing a Uniform Hiring Process and Formal Policies

During a review of information related to the hiring of employees, we noted a number of concerns related to the hiring process. Examples include:

- WSI selected individuals for employment who did not meet the minimum qualifications of the position.
- The involvement of the Human Resource Department with the hiring process was not consistent.
- WSI did not use a formal screening process for determining which applicants would be interviewed. As a result, we were unable to determine reasons why qualified candidates were not interviewed but candidates not meeting qualifications were interviewed.
- We noted a question was asked during the interview of two applicants which was technically specific and we could not determine the relevancy of the question as it related to the position. We did note one of the two applicants did have a technical background and knowledge in this area and this applicant was also an acquaintance of the supervisor of the position who was involved in the interview process.
- WSI has not been verifying the education of applicants selected and we noted instances in which work experience was also not verified.

WSI did not have a consistent, uniform process for hiring employees.

WSI has not established adequate formal policies related to the hiring process. For example, WSI does not have formal policies related to veterans' preference, job interview expenses, and moving expenses for newly hired employees.

Recommendation 2-3

We recommend Workforce Safety & Insurance establish a consistent and uniform process for hiring employees. The organization should, at a minimum:

a) Ensure selected applicants meet minimum qualifications of the position;
b) Centralize the hiring process within the Human Resource Department;
c) Establish a formal screening process and standardized scoring system which is consistently applied to all applicants;
d) Ensure questions asked of applicants are relevant and pertain to the position's primary duties; and
e) Verify work experience and education for all individuals hired.

Management's Response

CONCUR: In August of 2006, WSI implemented a revised hiring process. The modified hiring process includes the use of a register of applicants, uniform scoring sheets, and a certificate of eligible for vacant positions. This new process ensures that: applicants meet minimum requirements; the hiring process is centralized within HR; there is a formal screening and scoring process; questions asked of candidates are relevant; and work experience and education is verified. See Appendix C for the remainder of WSI's response.

State Auditor's Concluding Remarks

See Appendix C for the State Auditor's concluding remarks.

Recommendation 2-4

We recommend Workforce Safety & Insurance establish formal policies and procedures for the hiring process to provide clear guidance and enhance consistency in the process.

Management's Response

CONCUR: WSI created and implemented a formal Hiring Process procedure manual in August 2006 which provides clear guidance and enhances consistency in the hiring process. This procedure manual is housed in the HR Department.

Complying with Veterans' Preference

North Dakota Century Code Chapter 37-19.1 establishes a preference in public employment for veterans. Based on the hiring process used by WSI, we noted points for veterans were being inappropriately awarded during the interview phase instead of during the initial screening phase. We also noted confusion regarding the application of veterans' preference.

Recommendation 2-5

We recommend Workforce Safety & Insurance comply with veterans' preference requirements in North Dakota Century Code Chapter 37-19.1. The organization should, at a minimum:

a) Review veterans' preference requirements with the Office of the Attorney General and modify hiring procedures accordingly; and
b) Use certified mail to notify veterans of their nonselection.

Management's Response

CONCUR: As noted in management's response to Recommendation 2-3, WSI has revised the hiring process to include utilizing a register of applicants, uniform scoring sheets, and a certificate of eligible to ensure compliance with NDCC requirements related to veterans' preference. The modified process was outlined in a discussion with a representative of the Attorney General's Office. Based on this discussion, WSI is under the belief that it is now in compliance with the veterans' preference law.

Using Competitive Hiring Process

North Dakota Century Code Section 65-02-01 states the Executive Director may appoint the director of any division and this appointment must be on a nonpartisan, merit basis. When the Chief of Injury Services and the Leadership and Organization Excellence Executive were hired, a competitive process was not followed. The Executive Director noted he hired both individuals on his own based on his knowledge of the individuals and due to the fact that he trusted both. The Executive Director noted both individuals were considered to be his friends prior to their hiring. There was no documentation indicating how the hiring of these two individuals was done on a nonpartisan, merit basis.

Recommendation 2-6

We recommend Workforce Safety & Insurance use a competitive hiring process for all positions but document information as to how an appointment is being done on a nonpartisan, merit basis if the Executive Director makes an appointment without a competitive process.

Management's Response

CONCUR: While the necessary documentation was not placed in each individual's personnel file, they were legally appointed on a nonpartisan, merit basis. While he did have a past professional relationship with both individuals, these relationships provided the Executive Director with invaluable first-hand knowledge of their professional qualifications and knowledge, skills, and abilities. It was this knowledge that allowed the Executive Director to make their selections based on their individual "merit." Both individuals have a significant number of years of experience in the field of workers' compensation. Supporting documentation will be placed in each individual's file and in the files of any future appointments under 65-02-01.

Making Improvements with Payments to Employees

In review of salary information and payments to employees of WSI, we noted employees had not received the general increases provided by the Legislature for the 2005-2007 biennium. A formal Attorney General's Opinion was requested and the opinion noted WSI had to comply with the legislative intent to provide the across-the-board increases. We also noted payments provided to certain employees as bonuses did not comply with requirements in state law.

Complying with Legislative Intent on General Increases

Chapter 25 of the 2005 Session Laws identifies legislative intent regarding state employee compensation adjustments. The Chapter requires compensation adjustments of 4% for permanent state employees beginning July 1, 2005 and 4% beginning on July 1, 2006. We noted WSI did not provide the 4% general increases to employees. WSI was specifically listed within the Session Law as receiving an amount ($213,435) to provide the general increases to its employees. In prior bienniums when the Legislature provided general increases, WSI was specifically identified as being exempt from providing general increases. This did not occur with the 2005 Session Law. WSI believed it was still exempt from providing the general increases so we requested a formal Attorney General's Opinion. In the Attorney General's Opinion, dated June 16, 2006, the following was stated:

- The opinion of the Attorney General is that "all permanent, non-probationary employees at WSI who otherwise do not have documented levels of performance indicating they are not meeting standards must be provided the 4% across-the-board increase in salary in each year of the biennium to the extent funds are available."

- The Attorney General states "it is my understanding that WSI has operated under the assumption that it was not subject to the provisions governing permanent state employee compensation adjustments. As a result, considerable monies have already been allocated and spent for employee raises, often above and beyond the 4% provided as across-the-board increases. This has apparently affected the ability of WSI to provide additional 4% compensation adjustments beginning in July 2006."
- The Attorney General states "An agency further must affirmatively take steps to comply with the Legislature's statement of intent on state employee compensation adjustments for the second year of the biennium, including considering rescinding or reducing past increases above the across-the-board adjustment."
- The Attorney General states "it is my opinion that appropriate modifications or off-sets to the actual raises provided may be made to comply with legislative intent."

The Attorney General concluded WSI was required to provide the 4% across-the-board increases.

WSI provided us with information on August 9 which identified the actions it had taken to implement the Attorney General's Opinion. In review of this information, we noted WSI had used employees' average fiscal year 2005 salary as a starting point in applying the 4% which is inconsistent with the intent of Session Law. Using the average salary instead of an employee's actual June 30, 2005 salary resulted in employees being paid less than what was required. WSI's explanation for using the average fiscal year 2005 salary was that they were trying to convert employee salaries to match the state's system where pay raises are effective on July 1 of each year. We are unaware of any such state system as explained by WSI and, therefore, WSI's explanation is unreasonable.

WSI's first attempt at implementing the Attorney General's Opinion was inconsistent with the intent of Session Law.

In the process leading up to providing employees the general increases, WSI discussed certain issues with representatives of the Attorney General's Office which appear to relate to performance of a limited number of employees. However, WSI did not discuss their significant interpretation of using the average salary with the Attorney General's Office. We question why this significant issue was not brought to the attention of the Attorney General's Office prior to implementation. We did note WSI's original calculations for implementing the 4% increases had appropriately used employee's actual June 30, 2005 salaries. However, the average salaries were added into the calculations on July 19, one week prior to the Executive Director notifying employees of the increases. Not only was WSI's use of the average salary not within the intent of the Session Law, but WSI had to expend additional resources to again implement the 4% increases.

Following a meeting with representatives of the Attorney General's Office, WSI, and our office, WSI again attempted to implement the 4% general increases. In a limited review of this information, it does appear to provide the majority of employees with the increases as required by Chapter of 2005 Session Laws. However, we did identify four employees who did not appropriately receive the increase due to calculation errors. When we informed WSI of the errors, WSI noted subsequent appropriate adjustments were made.

WSI withheld increases from former and current employees citing early retirement agreements and performance related issues. In certain instances (10 total), we questioned the sufficiency of documentation regarding performance levels and the impact Chapter 25 of the 2005 Session Laws has on the early retirement agreements. WSI met with representatives of the Attorney General's Office and a representative of our office. The representatives of the Attorney General's Office agreed with WSI there were legitimate issues as to whether these employees were entitled to the 4% increase. After discussing the legal and factual issues, WSI decided to give the 4% increase to all but one employee based on that employee's documented performance.

Recommendation 2-7

We recommend Workforce Safety & Insurance ensure it complies with legislative intent related to employee compensation adjustments.

Management's Response

CONCUR: WSI has administered the four percent general increases in accordance with the Attorney General's formal opinion.

Complying with Bonus Requirements

In review of payments to employees, we noted certain employees received increases which were retroactively applied (made effective to an earlier date which resulted in a lump sum payment being made). Examples include:

- An employee received a $1,334 monthly increase (21%) in November 2005. The increase was applied back four months to July 2005. Based on information from WSI, the monthly increase consists of a performance evaluation adjustment of $188, an increase of $533 to have the employee's salary be at the minimum of a new pay range, and $613 established by the Executive Director. We were unable to verify how the $613 was determined.
- An employee received a $745 monthly increase (11%) in November 2005. The increase was applied back four months to July 2005. Based on information from WSI, the monthly increase consists of a performance evaluation adjustment of $265, an increase of $133 to have the employee's salary be at the minimum of a new pay range, and $347 established by the Executive Director. We were unable to verify how the $347 was determined.
- An employee received a $728 monthly increase (14%) in July 2005. The increase was applied back seven months to December 2004. Based on information from WSI, the monthly increase consists of a performance evaluation adjustment of $161, an increase of $87 related to a new compensation plan being implemented, and $480 established by the Executive Director. We were unable to verify how the $480 was determined.

When asked for reasons regarding the additional increases (those above performance evaluation adjustments and related to the new compensation plan), the Executive Director noted the employees were respected, their work was respected, the employees would be worked pretty hard, the organization believed and trusted them, and there needed to be increases for keeping staff and paying them closer to market. While it is reasonable for increases to be given to retain staff and pay closer to market, these increases should not be retroactively applied. The retroactive payments made for the increases established by the Executive Director are considered bonuses (does not include increases for performance evaluation or related to the new compensation plan). Requirements related to bonuses are within North Dakota Century Code Chapter 54-06. To provide bonuses, the chapter requires state agencies have a written policy in place and establishes a maximum bonus payment amount allowed. The bonus payments identified at WSI result in noncompliance with requirements in statute.

Retroactively applying increases for keeping staff and paying closer to market resulted in bonus payments being provided.

Recommendation 2-8

We recommend Workforce Safety & Insurance ensure payments made to employees comply with the bonus program requirements within North Dakota Century Code Chapter 54-06.

Management's Response

CONCUR: However, WSI disagrees with the conclusion that the retroactive pay increases are bonuses. Each identified employee in this category was either denied their right to an annual salary review or promoted to a new position with additional responsibilities but not immediately financially adjusted to reflect such responsibilities. As a result, two of the identified employees went two-and-a-half to three years without a compensation adjustment and the third went for over six months with additional duties for which they were not appropriately compensated. After the full analysis by the Hay Group was complete, the Organization was in a position to conduct the appropriate appraisals and compensation adjustments. These salary adjustments were then made retroactive to the appropriate date or to the extent possible. Consequently, these payments were for base compensation and not bonus pay. See Appendix C for the remainder of WSI's response.

State Auditor's Concluding Remarks

WSI identifies employees were denied their right to an annual salary review. These employees report to the Executive Director who went from May 2004 until the fall of 2005 without conducting appraisals of such employees. In our review of employee appraisals, we did identify recently hired employees conducting evaluations of employees. For example, we noted an employee who had been at WSI for less than a month completed a performance appraisal on two employees. We are also aware of other employees within WSI who were not provided salary increases for an extended period of time but no retroactive increases were provided to them.

WSI states after the analysis of the Hay Group was complete, the organization was in a position to conduct appropriate appraisals and compensation adjustments. We are unsure how this analysis allowed

WSI to conduct appropriate appraisals as appraisals were being conducted on the majority of other employees within WSI prior to the analysis being complete. See Appendix C for the remainder of the State Auditor's concluding remarks.

Making Improvements with Investigations

Based on a review of information regarding investigations of incidents involving WSI employees, we noted significant improvements were needed. We identified concerns with how WSI conducts such investigations as well as concerns with the actions taken by the organization upon completion of investigations. In addition, we noted WSI has not properly notified the state's Risk Management Division of certain investigations.

Improving How Investigations are Conducted

WSI has their own employees conduct investigations related to incidents involving harassment and noncompliance with the organization's policies. We noted concerns with who conducted the investigations and how certain investigations were conducted. Examples include:

- The Executive Director was identified as influencing who was to conduct an investigation which involved the Executive Director. The Executive Director insisted one of his department chiefs conduct the investigation. When the Internal Audit Manager noted Internal Audit should conduct the analysis, the Executive Director stated "it is HR's responsibility to conduct all such investigations. If anyone feels that my integrity is such that I will intentionally attempt to influence the outcome to my or anyone else's advantage, then I should be asked to tender my resignation immediately because I can not be trusted. If asked such I will do so today." The Executive Director forwards this information onto his three department chiefs noting he has "thrown down the gauntlet and could be called on it today. If called on it, I will without question resign." One of the Executive Director's department chiefs conducted the investigation.
- In certain investigations, the employee conducting the investigation was not free of conflicts of interests or was not independent. For example, we noted an investigator's direct supervisor was one of the individuals being investigated.
- When employees were interviewed in one-on-one settings, we noted the interview summary typed by the interviewer was not always reviewed or signed off by the interviewee. Uncertainty exists in regards to whether the interview summary is an accurate reflection of the information obtained.
- We noted investigation reports were not always signed and dated. It is unclear when a report is finalized, and if changes occur to a report, it is unclear when they occurred.

Individuals conducting investigations were not free of conflicts of interests or were not independent.

Recommendation 2-9

We recommend Workforce Safety & Insurance make improvements with how investigations of incidents involving employees are conducted. The organization should, at a minimum:

a) Ensure investigations are conducted by an independent source who is free of conflicts of interests;
b) Ensure individuals conducting investigations receive proper training;
c) Have interview sheets signed by the interviewee, specifically when interviews are conducted in a one-on-one setting; and
d) Ensure final investigation reports are signed and dated.

Management's Response

CONCUR: When issues arise that necessitate the initiation of an investigation, WSI concurs that it is paramount to ensure that this process is performed in a manner that uncovers all relevant facts in an unbiased manner. While WSI concurs with the recommendation, there are statements within the preceding narrative –that if/when taken out of context-- imply a situation in which the Executive Director may have intentionally directed the investigatory responsibilities to his direct report in order to prevent all applicable findings from being documented. See Appendix C for the remainder of WSI's response.

State Auditor's Concluding Remarks

WSI's statement related to an implication that such action was taken in order to prevent all applicable findings from being documented is misleading. We do not conclude on the reason why the Executive Director required his direct report to conduct this investigation. We conclude such a practice does not allow for the investigator to be free of conflicts of interest and places the investigator in an uncomfortable position. See Appendix C for the remainder of the State Auditor's concluding remarks.

Improving How Investigation Results are Implemented

In review of investigation reports and actions taken related to recommendations included in these reports, we noted concerns with a lack of action taken and results and recommendations of investigations being changed. Examples include:

Recommended actions from investigations were not always followed.

- As a result of inappropriately using WSI resources, a recommendation was made in April 2005 to have an employee forfeit eight hours of annual leave and require the employee to pay a monthly cell phone bill. This did not occur. This employee reports directly to the Executive Director. WSI noted the employee did surrender the annual leave and made a payment, but this was done only after the issues were brought to their attention during the audit (June 2006).
- An investigation report included a recommendation for the results to be communicated to the employee who had requested a review be performed. This was not done. The report also recommended an employee attend a counseling session, submit a letter of apology to another employee, and be encouraged to attend an alternative dispute resolution session. This did not occur. The offending employee is directly supervised by the Executive Director. After the

investigation was conducted, it was the Executive Director's opinion there existed conflicting information. We are unsure as to what conflicting information is being referenced as the conclusions of the report are supported by relevant evidence.

- An investigation was conducted when an outside contractor apparently made inappropriate, harassing comments to a WSI employee. This contractor is a human resource professional who was to provide consulting and executive mentoring services. The investigation report concludes the contractor violated WSI's harassment policy and recommends the contract be terminated with an option of review in six months. The Executive Director recommended a lesser penalty (a three month suspension). This was the second time we noted the contractor had made inappropriate comments. In each case, the Executive Director was aware of these comments. There was no documentation related to what was actually communicated to the contractor. While the contractor was to be under suspension and was not to be paid in November 2005, we did note such a payment was made.

Recommendation 2-10

We recommend Workforce Safety & Insurance make improvements with actions taken related to results and recommendations of investigations involving employees. The organization should, at a minimum:

a) Document actions taken or the justification for no actions taken in relation to recommendations from investigations;
b) Improve the monitoring of actions to be taken;
c) Document the reasons for changing conclusions or recommendations of investigations; and
d) Have results of investigations provided to the Board of Directors Audit Committee when the investigation involves the Executive Director.

Management's Response

CONCUR: WSI is committed to an effective investigation process and it should be noted that the detailed facts of each investigation exist because once management was notified of the issue, a full investigation was immediately initiated and documented. In the future, management will further document actions taken along with additional rationale for any divergence from the investigator's original recommendations and HR will be responsible for assuring all final recommendations are fulfilled and documented. See Appendix C for the remainder of WSI's response.

State Auditor's Concluding Remarks

WSI states facts of each investigation exist because once management was notified of the issue, a full investigation was immediately initiated and documented. Management having an investigation conducted is the minimal course of action required to be taken. Management's actions taken at the conclusion of investigations requires improvement. See Appendix C for the remainder of the State Auditor's concluding remarks.

Notifying Appropriate Entities

In review of information regarding investigations, we noted WSI had notified the state's Risk Management Division of certain incidents but not all incidents. For example, WSI did not provide proper notification of incidents involving harassment of employees. WSI believed whether or not Risk Management was to be notified was within their discretion. WSI has no such discretion if there is a potential claim against the state. Once it is determined there is a potential claim against the state, WSI is required to notify Risk Management of such incidents.

Recommendation 2-11

We recommend Workforce Safety & Insurance promptly notify the state's Risk Management Division of issues where there is a potential for a claim to be filed against the state including all issues related to harassment.

Management's Response

CONCUR: While most any act could potentially lead to a claim, WSI has to properly act as a gatekeeper in determining the credibility of the claim in each instance. Throughout this process, there was one instance identified in which the Organization agrees that a report should have been generated and was not. The Organization does concur that in the future an appropriate reporting vigilance must be kept in relation to this recommendation.

State Auditor's Concluding Remarks

WSI states it agrees there was one instance identified when a report should have been generated and was not. We identified three such instances. WSI concurs with one. For another instance, WSI did notify Risk Management but this occurred six months after the investigation and after we had identified to WSI they had not provided notification to Risk Management. In discussing this issue with a representative of Risk Management, they noted Risk Management should have been notified at the beginning of the process prior to an investigation being conducted. For the third incident, WSI did conduct an investigation which was not identified to Risk Management. In discussing this issue with a representative of Risk Management, they noted Risk Management should have been notified. The representative noted no investigation should occur until Risk Management is notified. Risk Management's statutory authority allows for Risk Management to close records of an ongoing investigation for a period of time which would be beneficial to the investigation as well as assist in avoiding potential claims against the state.

Making Improvements with Classification System

In a review of information regarding the classification system and the pay for performance system used by WSI, we noted both were not adequately monitored. We also noted an improper change with a salary range was allowed to occur within the classification system.

Monitoring Systems

We noted WSI did not adequately monitor either the classification system or the pay for performance system. Inequities and ineffective processes were allowed to continue without appropriate action taken to make changes. For example, we noted the pay for performance system used by WSI resulted in nearly every employee receiving a raise in calendar year 2004 and 2005. Also, the majority of employees received 3% raises in these two years. When a majority of employees are receiving salary adjustments every year and the majority receive the same salary adjustment, we question whether an actual pay for performance system is being used.

Recommendation 2-12

We recommend Workforce Safety & Insurance periodically monitor and evaluate the classification and pay for performance systems to ensure they are operating effectively and are accomplishing what WSI intends.

Management's Response

CONCUR: The most recent evaluation of WSI's compensation system was professionally conducted in the spring of 2005 by the Hay Group. WSI intends to follow the Hay Group's suggestion that WSI complete a subsequent assessment approximately every three years. Regarding the narrative statements, please see management's response to recommendation 2-1.

Making Changes to Pay Ranges

When an applicant for a job opening was selected, the former Chief of Employer Services wanted a salary to be offered which exceeded the maximum for the pay range assigned to the position. This applicant was an acquaintance of the former department chief. The Executive Director moved the position to a higher pay grade which resulted in a higher pay range for the position. This change occurred with no formal evaluation of the position. The effectiveness and integrity of the classification system are questionable when changes are made without a formal evaluation.

Recommendation 2-13

We recommend Workforce Safety & Insurance ensure changes made to pay ranges within the classification system are based on a formal evaluation process.

Management's Response

CONCUR: WSI takes the issue of its compensation structure as well as its professional duties very seriously. See Appendix C for the remainder of WSI's response.

State Auditor's Concluding Remarks

See Appendix C for the State Auditor's concluding remarks.

Additional Issues

During the work performed, we noted a number of areas where improvements are needed. We noted concerns regarding the accuracy of and increase in turnover rates computed by WSI. WSI has not adequately reviewed their policy handbook and has not established policies in a number of areas. WSI should end incentive programs and needs to review the absenteeism rate it has established for certain employees.

Improving how Turnover is Calculated

In our review of information related to turnover, we noted WSI had used different methods of calculating their turnover rate. WSI noted "past turnover calculation formulas varied depending upon for whom and for what reason the calculation was prepared." It became apparent WSI had not developed a standard calculation as late as March 2006. When requested by our office to provide the most recent turnover information, the Executive Director noted to employees in email "It is important to get our forever and standard calculation set ASAP so we can establish a consistent industry calculation."

WSI had not established a standard calculation for determining a turnover rate.

We did identify other concerns regarding turnover information. For example, WSI presented turnover rate information to a newspaper in February 2006 which excluded certain former employees from the calculation provided. This calculation used by WSI was not consistent with how the industry averages provided to the newspaper were computed. Another concern noted was both the Human Resources section and the Strategic Operations section were computing turnover information. Besides concerns related to efficient use of resources, we noted differences in the turnover information calculated by the two divisions.

WSI has seen an increase in turnover. Turnover information provided by WSI identifies the following turnover rates:

- FY 03: 5.4%
- FY 04: 6.6%
- FY 05: 8.2%
- FY 06: 12.2%

After the first three months of fiscal year 2007, the annualized turnover rate identified by WSI is approximately 15%. WSI noted to us the turnover rate was within an acceptable range and identifies it is under the industry average. WSI identified an industry average of 12.7%. We attempted to identify the reasonableness of using this industry average for comparison purposes but were unable to do so. The organization identifying the industry average collected data on annualized 2004 information by surveying businesses. The organization identified there were 41 businesses included in the insurance category but stated the data was confidential, they do not know the actual businesses who responded to the survey, and do not know exactly what type of insurance they were in.

While WSI does not identify turnover information by department, we did conduct a limited review of turnover by department. We noted significant turnover of employees in certain areas of the organization which may be indicative of problems which should be addressed.

Recommendation 2-14

We recommend Workforce Safety & Insurance make improvements with how turnover rates are calculated, presented, and reviewed. The organization should, at a minimum:

a) Ensure a standard, consistent turnover rate is used;
b) Have only one department responsible for calculating and tracking turnover;
c) Properly identify turnover rate information if differences in calculations exist; and
d) Identify turnover rate information by department and review areas where significant increases are occurring.

Management's Response

CONCUR: As a result of the turnover request from a newspaper and discussions with the Board Audit Committee regarding the turnover calculation, the importance of having a standard calculation was clearly indicated. It had been the practice of WSI to use the year-to-date (YTD) rate until 2006 when WSI also started to track an annualized turnover rate. The HR department is now the only unit responsible for calculating and tracking turnover. WSI concurs that expanding the turnover information down to the department level may provide additional benefit. HR will work to develop this additional turnover data. Finally, management would like to note that while the turnover rate information presented to the newspaper did exclude certain employees from the calculation, the exclusion of "Early Retirement, Released for Cause, and Temporary Employee" was clearly noted both verbally and in writing when the information was submitted.

Establishing a Periodic Review

In a review of WSI's Policy Handbook, we noted a number of areas where formal policies were lacking and inconsistencies existed. For example, WSI had not established a policy related to paying moving expenses of newly hired employees. We noted WSI had paid moving expenses of five employees (one of which exceeded $15,000). WSI did not have a policy in place to protect the state's investment for these expenditures (such as reimbursing the expenditures if employees left employment within a certain period of time). While WSI included a provision in the employment letters requiring reimbursing the expenditures if the employees voluntarily left, WSI legal counsel did not believe this was sufficient as it was not included in policy.

For policies established by WSI, we noted certain policies require modification or improvement. For example, the reduction in force policy established by WSI lacks significant criteria. Inadequate policies lead to inconsistencies and potential inequitable treatment of employees. We also noted WSI would change policies and back date the policy to make it appear effective sooner than it actually was. This creates confusion.

Recommendation 2-15

We recommend Workforce Safety & Insurance establish a formal procedure to periodically review the Policy Handbook, make the necessary changes, and date changes accordingly.

Management's Response

CONCUR: WSI has established a formal procedure to periodically review the Policy Handbook and make the necessary changes. Additionally, management would like to note that the only policy it is aware of being backdated was the bereavement policy. Feedback was communicated to the Executive Director questioning an exclusion from the policy. Based on this information, the Executive Director requested that the Human Resources Department review industry best practices. Based on this research, the bereavement policy was updated. WSI noted that the updated policy would have supported the employee who originally communicated the concern. Consequently, WSI backdated the policy based on the reasoning that had it been congruent with industry best practices at the time of the question, the employee would have been covered.

State Auditor's Concluding Remarks

WSI confirmed it backdated the policy. We question when it is ever appropriate to use a date other than the date when an event occurs. Using WSI's reasoning, we are concerned whether WSI would consider rectifying noncompliance issues with policy by simply backdating changes to policies.

Ending Incentive Programs

WSI identified nine employees were eligible for incentive (bonus) programs. In March 2006, an ergonomic consultant hired by WSI recommended the programs be discontinued due to the risk of repetitive motion injuries and increased mental stress. When conducting ergonomic training for state agencies, a WSI representative noted state agencies should not have such incentive programs.

Recommendation 2-16

We recommend Workforce Safety & Insurance end all incentive pay programs for their employees and ensure appropriate payment adjustments are made.

Management's Response

CONCUR: Due to an increasing frequency of repetitive stress injuries (RSIs), WSI consulted with a physical therapist to conduct a Job Safety Analysis. Based on the analysis, WSI agreed to eliminate all production-based incentive programs. WSI will ensure that appropriate compensation payments are made.

Reviewing Absenteeism Standard

We noted the Chief of Support Services had established a benchmark of 7.5% absenteeism for certain employees. When asked how this benchmark was established, the Chief of Support Services identified information which noted a 5% absenteeism rate was too high. However, we noted this information was irrelevant. The information provided related to how the 5% rate was calculated was significantly different than how WSI calculated the 7.5% rate. The 5% rate calculation did not include vacations and approved leave of absences. WSI is including these amounts in their calculation.

We noted employees who have been employed by the state for an extended period of time may not be able to stay within the 7.5% rate established by the Chief of Support Services. This is due to the amount of annual leave employees can accumulate during the year. A representative of the Office of the Attorney General noted annual leave is a benefit of employment with the state and employees must be given the opportunity to use their annual leave. Since the 7.5% rate is used as criteria within performance appraisals, certain employees may need to make a decision of not taking time entitled to them or risk having their appraisal rating adversely affected if they do take time entitled to them. This is not appropriate.

Recommendation 2-17

We recommend Workforce Safety & Insurance review and re-evaluate the reasonableness of a 7.5% standard for absenteeism. The organization should, at a minimum:

a) Ensure the absenteeism standard is not lower than the amount of annual leave employees are entitled to use in a year;
b) Ensure the absenteeism standard includes consideration for a reasonable amount of sick leave; and
c) Ensure leave taken under the Family Medical Leave Act or compensation earned under the Fair Labor Standards Act is not included in the calculation of the absenteeism rate.

Management's Response

CONCUR: The seven-and-a-half percent absenteeism rate was used when reviewing the Dependability section of the employee's performance evaluation. WSI will assure that any absenteeism standard set will not fall below the annual leave accrual rate of an employee including a consideration for a reasonable amount of sick leave with an exclusion for FMLA and FSLA leave.

WSI Management

Introduction

A goal of this performance audit was to answer the following question:

> "Are adequate policies and procedures established to provide appropriate leadership and accountability for Workforce Safety & Insurance?"

As the goal relates to Workforce Safety & Insurance (WSI) management, we determined management has not established adequate policies and procedures to provide appropriate leadership and accountability for the organization. We noted a number of areas of concern related to the organization's procurement system (Chapter 1 of this report), organization's personnel system (Chapter 2 of this report), strategic planning, and actions, or lack of actions, taken by the Executive Director. Significant improvements needed to be made by management are included in this chapter. Improvements of less significance were communicated to management in a separate letter. Chapter 4 addresses the answer to the above goal as it relates to the Board of Directors of WSI.

To determine whether WSI management had established adequate policies and procedures to provide leadership and accountability, we:

- Reviewed strategic planning information;
- Reviewed applicable management controls; and
- Interviewed selected staff.

WSI Organizational Structure

An Executive Director of WSI is appointed by an 11 member Board of Directors. The organization is comprised of three main departments with the department chiefs reporting directly to the Executive Director. In addition to the department chiefs, there are four other employees who comprise the executive team and report directly to the Executive Director.

In comparison of WSI's organizational structure from previous years to the current structure, we did note there was one less person included in the executive team. Prior to the current Executive Director starting at WSI, April 2004, there were eight vice presidents. While one less person is on the executive team, we noted the salary for the team of seven is higher than when it was a team of eight. The average executive team member salary as of March 2006 is 26% higher than the average salary of the prior executive team in March 2004. This equates to over $135,000 more a year being paid in salaries (using the difference of the average executive team member salary).

Improving Organization Culture and Morale

Throughout this audit, indications of low employee morale, problems with communication, and employees fearing retaliation were noted. While the performance audit did not specifically include a cultural assessment or morale evaluation, evidence indicated problems existed in these areas. WSI provided information to our office on September 22, 2006 which included results of an organizational culture survey conducted by an outside contractor. The results of the cultural survey confirmed information we had identified and conclusions we had made – there are significant areas of concern within WSI which need addressing. The cultural survey indicated significantly low ratings in a number of areas. The lowest scores were related to the following questions:

- There is a clear agreement about the right way and the wrong way to do things.
- The leaders and managers "practice what they preach."
- We respond well to changes in the business environment.
- Our approach to doing business is very consistent and predictable.

Our review identified the Executive Director should take appropriate actions to improve morale. Also, WSI should establish an effective open door policy and make significant improvements with communication between executive management and staff.

Taking Actions to Increase Morale

Our review during this audit identified information in which the Executive Director has taken action which results in apparent preferential treatment or favoritism being provided. Examples include:

- When WSI implemented a new compensation plan based on a review performed by the Hay Group, WSI calculated raise amounts for all employees. Employees could receive a raise allowing them to reach the minimum of the new pay grade assigned their position, or could get an increase termed an "XYZ" increase (based on the amount of time employee had in the position, a factor was applied to the salary for an increase with a maximum of 3.5%). The Executive Director provided increases to seven of his eight direct reports which were in excess of what WSI had computed. For example, while WSI's computed XYZ increase for the Chief of Injury Services identified a yearly increase of $416, the Executive Director increased this salary $8,992 a year. Also, the Chief of Employer Services was to receive an XYZ increase of $205 a year but the Executive Director increased this salary $5,996 a year. While there were other employees who received increases above what WSI had calculated, these differences related to a specific classification (all Claims Supervisors received additional adjustments for compression issues) or were due to reasonable adjustments made to the calculation.
- When WSI implemented a new compensation plan based on a review performed by the Hay Group, we noted the Executive Director had certain employees' increases retroactively applied (the increase was made effective to an earlier date). Four of the eight direct reports had their compensation increases retroactively applied. Two of these employees had not received salary increases for over two years. We did identify one other employee receiving a retroactive payment for the new system. No other employees were

noted as being allowed similar retroactive payments for the increases related to the new system.

- In review of investigation reports, we noted concerns with a lack of action taken and results/recommendations of investigations being changed. All instances we noted involved direct reports of the Executive Director or a contractor who was providing executive mentoring services. (These instances are further addressed in Chapter 2, "Improving How Investigation Results are Implemented" section.)
- In review of payments to employees, we noted certain employees received increases which were retroactively applied (made effective to an earlier date which resulted in a lump sum payment being made). We noted for three employees who report directly to the Executive Director, portions of the retroactive payments are bonuses which were in noncompliance with requirements in state law. (This is further addressed in Chapter 2, "Complying with Bonus Requirements" section.)

A significant number of employees identified favoritism as an issue within the organization and our review identified apparent preferential treatment and/or favoritism.

Employees within WSI also identify favoritism as an issue within WSI. Our office conducted an employee survey in February 2006 as part of the performance audit. Of the 192 employees responding to the statement "Favoritism is not an issue in raises or promotions," 50% selected "Strongly Disagree" or "Disagree." This is a significantly high negative response. Preferential treatment and/or favoritism have a negative impact on employee morale which, in turn, adversely impacts the organization.

In review of information related to actions taken by the Executive Director, we questioned whether the Executive Director had followed through with commitments or promises. This has a direct impact on morale of an agency when employees raise questions regarding whether or not the leader of the organization can be trusted. Examples noted include:

- In February 2006, WSI employees were emailed information regarding the salaries of all employees within the organization. After this event, the Executive Director emailed all employees stating "We are investigating the spamming and mailing with every resource we have. If we find any more details I promise you we will update you ASAP." Two days later the Executive Director forwards his Executive Team an email he wrote to the individual who allegedly emailed the salary information. In the email to the Executive Team, the Executive Director states "FYI – DO NOT FORWARD PRINT, COPY, OR SEND ON IN ANY MANNER. For FYI only." The Executive Director did not follow through on his promise to update employees if more details were identified but rather, chose to inform the Executive Team only. In discussing this situation with the Executive Director, we were provided two different reasons for not informing employees. The Executive Director first noted to us he did not send information to all employees as his decision was not to climb into the gutter with the individual sending the email and saw no need to notify employees. Three days later, the Executive Director stated he did inform the agency to the point he could noting it would have been unethical and possibly liable to widely and publicly announce a name to the whole agency that he could not prove.

- The Executive Director emailed all employees in June 2005 referencing his commitment to personally visit everyone who worked at WSI. The email notes the Executive Director had not spent an equal amount of time with each person as first intended, he needed to make time available to those who had not received a promised initial visit, and requested employees to schedule a time with his Executive Secretary. In discussing this with the Executive Director, he noted when he started at WSI, his 90-day plan said he would meet with all employees. The Executive Director noted he did not meet with everyone in the first 90 days as expressed but he did eventually meet with everyone (some in teams to accommodate his schedule or the employees' schedule).

In review of the information above, we did note the Executive Director may have promised or committed himself to actions which were not reasonable. For example, promising employees information which later is determined to be possibly unethical or could create a liability if it were provided is apparently creating an unreasonable expectation. Also, meeting personally with over 200 employees within 90 days would appear unrealistic given the number of employees, relatively short period of time, and needing to fulfill other responsibilities.

Recommendation 3-1

We recommend the Workforce Safety & Insurance Executive Director make improvements with actions taken in order to increase morale of the organization. While this will encompass a number of areas, the Executive Director should, at a minimum:

a) Ensure actions taken are not resulting in preferential treatment and/or favoritism; and
b) Follow through with commitments or promises, ensure unreasonable commitments are not made, and notify all applicable parties if promises or commitments are unable to be adhered to.

Management's Response

CONCUR: WSI concurs that continued actions should be taken to focus on morale; however, WSI does not concur that any favoritism or consistent pattern of not following through on commitments exists. See Appendix D for the remainder of WSI's response.

State Auditor's Concluding Remarks

WSI states it does not concur any favoritism exists. This statement concerns us given the information identified and the large number of employees citing favoritism as an issue within the organization. See Appendix D for the State Auditor's concluding remarks.

Having an Effective Open Door Policy

WSI identifies it has an open door policy in which employees can bring issues to management. Based on a review of survey comments, discussions with employees, and WSI information, WSI does not have an effective open door policy. Employees identified a fear of identifying information to management and a fear of possible retaliation. Results from two different surveys verify the lack of an effective open door policy within WSI.

While WSI identified it has an open door policy, we noted information which identifies the open door policy is ineffective.

- Our office conducted an employee survey in February 2006 as part of the performance audit. Of the 192 employees responding to the statement "I am able to take issues to or can disagree with senior management without fear of consequences," 44% selected "Strongly Disagree" or "Disagree." In review of written comments submitted by employees, 42 employees were identified as making comments related to fear of retaliation, afraid to speak out, and WSI not having an actual open door policy.
- A brief survey of employees conducted by the Executive Director in April 2006 asked employees "Are you afraid you will lose your job if you honestly speak out?" Of the employees responding, 46% selected "YES."

An effective open door policy should allow all employees to discuss information with management, which in turn would allow management to be aware of and potentially deal with issues in a timely and effective manner. For an open door policy to be effective there must be no retaliation or fear of retaliation from management if an employee brings a legitimate issue to its attention. We noted certain actions taken by WSI may have added to employees' fears regarding retaliation. For example, when an employee brought an issue to human resources within WSI, the Executive Director wanted the subsequent investigation to include who made the request to review documentation. The person who brought the issue forward is irrelevant and further adds to employees' fears. An ineffective open door policy can negatively impact morale of an organization and thus, impact employee productivity.

Recommendation 3-2

We recommend Workforce Safety & Insurance take appropriate action to have an effective open door policy under which employees can bring issues to management without actual retaliation or fear of retaliation.

Management's Response

CONCUR: WSI's current Executive Director has had an open door practice since arriving in 2004 and there have been zero cases of retaliation. As with all Open Door Policies/Practices, there is a level of trust that must be present for it to be effective. WSI management continues to work to establish the trust. It is important to note that for an Open Door Policy/Practice to be effective, any manager (including the Executive Director) must walk freely and talk with employees in their comfort zone. Additionally, any and all forms of retaliation are not tolerated and will not be condoned. See Appendix D for the remainder of WSI's response.

State Auditor's Concluding Remarks

WSI states there have been zero cases of retaliation. This is a very bold statement and contradicts a number of employee comments identified in the employee survey we conducted as well as information we obtained during interviews. When WSI's own survey identifies 46% of respondents believe they will lose their job if they honestly speak out, there is an indication retaliation, perceived or actual, has occurred or exists. See Appendix D for the remainder of the State Auditor's concluding remarks.

Improving Communication

As part of the performance audit, an employee survey was sent in February 2006. Of the 193 employees responding to the statement "Management communicates well with employees," 47% selected "Strongly Disagree" or "Disagree" (management was defined as upper/senior management of WSI). This identifies a significant problem associated with the communication between executive management and other employees of the organization. Communication problems have a negative impact on employee morale and, thus, the productivity of employees. Open, honest, and adequate communication between executive management and employees should exist to foster positive employee attitudes.

Recommendation 3-3

We recommend Workforce Safety & Insurance make significant, timely improvements related to communication between executive management and other employees of the organization.

Management's Response

CONCUR: WSI has revamped how Executive Management communicates with the organization. A regular weekly column in "The Chronicle" from the Executive Director outlines his calendar and some personal thoughts. The Assistant Communications Team (ACT), with representatives from each department, has been established to provide routine feedback from all departments. Regular meetings with Executive Team members are conducted to facilitate open discussion. Collection boxes have been placed where anonymous questions or suggestions can be placed. The Executive Director also periodically attends weekly staff meetings.

Improving the Use of Resources

In February 2006, WSI employees were emailed information regarding the salaries of all employees within the organization. The Executive Director emailed all employees stating "We are investigating the spamming and mailing with every resource we have. If we find any more details I promise you we will update you ASAP." When asked what resources were used, the Executive Director identified the Special Investigations Unit (SIU), IS (information systems) unit, General Counsel, and himself. The Executive Director specifically requested SIU to conduct an investigation in order to find out who sent the information, what could they find on this person, and whether or not a law was broken.

North Dakota Century Code Section 65-02-23 states WSI is to establish a fraud unit. The section states the fraud unit is to investigate and review any alleged case of fraud against the fund by employers, injured workers, or providers of medical or other services. The use of SIU to attempt to track down an individual who emailed public information to WSI results in noncompliance with legislative intent as this unit was not established for this purpose. The costs associated with SIU's involvement in the investigation are unknown.

After all employees received an email containing salary information, WSI inappropriately used certain resources to investigate who had sent the email.

When the Executive Director made the request to SIU to conduct the investigation, he provided two names of former employees to include as suspects. SIU was informed by WSI's information systems unit the email had originated at a public library. SIU accessed the Department of Transportation's (DOT's) driver's license image program. SIU printed at least one of the suspect's picture from the driver's license image program. SIU showed pictures of the two suspects to employees at the public library where the email had originated. SIU also accessed the driver's license image program for two other individuals – one a current employee of WSI and one a former employee of WSI (the pictures of these two individuals were not apparently shown to employees at the public library). North Dakota Century Code Chapter 39-33 identifies driver's license images, as well as social security numbers and medical information, as "highly restricted personal information."

The use of the driver's license system to access photos was inappropriate and violated the contract WSI has with DOT as well as state law requirements. The contract requires WSI to use the driver's license image program for official use only. A representative of DOT confirmed WSI's purpose for accessing the program was not an official use. DOT is waiting for the completion of the performance audit to take appropriate action.

When the Executive Director used additional resources beyond SIU to investigate who had sent the emails to WSI, the use of these resources constitutes abuse as defined by Government Auditing Standards. The costs associated with the use of the IS unit and General Counsel are unknown. As defined by Government Auditing Standards:

> "Abuse is distinct from fraud, illegal acts, or violations of provisions of contracts or grant agreement. When abuse occurs, no law, regulation, or provision of a contract or grant agreement is violated. Rather, abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances."

Recommendation 3-4

We recommend Workforce Safety & Insurance comply with legislative intent and ensure the Special Investigations Unit's resources are used appropriately.

Management's Response

CONCUR: The Unit is not exclusively the "fraud unit" referred to in 65-02-23. In other words, the fraud unit is not the same entity as SIU. Rather, the fraud unit is encompassed by, and is one component of SIU. The Unit's functions also include assistance with claim compensability, subrogation, judgment collection, and any violations of Title 65 (for example, unlawful retaliation under section 65-05-37).

State Auditor's Concluding Remarks

WSI identifies additional responsibilities of SIU beyond being the fraud unit. These responsibilities also do not identify where the use of SIU to investigate who had sent the email would be appropriate.

Recommendation 3-5

We recommend Workforce Safety & Insurance comply with contractual provisions and ensure the Department of Transportation's driver's license image program is accessed for official use only.

Management's Response

Concur: While management concurs that WSI should ensure access to information is for official use only, WSI does not concur that the use of the photos was inappropriate in this circumstance. As provided in the responses to Recommendations 3-4 and 3-6, the e-mail giving rise to SIU's involvement was potentially a legal and/or human resource issue. Because SIU's function is not limited to only investigating fraud, the use of the two photos was reasonably required to carry out SIU's function in the preliminary investigation. WSI did not breach its contract with DOT, nor was state law violated. WSI has, and will continue to take its responsibilities regarding DOT-accessed information seriously.

State Auditor's Concluding Remarks

While WSI does not concur the use of the photos was inappropriate, we concluded and DOT agreed with our conclusion that accessing the driver's license image program was not appropriate.

Recommendation 3-6

We recommend Workforce Safety & Insurance use resources in an efficient and proper manner to ensure the use of resources does not result in abuse.

Management's Response

CONCUR: While management concurs with the recommendation, it does not concur that any abuse was conducted. As stated in the narrative, Government Auditing Standards (in part) note: "…abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances." (Emphasis Added) Initially, the manner in which the e-mail in question was sent was thought to possibly involve legal and/or internal resource abuse issues --depending upon whether or not any current WSI employees could have possibly been involved in the e-mail's distribution. Due to the potential legal issues, the SIU was directed by the Executive Director to conduct a preliminary investigation of the issue. Because SIU is not limited in function to just investigating fraud, management disagrees that the Executive Director's use of the unit was abuse. Instead, it is management's belief that a prudent person would have acted in a similar manner when given the same set of legal and ethical facts and circumstances.

State Auditor's Concluding Remarks

WSI states initially there were possible legal and/or internal resource abuse issues. We are unable to determine why WSI needed photos of individuals to make a determination of whether such issues existed. SIU had information made available to it by WSI's information systems unit as to where the email originated. The only purpose of using photos was to have them viewed by employees of the public library to determine whether such individuals were at the library. This has nothing to do with determining whether laws are broken and only relates to attempting to identify the person sending the emails.

Improving Areas Related to Strategic Planning

In a review of information regarding planning for the organization, we noted WSI has lacked a strategic plan for a number of years. WSI had not developed a strategic plan in a timely manner after the Board of Directors established its direction. We noted concerns with information within WSI's strategic plan. Information related to strategic planning is not included on WSI's web site.

Establishing and Implementing a Plan

In November 2004, the Board of Directors established its Outcomes. It was approximately a year later that WSI formulated strategies and identified a strategic plan for implementing the Board's Outcomes. We noted WSI was attempting to coordinate a strategic planning session with the Board as far back as January 2002. Yet, it was over three and a half years later that the organization establishes a strategic plan. A lack of a strategic plan makes it difficult to measure an organization's success and WSI went an extended period of time with no plan to assist in focusing the organization's resources and efforts.

When WSI had a strategic visioning and planning session, only the Executive Team was included in this process with minimal, if any, other WSI staff involved. The CEO membership organization WSI pays $12,000 a year to be a member of, identifies that prior to undertaking a strategy planning process, management must understand unless it is committed to involving the entire employee staff, the plan won't work.

Improvements with the strategic plan are needed.

WSI's mission is "Our mission is our passion. Our Passion is North Dakota's workforce. To us, it's personal." In October 2005, WSI employees provided input regarding the mission and employees noted they did not understand and did not like the terms "passion" and "personal." Having a mission statement the employees do not understand is an indication of a very poor mission. In addition, the facilitator of the review of the strategic plan also noted concerns with the mission noting the mission should, at a minimum, identify "the who" and "the what." In our review of the mission, we noted concerns with the phrase "To us, it's personal." WSI should be a professional, objective organization and when things are taken personally, there is an inherent risk the professionalism and objectivity of the organization is impacted.

We noted other concerns regarding the information within WSI's strategic plan.

In a limited review of information pertaining to WSI's plan, we noted information related to implementation was not accurate. For example, the strategy "Provide on-site consultative services for Preferred Markets" was identified by WSI as being completed on December 1, 2005. No such on-site visits had been provided by December 1, 2005.

Recommendation 3-7

We recommend Workforce Safety & Insurance establish and implement its strategic plan in a timely manner, once the Board of Directors establishes revised outcomes. The organization should, at a minimum:

a) Review and modify its mission;
b) Reevaluate the purpose and other structural elements of the strategic plan;
c) Ensure employee involvement is obtained when developing the plan; and
d) Ensure information related to completion of strategies is accurate.

Management's Response

CONCUR: (a) and (b) WSI concurs with these recommendations to the extent that the Board of Directors makes such modifications at its retreat in the first quarter of 2007 where –in part—the Board will review the mission, vision, values, and outcomes.

(c) WSI concurs with the recommendation that employee involvement is critical and that is why WSI extensively involved employee participation in the creation of the current strategic plan. See Appendix D for the remainder of WSI's response.

(d) WSI concurs it should ensure information related to completion of strategies is accurate. The example outlined in the narrative "Provide on-site consultative services for Preferred Markets" was identified as complete on December 1, 2005, because it had been deployed for implementation. The Safety Outreach Program had been researched, defined, and developed and the "preferred markets" had been identified which included employers within high risk industries as well as other high risk employers. The act of deploying the plan began in January of 2006 and will continue on an ongoing basis. WSI's core team has established a process to monitor strategy completion and will continue to periodically monitor to ensure the most complete and accurate information is available.

Including Information on WSI Web Site

While WSI has included core values, vision, and mission on their web site, other strategic planning information and the Board of Directors' Outcomes are not on the web site. WSI should ensure relevant and pertinent information is easily accessible to employers who are paying premiums, injured workers receiving benefits, and other interested parties.

Recommendation 3-8

We recommend Workforce Safety & Insurance include relevant strategic planning information and the Board of Directors' Outcomes on their web site.

Management's Response

CONCUR: WSI concurs it should include relevant strategic planning information and the Board of Directors' Outcomes on its website. As of November 2006, WSI posted the Board of Director's outcomes as well as relevant strategic planning information on WSI's website.

Ensuring Accurate Information is Provided

During our review of information, we identified a number of areas in which information provided by WSI appears to be misleading, inaccurate, or does not properly include all relevant information. This related not only to information provided to us during the audit, but included information WSI provided to legislative committees, other state entities, and other parties. Examples noted include:

- On February 22, 2006, WSI submitted written testimony to the legislative Employee Benefits Programs Committee regarding WSI's pay for performance system. WSI noted "In June 2005, the Hay Group evaluated WSI's pay for performance process and validated it as being operated in an appropriate manner." We determined work was not performed by the Hay Group regarding validating the pay for performance as being operated in an appropriate manner. When we contacted a representative of the Hay Group, they noted validating the process was not part of the scope of work performed.
- We noted WSI's proposed budget to the 2005 Legislature included $1 million for safety partnership grants. WSI received continuing appropriation authority for safety programs during the Legislative Session. However, the $1 million for safety grants was not removed from the budget request. Based on discussions with WSI, the $1 million appears to have been used to pay for raises and information technology projects.
- On August 29, 2006, WSI submitted a written response to us related to a question on increases provided to employees when the new compensation plan was implemented. WSI stated the Executive Director informed the Board of Directors that some WSI employees would receive performance increases greater than what was initially recommended by the Hay Group analysis. No such statement was made to the Board and WSI later stated the phrase "the performance increases greater than what was initially recommended by the Hay Group analysis" was not made.
- On September 12, 2006, WSI provided information to the Attorney General's Office related to reasons for withholding 4% general increases from certain employees. In review of the information provided and comparing it with other information WSI had, there was information not provided to the Attorney General's Office which was necessary to make an accurate and informed decision.
- On October 4, 2006, WSI provided information to the Budget Section related to a request for an additional $250,000 spending

authority. In response to a question, WSI stated just the Executive Director and new employees in an orientation period did not get the 4% general increase. We noted WSI had also withheld the increase for employees with performance related issues (nine) and withheld payments to four other employees due to an apparent error.

- In the work conducted as part of the biennial performance evaluation, we noted the hired consultant had identified a few errors with information in some of the quarterly operating reports and had encouraged WSI staff responsible for each segment of the operating report to carefully validate contents before the report is published.

There were a number of other areas identified throughout the audit. While WSI has noted such information was not provided to be misleading and they did not intentionally make errors, we noted a trend with information provided which appeared to make information incomplete or inaccurate.

Recommendation 3-9

We recommend Workforce Safety & Insurance take appropriate steps to ensure information it provides is accurate.

Management's Response

CONCUR: Whereas WSI agrees that all disseminated information should be as accurate as reasonably possible it disagrees that the examples sited in the narrative prove that a trend exists in which inaccurate information is routinely disseminated. See Appendix D for the remainder of WSI's response.

State Auditor's Concluding Remarks

See Appendix D for the State Auditor's concluding remarks.

Improving Planning Processes

In a review of information, we identified WSI requires improvement with planning for vacancies and making changes to management philosophies. WSI does not have a formal process for succession planning. We noted management philosophy was changed and training provided was occurring too quickly.

Implementing Succession Planning

Turnover within WSI increased during fiscal year 2006. In fiscal year 2007, turnover continues to increase and we noted WSI lost two employees in high level positions – the Finance Director and the Chief of Employer Services. We noted when the Finance Director left, WSI did not have an employee within the department who had the knowledge and/or training to fill in this position on a part time basis. The vacancy of the Finance Director position also appears to be part of the reason a significant raise was provided to the Human Resource Manager who had been with WSI for a year. In August 2006, this manager received over an 18% raise as WSI apparently could not afford to lose another high level position within the Support Services department.

Recommendation 3-10

We recommend Workforce Safety & Insurance implement succession planning as an ongoing process to identify, assess, and develop talent to ensure leadership and management continuity throughout the organization.

Management's Response

CONCUR: Prior to this audit WSI had identified the need for succession planning and a skill-based career path for its employees. The current HR Manager was hired in August 2005 with the expectation that they would be responsible for building a succession planning process for the organization. Since this time, strategies have been established to enhance the effectiveness of individual staff members including providing opportunities for professional improvement/growth and to create a skills-based career path to provide employees with the opportunity to advance their skills and grow within their position as they develop necessary skills.

Making Changes with Management Philosophy

Starting in late April 2005, WSI had "Good to Great" training. This was followed by a Hedgehog Council kickoff three weeks later and training on Total Quality Management (TQM) occurred the next months. Following the training on TQM (outside vendor paid over $18,000), WSI put TQM training and implementation on hold as there was too much information being provided and too much was going on within the organization. The Executive Director also noted a lack of funding to continue training. Training appears to have been put on hold in the fall of 2005 which is relatively early in the biennium.

Recommendation 3-11

We recommend Workforce Safety & Insurance ensure adequate planning, including consideration for impact on staff time and other resources, is conducted prior to changes and training on management philosophy is implemented.

Management's Response

CONCUR: Management admits that the planning of the change did not develop as effectively as it had planned; however, each of the steps was designed to build one on top of the other to arrive at the final strategic plan ("Good to Great" training, hedgehog council, and Total Quality Management (TQM) training, etc…). The steps were planned and were conducted in such a way as to involve organizational staff in the planning and implementation. See Appendix D for the remainder of WSI's response.

Making Changes with the Internal Audit Department

An Internal Audit Department exists within WSI and the Internal Audit Manager reports to the Board of Directors Audit Committee. In our review of information, we noted Internal Audit should have a function added to its responsibilities. We also identified a staffing reduction occurred with Internal Audit which has impacted its ability to fulfill its mission.

Increasing the Responsibility of Internal Audit

A function of WSI's Quality Assurance Director is to facilitate the implementation of recommendations from performance reviews, financial audits, internal audits, and other applicable reviews. Guidance provided by The Institute of Internal Auditors states a function for Internal Audit to consider is to administer/maintain "the comprehensive follow-up database for recommendations and action plans resulting from internal audit engagements and the work of external auditors and other internal evaluation and investigation functions." The Quality Assurance Director reports directly to the Strategic Executive which could create conflict of interest and independence problems when there are recommendations addressing areas related to the Strategic Executive.

Recommendation 3-12

We recommend Workforce Safety & Insurance move the Quality Assurance Director's function of facilitating implementation of recommendations to Internal Audit.

Management's Response

DO NOT CONCUR: WSI does not concur with the recommendation to move the Quality Assurance (QA) Director's function of facilitating the implementation of recommendations to the Internal Auditor Department. The QA function was established to assist management in coordinating and monitoring the implementation of recommendations from the various internal and external audits/reviews. Currently, Quality Assurance produces status reports and reports them to the Board Audit Committee.

Practice Advisories 2500-1 and 2500.A1-1, interpretations of Standard 2500 from the International Standards for the Professional Practice of Internal Auditing, provide additional guidance relating to the role of internal audit in monitoring progress and the follow-up process.

Consistent with the guidance found within these advisories, QA will modify the existing process and provide periodic updates including the management status reports to internal audit for evaluation and validation. Internal audit will then report the results of their follow-up work to the Board Audit Committee.

State Auditor's Concluding Remarks

WSI states it will have the Quality Assurance Director provide periodic reports to Internal Audit for evaluation and validation. This provides more support for the recommendation to have this function within Internal Audit. Another benefit for Internal Audit is the knowledge and education it will gain as part of this process which should assist in identifying additional areas to review where improvements can be made.

Reviewing Staffing Levels

In August 2005, the Executive Director requested a position be moved from Internal Audit and provided to him to use as deemed appropriate. The Board of Directors Audit Committee allowed this one-third reduction in staffing of Internal Audit without apparently formally approving the change (no motion approved) and did so less than a year after having a prior Internal Audit Manager specifically inform them that three positions were needed. The Internal Audit position was allowed to go to the Executive Director without the Audit Committee even knowing how the position was to be used by the Executive Director. The Executive Director used this position to create a new position within WSI (Leadership & Organization Excellence Executive). The difference in the ending salary of the Internal Audit position and the starting salary of the new position amounted to over $46,500 a year.

A position was removed from Internal Audit with no analysis of the impact on Internal Audit's mission.

The Audit Committee allowed Internal Audit staffing to be reduced by one-third. This occurred with no analysis of the benefit of what the position would be used for or an analysis of what the impact was of the reduction on Internal Audit's mission. The move of the position has significantly impacted the operations of Internal Audit which has been further adversely affected by the fact there has been no Internal Audit Manager since December 2005. If Internal Audit is to fulfill its mission of providing timely, value-added audit services to all management levels and the Board, it must be adequately staffed. If the function of facilitating recommendations is moved to Internal Audit as discussed in the previous section, a review of staffing levels should include the impact of this move.

Recommendation 3-13

We recommend Workforce Safety & Insurance conduct an in-depth review of the staffing level of Internal Audit and determine an adequate staffing level for Internal Audit to effectively fulfill its mission.

Management's Response

CONCUR: In response to the narrative preceding the recommendation, there have been past discussions relating to staffing of the Internal Audit Department. In summary, at the August of 2005 Board Audit meeting, the committee members discussed that: the Internal Audit Manager requested to fill a vacancy and maintain department at 3 FTE; Internal audit historically did not do much follow-up and there was now a Quality Assurance position to review and monitor recommendation implementation; with the QA position was there still a need for a third full-time person, there was no historical data to help justify staffing levels; that Internal Audit would start tracking time spent on audits so historical data would exist for any future reviews; and, there was a high turnover within the Internal Audit department. Following the discussion, the Executive Director suggested keeping Internal Audit at two plus Quality Assurance until there was enough data to support the request. He further noted that between the internal and external audits there existed a significant auditing presence. The Executive Director did request to use the vacant position until such time as the data could determine an appropriate staffing level.

State Auditor's Concluding Remarks

WSI states there had been past discussions relating to staffing of Internal Audit. However, there was no documented analysis of an adequate staffing level of the department. Rather than complete such an analysis prior to making changes, WSI made changes (removed a position) until there was enough data to support the prior staffing level. This appears the reverse of a normal course of action taken as usually an analysis is conducted to support a change; not make a change and then do an analysis to support the change.

Increasing Blanket Bond Coverage Amount

A blanket bond is a bond that collectively covers all public employees and public officials of an entity without the necessity of identifying names or positions as a part of the bond. WSI has a blanket bond with coverage up to $250,000. This is an inadequate amount of coverage given the size of WSI's investments (over $1.1 billion), revenue (over $100 million in premiums billed to employers prior to dividends), and expenditures (over $100 million in operating expenses). WSI is at an increased risk of financial loss due to management not adequately protecting the organization's resources.

Recommendation 3-14

We recommend Workforce Safety & Insurance significantly increase their blanket bond coverage amount.

Management's Response

CONCUR: WSI will increase its blanket bond coverage from the current amount of $250,000 to the maximum offered by the State Bonding Fund of the North Dakota Insurance Department --$2,000,000. Additionally, management will review increasing the blanket coverage to a higher level if applicable.

Improving the Calculation of Premium Dividend Credits

The Board of Directors passed a resolution in June 2005 providing for a 40% premium dividend credit for employers with active policies and in good-standing. The credit was not to be applied to minimum premium accounts ($125), accounts in a delinquent/unsatisfactory/or not good standing status, and optional all-states premium. The dividend was to be applied to the estimated premium and it could not result in a premium due of less than $125. Based on a limited review of information, we noted certain employers received a dividend credit in excess of 40% and certain employers had a premium due that was less than $125 after the dividend credit was applied.

The errors in calculation appear to have occurred when the initial billed premium amount had an adjustment made to it. After an adjustment was made to the premium amount, WSI did not make a corresponding adjustment to the dividend credit. As long as an employer account is still active for the next premium billing cycle, WSI should be able to make appropriate adjustments to correct the errors. However, when employer accounts have been closed, WSI will need to make other attempts to recoup the money owed (WSI estimated the errors on closed accounts is over $17,000).

Recommendation 3-15

We recommend Workforce Safety & Insurance correctly calculate premium dividend credits and take appropriate action to recover lost premium amounts.

Management's Response

CONCUR: WSI concurs it should correctly calculate premium dividend credits and take appropriate action to recover lost premium amounts. See Appendix D for the remainder of WSI's response.

Board of Directors

Introduction

A goal of this performance audit was to answer the following question:

> "Are adequate policies and procedures established to provide appropriate leadership and accountability for Workforce Safety & Insurance?"

As the goal relates to the Board of Directors, we determined the Board has not established adequate policies and procedures to provide appropriate leadership and accountability for the organization. We noted a number of areas where improvement could be made relating to the Board's governance of the organization as well as compliance with its adopted governance model. Significant improvements needed to be made by the Board are included in this chapter. Improvements of less significance were communicated to Board management in a separate letter. Chapter 3 addresses the answer to the above goal as it relates to management of Workforce Safety & Insurance (WSI).

To determine whether the Board had established adequate policies and procedures to provide leadership and accountability, we:

- Reviewed the Board's bylaws, governance policies, and meeting minutes;
- Reviewed information related to the Carver Policy Governance Model; and
- Interviewed Board members.

Performance Audit and Performance Evaluation

North Dakota Century Code Section 65-02-30 requires a performance evaluation be conducted of WSI every biennium. The firm is selected by the Office of the State Auditor to complete the performance evaluation. The Request for Proposal (RFP) sent out by our office for the performance evaluation contained 11 elements. After receiving proposals and evaluating information, a decision was made to remove three elements from the performance evaluation and include those elements as areas to consider as part of a performance audit. These three areas included human resource management, consulting contracts, and Internal Audit and the Board of Directors Audit Committee.

As with every performance audit, during the first phase of the audit information is collected regarding an organization, department, or function. This is used to establish the scope of the performance audit. During the first phase of this audit, we did identify concerns related to various areas of WSI including:

- Human resource management: due to concerns noted in this area, an applicable goal and related objectives were developed. Results of this goal are identified in Chapter 2 of this report.
- Procurement: due to concerns noted in this area, a goal and related objectives were developed. This did include reviewing consulting contracts which was an element from the RFP for the performance evaluation. Results of the goal are identified in Chapter 1.

- Management and leadership: we identified concerns regarding the Audit Committee and Internal Audit as well as concerns related to communication, leadership, and accountability. Due to this, a goal and applicable objectives were developed which encompassed these areas. The results of the goal are identified in this chapter and Chapter 3. The conclusion on this goal also relied on information obtained during the review of human resources and procurement.

The performance evaluation conducted on WSI included elements to evaluate performance measurements and review the Board of Directors to determine whether the Board complied with a section of law and the Boards bylaws. The work performed by the outside consultant was taken into consideration during the work we performed regarding the Board. Our scope was significantly different than the scope of work required to be performed by the consultant. When it became apparent work needed to be included on the Board regarding issues such as accountability, leadership, and compliance with the Board's adopted governance model and policies, we included this within the scope of our work. These areas were not included in the scope of the performance evaluation. Thus, the issues identified in this chapter relate to Board improvements which were not required to be included as part of the performance evaluation.

Complying with Legislative Intent

In 1997, the 55th Legislative Assembly established the Board Directors of WSI. Prior to this, the Governor was responsible for the organization. According to WSI's web site, the role of the Board is to ensure continuity of leadership at WSI and to ensure WSI operates efficiently and effectively. Based on our review, we noted the Board needs to change how it operates and functions. The Board does not ensure WSI operates efficiently and effectively as the Outcomes established by the Board require improvement, performance criteria needs to be established, and the Board needs to establish an adequate monitoring report. The Board has not complied with the principles of the adopted Carver Policy Governance Model and Board members require additional education on this model of governance. The individual who designed the Carver Policy Governance Model noted a partial implementation of the Carver Model can be worse than not using it at all. The Board has only partially implemented the model. Additional information on these areas as well as other areas which require improvement is addressed within this chapter.

The Board meets quarterly and on an as needed basis. In a review of the Board's minutes, we noted the Board is meeting for a minimal amount of time and it is questionable whether a Board can effectively govern an entity like WSI in such a minimal amount of time. Beginning with the November 2003 quarterly meeting and going forward, we identified the 11 quarterly board meetings lasted, on average, 3 hours. Thus, the Board spends approximately 12 hours a year meeting as a full

Board. This does not include the strategic planning seminar held in November 2004 which lasted less than 8 hours. The Board has followed a quarterly board meeting schedule for an extended period of time.

The Board is comprised of 11 members – 6 representing employers, 3 representing employees, 1 representing medical providers, and 1 appointed at large. While state law requires one employee member to have received workforce safety and insurance benefits and another separate employee member to represent organized labor, the Board has allowed one member to serve both of these requirements. We requested an Attorney General's Opinion to clarify member representation and the formal opinion states one person may not serve as the employee representative who has received WSI benefits and as the employee representative for organized labor. According to the Attorney General, the Board is in noncompliance with legislative intent.

The Board of Directors was established as a governing board and our review of information identifies the Board does not comply with this legislative intent.

The noncompliance with legislative intent has allowed two of the three Board members representing employees to be appointed based on no criteria. We question whether the employee representation on the Board has been sufficient considering the noncompliance issue and the fact the majority of motions are passed unanimously. Also, one appointed member, for which there is no criteria, is a Risk Manager of one of the largest electric generation and transmission cooperatives in the nation. The other appointed employee representative, for which there is no criteria, is a Controller. It is unclear how these members represent employees.

Our interview of Board members and review of emails raised concerns regarding the time commitment and effort of members. Two members were identified as discussing the fact they had other jobs. One of these members commented during an Audit Committee meeting they find it very difficult to make decisions on things when they are not there day to day, and to manage what someone's doing within an office that they basically spend zero time with other than at meetings, makes it uncomfortable. We noted another member of the Board had emailed the Executive Director stating "We may have dialogue and exchange our views, but I have absolute confidence we will never have different positions."

Based on our review, it appears the Board is not fulfilling its responsibility. The Board was established to be a governing board of WSI and we conclude the Board has not complied with legislative intent.

Recommendation 4-1

We recommend the Workforce Safety & Insurance Board of Directors comply with legislative intent and effectively govern the organization.

Management's Response

CONCUR: Although the Board agrees that it should comply with legislative intent and effectively govern the organization, the Board does not concur that it has not done so. The narrative prefacing this recommendation provides incomplete information and isolated incidents in an attempt to support a broad, sweeping conclusion. Although highly critical, there is not a meaningful remedy suggested in the recommendation as to how the organization is not being effectively governed by the Board or how it could be better governed. See Appendix E for the remainder of the Board's response.

State Auditor's Concluding Remarks

The Board states the narrative prefacing the recommendation provides incomplete information and isolated incidents in an attempt to support a broad, sweeping conclusion. All conclusions are based on sufficient audit evidence. Based on the information leading up to Chapter 4 and the corresponding recommendations made to the Board in Chapter 4, it is evident the Board has not complied with legislative intent and is not effectively governing the organization.

The Board states there is not a meaningful remedy suggested in the recommendation as to how the organization is not being effectively governed or how it could be better governed. The remainder of Chapter 4 identifies a number of recommendations related to how the Board could improve and effectively govern the organization. It is concerning that the Board is not aware the intent of the remaining recommendations in the chapter address areas where the Board can better govern.

Establishing the Board's Role

In review of Board minutes, we noted when the Board is passing motions which appear to establish a policy or requirement, there is no additional documentation of the requirement placed into Board policy. Also, there is no formal documentation identifying all of the Board's statutory responsibilities and institutional memory must be relied upon for ensuring compliance.

While the Board is authorized to transfer moneys between line items of the budget, this no longer occurs as no line items exist.

North Dakota Century Code (NDCC) Section 65-02-03.3 states the Board may authorize WSI to transfer moneys between line items within WSI's budget. In discussing this with a representative of the Office of Management Budget, this was the apparent reason WSI was allowed to have a one line item budget. We noted the Board no longer authorizes transfers between line items as the line items no longer exist. Also, we noted the Board's monitoring of the budget appears to be minimal. NDCC Section 65-02-03.3 requires the Board to prepare, with assistance of WSI, the budget for the organization. We noted the budget is prepared by WSI staff with limited parameters or guidelines established by the Board and there are limited policies established related to the Board's role in the budget.

Recommendation 4-2

We recommend the Workforce Safety & Insurance Board of Directors formally establish its role regarding when Board involvement and/or approval is required.

Management's Response

CONCUR: The Board's statutory responsibilities will be placed within its existing planning calendar to ensure continued consistency and compliance. Additionally, as noted in the narrative, NCDD 65-02-03.3 (Board - Powers and duties) does state: "The board may authorize the organization to transfer moneys between line items within the organization's budget." (Emphasis Added) The Board was originally given the authority to transfer between line items. Since the Board already had the authority to move between line items, the organization was given a single-line appropriation. The Board feels it is appropriately advised of any significant budgetary changes and is fulfilling its legislative and governance obligations.

Improving Board Governance

The Board of Directors of WSI has adopted the Carver Policy Governance Model. This is a model of governance designed to empower boards of directors to fulfill their obligation of accountability for the organization they govern. The model is to enable a board to focus on the larger areas, to delegate with clarity, to control management's job without meddling, and to rigorously evaluate the accomplishment of the organization. Our review of the Carver Model and the Board of Directors actions identified noncompliance issues. Board members do not appear to be properly educated on the model and should receive additional training. The Outcomes established by the Board require improvement and the Board should establish measurable performance criteria. The Board is lacking an adequate monitoring report which relates to its established Outcomes and other established criteria.

Complying with the Carver Model

Our review identified a number of areas in which the Board is in apparent noncompliance with principles of the Carver Policy Governance Model. For example, under the Carver Model, a board speaks on behalf of the organization's owners and is to be committed to representing the interests of the owners so it will not allow itself to make decisions based on the best interests of those who are not the owners. The model also notes boards must learn to distinguish between owners and customers, for the interests of each are different. In discussions with all Board members, there was no consensus from the members as to who the owners and customers were. We also noted noncompliance issues regarding the Carver Model related to the Outcomes established by the Board and performance expectations were not being clearly defined and monitored. The individual who designed the Carver Policy Governance Model noted a partial implementation of the Carver Model can be worse than not using it at all and the Board has only partially implemented the model.

Based on our discussions with Board members, it was apparent members did not have adequate knowledge regarding the Carver Model.

The Board is in apparent noncompliance with the principles of its adopted governance model and Board members require additional education and training on the model.

Three members were unable to explain the model or how it was used by the Board. In addition, in February 2006 when the Executive Director asked the Audit Committee to consider the structure of the Internal Audit Department, the Executive Director noted the current reporting relationship went against the Carver Model. The reporting relationship does not go against the Carver Model. Rather than the Audit Committee correctly identifying this does not go against the Carver Model, the Audit Committee approved a change. This was then approved by the full Board the following day. Since this required a modification of policy, the change did not become effective immediately. At the next quarterly meeting, the Board was informed of the inappropriateness of the change of the reporting relationship by their outside financial auditors and the Board determined not to proceed.

Recommendation 4-3

We recommend the Workforce Safety & Insurance Board of Directors comply with the Carver Policy Governance Model.

Management's Response

CONCUR: The Board has established its structure in accordance with John Carver's, PhD Principles of Governance. Whereas the Board concurs that it is important to comply with this style of governance, it does not concur with the auditor's interpretation of this model. The statement that the Board of Directors is in noncompliance with the Carver Model implies the existence of a single model which serves as a standard structure for all boards. While Dr. Carver does establish certain principles, practices, and protocols which characterize, or possibly hallmark, the boards that are successful in order to compare and contrast to those that are unsuccessful, he also acknowledges in his own writings that a myriad of forms and sub-forms of boards exist. Within Dr. Carver's book, Boards That Make a Difference, it is clearly acknowledged that there are different types of boards with different styles. How a board operates is dependent upon many factors, which include but are not limited to organizational structure, member composition, and entity stakeholders. Consequently, the Board does not concur with the statement it has only partially implemented the Carver Model. Again, this model is not a one-size fits-all, cookie cutter template. Dr. Carver says as much in the following quotation referring to boards. "Values and perspectives that govern an organization can be divided into four categories, whether or not the board recognizes or uses them." This text indicates very clearly that Dr. Carver acknowledges the differences in boards.

State Auditor's Concluding Remarks

The Board states it does not concur with the auditor's interpretation of the Carver Model. We used information directly from the developer of the governance model and compared WSI information to the information specifically identified in Carver materials.

The Board includes our statement that the Board is in noncompliance with the Carver Model implies the existence of single model. This is a misleading statement. We do not imply one single model exists. However, we do note the principles of the model are the same, regardless of the type of board, and it is the principles identified in the model with which the Board does not comply.

Recommendation 4-4

We recommend the Workforce Safety & Insurance Board of Directors obtain additional education and training on the Carver Policy Governance Model.

Management's Response

CONCUR: The Board concurs that additional training would be beneficial and appropriate. With the addition of new Board members in 2007, it will be an opportune time to augment the organization's knowledge-base with enhanced and qualified Carver education and training. In addition to orientation of new Board members, WSI will request that Mr. Carver and\or a representative of his designation travel to North Dakota to provide a Board education segment at a future meeting.

Establishing Proper Outcomes

In addressing one of the Carver Model principles, the Board's Governance Policy states "the board is to determine what good the organization is to accomplish, for whom, and at what cost or relative worth. The Board focuses on the Outcomes, not the means that the CEO uses to achieve them." The Carver Model identifies the "ends" are always about the changes to be made for persons outside the organization, the "ends" should not describe the organization itself or its activities, and the "ends" policies should not be about the staff.

The Outcomes established by the Board need revision.

The Board established six Outcomes (or "ends") in November 2004. In our review of the Outcomes, we identified concerns with all six Outcomes complying with the "ends" criteria established under the Carver Model. For example, the Outcome "Enhance WSI Staff Development" clearly does not comply as the "ends" should not be about the staff. Due to this, the Board is not able to effectively govern under the Carver Policy Governance Model.

Recommendation 4-5

We recommend the Workforce Safety & Insurance Board of Directors establish Outcomes that determine what good the organization is to accomplish, for whom, and at what cost or relative worth.

Management's Response

CONCUR: The WSI Board of Directors will ensure that all Outcomes are developed in accordance with the criteria established within the Carver Model of Board Governance.

Establishing Measurable Performance Criteria

Under the Carver Model, being accountable in leadership of the organization requires the board to be definite about its performance expectations and to assign these expectations clearly. While the Board has established Outcomes and Executive Limitations, the Board has not established definite performance expectations. As a result, the Board has no measurable performance targets in which the Board can compare actual performance to expected performance for all the Outcomes.

Executive Limitations are the constraints on the Executive Director's authority which establish boundaries of prudence and ethics within which all executive activity and decisions must take place. The Executive Limitations established by the Board are very broad.

Recommendation 4-6

We recommend the Workforce Safety & Insurance Board of Directors establish detailed, measurable performance criteria within the Outcomes and Executive Limitations policies.

Management's Response

DO NOT CONCUR: The establishment of the type of measurable performance criteria alluded to within the preceding narrative would constitute a situation in which WSI's Board of Directors would be acting in a way inconsistent with Dr. Carver's most basic direction related to effective methodological governance protocol. See Appendix E for the remainder of the Board's response.

State Auditor's Concluding Remarks

Based on our review of information related to the Carver Model, this recommendation is not inconsistent with effective methodological governance protocol. If the Board does not establish measurable criteria, we are unsure how the Board can measure or determine whether established expectations are met.

Establishing an Adequate Monitoring Report for Board Expectations

The Board receives a quarterly operating report generated by staff of WSI. The report is compiled by relying on key data elements captured in the department measures. The report does not identify performance data directly related to expectations set by the Board in its Outcomes and Executive Limitations policies. In addition, this report does not appear to address the Board's Outcomes. As a result, the Board does not have a mechanism in place to effectively govern and hold the Executive Director accountable related to the Board's established expectations. The Board should establish a separate monitoring report for the purpose of determining whether board expectations are being fulfilled. This would not take the place of the quarterly operating report which should still be generated.

Recommendation 4-7

We recommend the Workforce Safety & Insurance Board of Directors establish a separate monitoring report for the purpose of determining whether board expectations, set in its Outcomes and Executive Limitations policies, are being fulfilled.

Management's Response

CONCUR: The Board will review and expand, if necessary, monitoring information for the purpose of determining whether board expectations are being fulfilled.

Evaluating Board Performance

The Board's Governance Policy states in order to aid WSI and to achieve the Board's mission, the Board will monitor and regularly discuss the Board's process and performance. The Board did not have a formal plan established to regularly discuss its process and performance. A number of areas addressed in this report related to the Board may have been identified if an adequate monitoring process had been followed.

Recommendation 4-8

We recommend the Workforce Safety & Insurance Board of Directors periodically conduct an evaluation on the Board's and individual members' performance including each committee's and individual committee members' performance.

Management's Response

CONCUR: The Board will consider this recommendation as part of their scheduled January 2007 Board retreat.

Improving Processes Once Outcomes are Established

After the Board of Directors established six new Outcomes in November 2004, the Board did not make changes to policies in a timely manner. The changes were not approved until June 2006. We noted the policies still reference an outdated mission statement of the organization.

While the Board established the Outcomes in November 2004, it was not until October 2005 that WSI formulated strategies and identified a strategic plan. As of July 2006, WSI's plans used to achieve the Board Outcomes indicated they are partially implemented with only one of the six Outcomes' plans being greater than 50% complete.

Recommendation 4-9

We recommend the Workforce Safety & Insurance Board of Directors improve the governance process used once Outcomes are established or modified. The Board should, at a minimum:

a) Timely incorporate changes into policy; and
b) Adequately monitor the organization's progress in developing a plan to accomplish the Outcomes.

Management's Response

CONCUR: In regard to part (a) of the recommendation, with few exceptions, Board policy changes have been incorporated timely. The reason for the delay with the Outcomes policies and strategic plan formulation has been outlined in management's response to Recommendation 3-7. In regard to part (b) of the recommendation, the Board education topic at the August of 2006 Board meeting was staff presentations on strategy implementation and a progress update on overall strategy implementation. It is the Board's intent to continue to receive periodic updates from staff relative to overall strategic plan implementation at subsequent Board meetings.

Evaluating the Executive Director

In review of the Board of Directors process for evaluating the Executive Director, we noted improvements were necessary to ensure established expectations are being met and to hold the Executive Director accountable. The committee evaluating the performance of the Executive Director should be providing a salary recommendation to the Board upon completion of the evaluation.

Making Changes to the Executive Director's Evaluation

Under the Carver Policy Governance Model, being accountable for leadership of the organization requires a board to determine if the established expectations are being met. Monitoring or evaluative information is to speak directly to whether board expectations are being fulfilled. Consequently, monitoring should be related to expectations set by the board in its "ends" and Executive Limitations policies. We noted the Board's 2004 and 2005 evaluation of the Executive Director included criteria developed from the essential functions as identified in the job description rather than relying on the Outcomes and Executive Limitations.

The Board needs to improve its evaluation process of the Executive Director.

The Board's Governance Policies identify the evaluation of the Executive Director is to be determined from Executive Director reports, internal audit reports, and external reports. When conducting the evaluation, the Board used more than the reports established within the policy. For example, the Board used surveys of selected WSI employees. Not only did questions asked in surveys not relate to Board expectations, but we question whether a sufficient number of employees are surveyed. In 2005, the Executive Director's direct reports are surveyed as well as 25 WSI staff, but only 10 of the 25 staff responded.

The Board has not conducted a proper evaluation of the Executive Director and is in noncompliance with the evaluation process under both the Carver Model and the Board's Governance Policies. As a result, the Board did not have an adequate means to determine whether performance was acceptable or not.

Recommendation 4-10

We recommend the Workforce Safety & Insurance Board of Directors evaluate the Executive Director's performance solely on established criteria in Outcomes and Executive Limitations policies which measure the degree of organizational success.

Management's Response

CONCUR: The WSI Board of Directors will review this recommendation with a Carver Governance consultant to ensure the formulation of a methodology that ensures the Executive Director's performance is based on the Outcomes.

Providing a Salary Recommendation

The Board of Directors' Bylaws state the Executive Performance Committee is responsible for providing a salary recommendation for the Executive Director. After completing the Executive Director's evaluation in 2004 and 2005, the committee did not provide a salary recommendation to the full Board. When the Board approved a salary increase for the Executive Director in 2004, the Board identified an incorrect base salary amount. This created confusion as to what the raise was to be and this may have been avoided if the Executive Performance Committee had made a recommendation as required by policy.

Recommendation 4-11

We recommend the Workforce Safety & Insurance Board of Directors Executive Performance Committee provide a salary recommendation for the Executive Director after evaluating the Executive Director's performance.

Management's Response

CONCUR: The Executive Performance Committee for Workforce Safety & Insurance's Board of Directors will provide salary recommendations for the Executive Director after evaluation.

Increasing Board Member Compensation

Board members receive a daily compensation rate of $100 for each meeting attended or for other board related duties. They are reimbursed for mileage and expenses at the same rate as provided state officers. In review of other boards, we noted this amount is low. For example, two large insurance companies in the state had board of directors receiving compensation ranging from $17,000 to $28,750 with the president of one board receiving $39,450. In comparison to another state which has a monopolistic workers' compensation system, we noted oversight commission members receive $2,000 for each meeting attended, not to exceed $18,000 in a year.

In comparison to other boards, WSI's Board of Directors' compensation is low.

According to WSI, there has been an increase in the number of applications received when there are Board vacancies. To ensure interest continues for Board vacancies, adequate compensation for work performed should be provided. A higher level of expectation is being established for Board members within this report. This higher level of expectation should result in additional compensation.

Recommendation 4-12

We recommend the Workforce Safety & Insurance Board of Directors increase the amount of compensation Board members receive.

Management's Response

NOT ABLE TO RESPOND: It would be inappropriate for the Board to take any position in relation to this recommendation without public discussion.

State Auditor's Concluding Remarks

We do not understand the Board's response to this recommendation. According to NDCC Section 65-02-03.2, the Board is responsible for determining the compensation Board members are entitled to receive for days spent in attendance at Board meetings or other business as approved by the Board. Thus, the Board is statutorily required to set its compensation.

Ensuring Information is Provided to All Members

On October 17, 2003, a Board of Directors meeting began with a motion to sever the employment relationship with the Executive Director. The minutes of the meeting reflect certain members were confused and apparently did not have information other members had. One member believed there had been a number of communications that had gone on that the entire Board had not been privy to. When the vote was taken to sever the employment relationship, 8 members voted yes, 2 voted no, and 1 attempted to abstain from voting. A representative of the Attorney General's Office informed the member a conflict of interest was needed to abstain. The member identified they did not have enough information and the Attorney General's Office representative informed them this did not constitute a conflict of interest. The member then voted no.

For the Board to make an informed decision, information available to certain Board members should be made available to all Board members prior to votes being taken on motions. When a motion is made at the beginning of a meeting for the Board to take such an action as it did, questions arise regarding whether discussions among Board members occurred prior to the meeting.

Recommendation 4-13

We recommend the Workforce Safety & Insurance Board of Directors ensure necessary and pertinent information is provided to all Board members before voting on motions.

Management's Response

CONCUR: The Board concurs that it should ensure necessary and pertinent information is provided to all Board members before voting on motions. Board leadership asserts that it works diligently to timely disseminate pertinent information to all Board members. Although there may be occasions where Board members may not have the exact same level of information, Board members assert they are able to make informed decisions.

Establishing a Plan for Vacancies of the Executive Director Position

The Board has no formal plan for actions it is to take when there is a vacancy in the Executive Director position.

When the former Executive Director was removed on October 17, 2003, the Board of Directors did not promptly select all members of a Search Committee. At the November 4 meeting, discussions were held regarding collection of information and the Chair of the Board was requested to appoint committee members by November 20. The Search Committee was still not identified and the Board was still updating the Executive Director job description at the meeting on November 20.

During the absence of the Executive Director, a Transition Team comprised of WSI Vice Presidents was established. The Board originally established a team of four excluding representation from one department the Board identified as important. A month after establishing the team, the Board voted to add another Vice President. The minutes of meetings reflect the Board did not define the expectations of the Transition Team. We noted the Vice Presidents of the organization did not have performance appraisals conducted in a timely fashion which would negatively impact the employees as salary increases are dependent upon a performance appraisal being conducted.

The Search Committee was responsible for reviewing applications for the open Executive Director position. Phone interviews were conducted with applicants, and four applicants were brought to the city for additional interviews. We noted WSI paid the expenditures of the spouse of at least one of the applicants. No formal guidance or policies were established by the Board regarding acceptable expenses for the second interview of candidates.

Recommendation 4-14

We recommend the Workforce Safety & Insurance Board of Directors establish a formal plan for actions it will take when the Executive Director position is vacant. The formal plan should, at a minimum:

a) Identify the Board's role and functions during the transition;
b) Establish appropriate Board committees in a timely manner;
c) Identify the payment of applicant interview expenses including expenses for second interviews; and
d) Identify how performance appraisals of employees reporting directly to the Executive Director position will be conducted.

Management's Response

CONCUR: The Board concurs that succession planning in this area is worthwhile. The Board will consider the provisions of this recommendation in its analysis to provide for the most appropriate succession and transition plan.

Clarifying the Executive Director's Expense Allowance

During the interviewing and selection process for the Executive Director position, the position's salary range and the fact the position does not include any bonuses or perks was clearly communicated to applicants. When the Board of Directors offers the open position to its first choice, the applicant requested a higher salary and the Board withdrew the offer. When discussing a salary offer for the second choice, the Board went into executive session. When the Board approved the hiring of the current Executive Director, the minutes identify an amount of a base salary "with a housing/business expense allowance of $18,000." Since the Board had gone into executive session to discuss the salary, no information available to the public was identified as to the reason for providing such an allowance (even though all applicants were specifically informed no such allowance would be offered) and what the allowance is to be used for. Neither the Chair of the Board nor the Executive Director indicated further guidance being provided on the allowance. We did note expenditures were incurred by the Executive Director which were reimbursed by WSI and appeared to relate to expenses which a typical business expense allowance would cover (this is further addressed in Chapter 1).

Recommendation 4-15

We recommend the Workforce Safety & Insurance Board of Directors formally document the types of expenses intended to be included in the Executive Director's expense allowance and clearly communicate this information to the Executive Director and the individual responsible for approving all Workforce Safety & Insurance expenditures.

Management's Response

DO NOT CONCUR: See Management's Response to Recommendation 1-8.

State Auditor's Concluding Remarks

The Board does not concur that clarification for an expense allowance is required. This statement concerns us considering the Board had specifically provided such an allowance to the Executive Director. The fact the Board decided to eliminate this account and include the amount as salary is irrelevant as this occurred after the concerns regarding the expense allowance were brought to management's and the Board's attention. We did not state such an allowance should not have been provided but noted clarification was needed.

Making Improvements with the Audit Committee

Two standing committees are established within the Board of Directors Bylaws. One is an Audit Committee which has a number of responsibilities. These include reviewing audit recommendations, monitoring the Executive Director's response to audit recommendations, and evaluating the performance of and providing a salary recommendation for the Directors of the Internal Audit Department and the Office of Independent Review. We noted the Audit Committee has not clearly established its processes, procedures, and responsibilities. In review of actions taken by the Audit Committee, we noted the committee was not following a Board motion related to performance related contracts.

Establishing a Charter

In a review of information regarding the Audit Committee, we noted the committee does not have an established charter. As a result, the Audit Committee is determining what responsibilities it has and the processes it will follow rather than appropriately having the Board establish such information. Guidance regarding charters is available from a number of sources and the Board should review such guidance prior to a charter being established.

Recommendation 4-16

We recommend the Workforce Safety & Insurance Board of Directors review guidance on audit committees and audit committee charters provided by the American Institute of Certified Public Accountants and The Institute of Internal Auditors and establish a charter for the Board Audit Committee.

Management's Response

CONCUR: The Board concurs it should review guidance on audit committees and audit committee charters. The Board Audit Committee will review information to determine if a charter would be beneficial above and beyond the guidelines established within the existing Board bylaws and governance policies.

Making Changes with the Employee Fraud Hotline

WSI has established an employee fraud hotline which provides a phone number WSI employees can call to report potential fraudulent activity (WSI also has a fraud hotline for reporting injured worker, employer, and provider fraud). While the call for the employee fraud hotline goes to an outside CPA firm, the issues are then reported to the Chief of Support Services and the Director of Human Resources. This information should be sent to an independent party, such as Internal Audit. The Board Audit

Committee is responsible for compliance with laws, regulations, and ethics. The Audit Committee should provide oversight of a fraud hotline.

Recommendation 4-17

We recommend the Workforce Safety & Insurance Board of Directors Audit Committee ensure all information obtained from the organization's internal employee Fraud Hotline is sent directly to Internal Audit.

Management's Response

CONCUR: The internal employee fraud hotline reports will be routed to the Internal Audit Manager who will then follow the directives under the "Responsibility" section of the Internal Audit Charter.

Complying with Board Motions

A motion was approved at the November 20, 2003 Board meeting requiring the Audit Committee be informed of performance related contracts that have an estimated cost of $100,000 for the biennium. While the motion specifically states the Audit Committee is only to be informed of performance related contracts, we noted the Audit Committee passed motions to approve a contract, to approve the awarding of a contract extension, to approve a WSI staff recommendation to renew a contract, and to approve WSI to move forward with a request for proposal. In February 2005, there was confusion regarding Board policy for requiring request for proposals for services exceeding $100,000.

Recommendation 4-18

We recommend the Workforce Safety & Insurance Board of Directors Audit Committee comply with the Board's motion regarding performance related contracts or take appropriate action to have the Board pass a motion which clarifies the Audit Committee's role with performance related contracts.

Management's Response

CONCUR: At its October 12, 2006, Board meeting, the Board voted to forgo the mandated board oversight of contracts in excess of $100,000.

Audit and WSI Background Information

Purpose and Authority of the Audit

The performance audit of aspects of Workforce Safety & Insurance (WSI) was conducted by the Office of the State Auditor pursuant to authority within North Dakota Century Code Chapter 54-10. WSI is required by state law to have a biennial performance evaluation conducted. Certain elements within the Request for Proposal, issued by the Office of the State Auditor, for a consultant to conduct the performance evaluation were not awarded. Instead, these elements were considered as part of this performance audit.

A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action. The purpose of this report is to provide our analysis, findings, and recommendations regarding our limited review of WSI.

Background Information

WSI is the sole provider of workers' compensation insurance in the state. This requires employers to purchase workers' compensation from the state fund.

In 1997, the Legislature passed legislation to create a Board of Directors to govern WSI, removing such authority from the Governor. The Board is comprised of 11 members representing employers (6), employees (3), and medical providers (1) with one member appointed at large (1). The Board is to ensure continuity of leadership at WSI and to ensure WSI operates efficiently and effectively.

WSI is organized into three major departments – Employer Services, Injury Services, and Support Services. Other major functions include General Counsel, Special Investigations Unit, Communications, Strategic, and two departments which report to the Board Audit Committee – Internal Audit and Office of Independent Review.

Prior to employer dividend credits, employer premiums exceed $100 million a year. WSI has over $1 billion in investments. The organization is a specially funded state agency with a one line item appropriation. WSI's budget for the 2005-2007 biennium was approximately $33.3 million ($1.1 million more than the previous biennium) and WSI was authorized 223.24 full-time equivalents (FTE).

Goals of the Audit

North Dakota Century Code Section 54-10-01 requires our office to conduct performance audits in accordance with generally accepted government auditing standards. The goals of our audit, listed below, include the necessary elements of a performance audit conducted in accordance with generally accepted government auditing standards.

Goal One

Has Workforce Safety & Insurance established an adequate procurement system?

Goal Two

Has Workforce Safety & Insurance established an adequate human resource management system?

Goal Three

Are adequate policies and procedures established to provide appropriate leadership and accountability for Workforce Safety & Insurance?

Scope and Methodology

This audit was conducted in accordance with generally accepted government auditing standards and includes appropriate performance auditing and evaluation methods. Audit field work was conducted from the end of March 2006 to the end of October 2006. The audit period for which information was collected and reviewed was July 1, 2003 through March 31, 2006. In certain instances, additional information was reviewed. This was due, in part, to obtain and review recent information related to the organization and actions taken by WSI related to salary increases required by law. Specific methodologies are identified in the respective chapters of this report.

Board and WSI Comments Regarding the Audit

From the very start of this performance audit, it was evident to our office the Board and executive management of WSI were against a performance audit being conducted. There were comments made by both the Board and WSI management which appeared unprofessional and inappropriate and led to a negative tone being set at the beginning of the audit. Examples used to make this conclusion include:

- At the February 8, 2006 Board Audit Committee meeting, representatives of the Office of the State Auditor provided information to the Audit Committee regarding the performance audit. It became clear the Audit Committee was against the performance audit. The Chair of the Audit Committee attempted to interpret Government Auditing Standards and it became obvious, he did not correctly understand the standards. The Chair of the Audit Committee also sent emails to the Executive Director and individuals of a newspaper stating he did not support the performance audit and the audit was not welcome. It is concerning to the Office of the State Auditor that a chair of an Audit Committee would act in such a manner. Based on the information contained in this audit report, it is obvious to the Office of the State Auditor such a performance audit was needed in the areas reviewed.
- A representative of the Office of the State Auditor provided information to WSI employees at an all employee meeting on February 9, 2006. After this presentation concluded, the Executive Director's opening comments to employees were he encouraged everyone to fill out the employee survey as it was a great opportunity to get information from an independent source. The Executive Director then stated they did not agree with the

performance audit. The Executive Director stated he disagreed with the performance audit piece on how management was running the organization and human resources as he considers that to be management. The Executive Director stated if the State Auditor's Office wanted to do all that, than his personal opinion was that the State Auditor's Office should apply for his job and get the Board to dump him.

- At the same employee meeting as noted in the previous bullet, the Chair of the Board of Directors addressed the employees. The first comment the Chair had was the meeting was a boring session as far as he was concerned. It should be noted the Chair was not invited to this meeting so it was unclear to us why the Chair attended. The State Auditor's Office had attempted to meet with employees of WSI without executive management present. This request was made to allow employees an opportunity to feel more comfortable and to ask questions which may not have been asked if executive management was present. The Executive Director denied our request for this and insisted he and executive management attend the meeting.

Appendices

List of Recommendations

Recommendation 1-1

We recommend Workforce Safety & Insurance take appropriate action to formally establish an adequate procurement system. The organization should, at a minimum:

a) Ensure purchasing policies are thoroughly documented, communicated to appropriate employees, and implemented;
b) Centralize recordkeeping of procurement information; and
c) Establish an adequate monitoring process to monitor compliance with laws, Office of Management and Budget guidelines, and the organization's policies.

In establishing a formal procurement system, the organization should ensure changes are made to address all areas identified in the report as requiring improvement, including compliance issues.

Recommendation 1-2

We recommend the Workforce Safety & Insurance Procurement Office be involved at the beginning of all competitive, limited competitive, noncompetitive, and negotiated purchases.

Recommendation 1-3

We recommend Workforce Safety & Insurance make improvements with how public funds are used. The organization should, at a minimum:

a) Ensure expenditures comply with constitutional provisions, North Dakota Century Code requirements, and OMB Policies; and
b) Ensure expenditures are for necessary and reasonable purposes.

Recommendation 1-4

We recommend Workforce Safety & Insurance use the established evaluation and selection methodology to ensure fairness in awarding contracts.

Recommendation 1-5

We recommend Workforce Safety & Insurance ensure contracts are in place before work commences or continues on an expired contract.

Recommendation 1-6

We recommend Workforce Safety & Insurance ensure contracts are not paid until the services have been performed to the organization's satisfaction.

Recommendation 1-7

We recommend Workforce Safety & Insurance formally analyze potential temporary employee relationships to ensure contractors are not hired as temporary employees.

Recommendation 1-8

We recommend Workforce Safety & Insurance make improvements related to reimbursements to the Executive Director. The organization should, at a minimum:

a) Require the Executive Director to use his business expense allowance;
b) Ensure the person preparing the Executive Director's voucher is not the person approving the voucher and is not a person reporting directly to the Executive Director; and

c) Ensure the person approving the reimbursements has sufficient knowledge of the Board of Directors' intent relating to the Executive Director's business expense allowance.

Recommendation 1-9

We recommend Workforce Safety & Insurance make improvements with reimbursing employees for taxes already paid by employees. The organization should, at a minimum:

a) Ensure tax reimbursement payments are reasonable and done in accordance with established agreements;
b) Attempt to recover the amounts improperly paid to employees; and
c) Ensure requests made to the Chair of the Board of Directors are reasonable.

Recommendation 1-10

We recommend Workforce Safety & Insurance comply with legislative intent and apply expenditures to the appropriate biennium.

Recommendation 2-1

We recommend Workforce Safety & Insurance improve the employee performance appraisal process and ensure the pay for performance system operates in an effective manner. The organization should, at a minimum:

a) Ensure the performance appraisal process is adequately monitored for compliance with policies including appraisals being completed annually;
b) Establish the criteria to be used for measuring performance at the beginning of an appraisal period;
c) Update performance appraisal policies in a timely manner;
d) Have supervisors evaluated by those they supervise; and
e) Provide training to employees related to properly completing performance appraisals.

Recommendation 2-2

We recommend Workforce Safety & Insurance comply with North Dakota Century Code Section 54-06-21 and ensure performance appraisal forms are signed by employees before placing them in personnel files.

Recommendation 2-3

We recommend Workforce Safety & Insurance establish a consistent and uniform process for hiring employees. The organization should, at a minimum:

a) Ensure selected applicants meet minimum qualifications of the position;
b) Centralize the hiring process within the Human Resource Department;
c) Establish a formal screening process and standardized scoring system which is consistently applied to all applicants;
d) Ensure questions asked of applicants are relevant and pertain to the position's primary duties; and
e) Verify work experience and education for all individuals hired.

Recommendation 2-4

We recommend Workforce Safety & Insurance establish formal policies and procedures for the hiring process to provide clear guidance and enhance consistency in the process.

Recommendation 2-5

We recommend Workforce Safety & Insurance comply with veterans' preference requirements in North Dakota Century Code Chapter 37-19.1. The organization should, at a minimum:

a) Review veterans' preference requirements with the Office of the Attorney General and modify hiring procedures accordingly; and
b) Use certified mail to notify veterans of their nonselection.

Recommendation 2-6

We recommend Workforce Safety & Insurance use a competitive hiring process for all positions but document information as to how an appointment is being done on a nonpartisan, merit basis if the Executive Director makes an appointment without a competitive process.

Recommendation 2-7

We recommend Workforce Safety & Insurance ensure it complies with legislative intent related to employee compensation adjustments.

Recommendation 2-8

We recommend Workforce Safety & Insurance ensure payments made to employees comply with the bonus program requirements within North Dakota Century Code Chapter 54-06.

Recommendation 2-9

We recommend Workforce Safety & Insurance make improvements with how investigations of incidents involving employees are conducted. The organization should, at a minimum:

a) Ensure investigations are conducted by an independent source who is free of conflicts of interests;
b) Ensure individuals conducting investigations receive proper training;
c) Have interview sheets signed by the interviewee, specifically when interviews are conducted in a one-on-one setting; and
d) Ensure final investigation reports are signed and dated.

Recommendation 2-10

We recommend Workforce Safety & Insurance make improvements with actions taken related to results and recommendations of investigations involving employees. The organization should, at a minimum:

a) Document actions taken or the justification for no actions taken in relation to recommendations from investigations;
b) Improve the monitoring of actions to be taken;
c) Document the reasons for changing conclusions or recommendations of investigations; and
d) Have results of investigations provided to the Board of Directors Audit Committee when the investigation involves the Executive Director.

Recommendation 2-11

We recommend Workforce Safety & Insurance promptly notify the state's Risk Management Division of issues where there is a potential for a claim to be filed against the state including all issues related to harassment.

Recommendation 2-12

We recommend Workforce Safety & Insurance periodically monitor and evaluate the classification and pay for performance systems to ensure they are operating effectively and are accomplishing what WSI intends.

Recommendation 2-13

We recommend Workforce Safety & Insurance ensure changes made to pay ranges within the classification system are based on a formal evaluation process.

Recommendation 2-14

We recommend Workforce Safety & Insurance make improvements with how turnover rates are calculated, presented, and reviewed. The organization should, at a minimum:

a) Ensure a standard, consistent turnover rate is used;
b) Have only one department responsible for calculating and tracking turnover;
c) Properly identify turnover rate information if differences in calculations exist; and
d) Identify turnover rate information by department and review areas where significant increases are occurring.

Recommendation 2-15

We recommend Workforce Safety & Insurance establish a formal procedure to periodically review the Policy Handbook, make the necessary changes, and date changes accordingly.

Recommendation 2-16

We recommend Workforce Safety & Insurance end all incentive pay programs for their employees and ensure appropriate payment adjustments are made.

Recommendation 2-17

We recommend Workforce Safety & Insurance review and re-evaluate the reasonableness of a 7.5% standard for absenteeism. The organization should, at a minimum:

a) Ensure the absenteeism standard is not lower than the amount of annual leave employees are entitled to use in a year;
b) Ensure the absenteeism standard includes consideration for a reasonable amount of sick leave; and
c) Ensure leave taken under the Family Medical Leave Act or compensation earned under the Fair Labor Standards Act is not included in the calculation of the absenteeism rate.

Recommendation 3-1

We recommend the Workforce Safety & Insurance Executive Director make improvements with actions taken in order to increase morale of the organization. While this will encompass a number of areas, the Executive Director should, at a minimum:

a) Ensure actions taken are not resulting in preferential treatment and/or favoritism; and

b) Follow through with commitments or promises, ensure unreasonable commitments are not made, and notify all applicable parties if promises or commitments are unable to be adhered to.

Recommendation 3-2 We recommend Workforce Safety & Insurance take appropriate action to have an effective open door policy under which employees can bring issues to management without actual retaliation or fear of retaliation.

Recommendation 3-3 We recommend Workforce Safety & Insurance make significant, timely improvements related to communication between executive management and other employees of the organization.

Recommendation 3-4 We recommend Workforce Safety & Insurance comply with legislative intent and ensure the Special Investigations Unit's resources are used appropriately.

Recommendation 3-5 We recommend Workforce Safety & Insurance comply with contractual provisions and ensure the Department of Transportation's driver's license image program is accessed for official use only.

Recommendation 3-6 We recommend Workforce Safety & Insurance use resources in an efficient and proper manner to ensure the use of resources does not result in abuse.

Recommendation 3-7 We recommend Workforce Safety & Insurance establish and implement its strategic plan in a timely manner, once the Board of Directors establishes revised outcomes. The organization should, at a minimum:

a) Review and modify its mission;
b) Reevaluate the purpose and other structural elements of the strategic plan;
c) Ensure employee involvement is obtained when developing the plan; and
d) Ensure information related to completion of strategies is accurate.

Recommendation 3-8 We recommend Workforce Safety & Insurance include relevant strategic planning information and the Board of Directors' Outcomes on their web site.

Recommendation 3-9 We recommend Workforce Safety & Insurance take appropriate steps to ensure information it provides is accurate.

Recommendation 3-10 We recommend Workforce Safety & Insurance implement succession planning as an ongoing process to identify, assess, and develop talent to ensure leadership and management continuity throughout the organization.

Recommendation 3-11	We recommend Workforce Safety & Insurance ensure adequate planning, including consideration for impact on staff time and other resources, is conducted prior to changes and training on management philosophy is implemented.
Recommendation 3-12	We recommend Workforce Safety & Insurance move the Quality Assurance Director's function of facilitating implementation of recommendations to Internal Audit.
Recommendation 3-13	We recommend Workforce Safety & Insurance conduct an in-depth review of the staffing level of Internal Audit and determine an adequate staffing level for Internal Audit to effectively fulfill its mission.
Recommendation 3-14	We recommend Workforce Safety & Insurance significantly increase their blanket bond coverage amount.
Recommendation 3-15	We recommend Workforce Safety & Insurance correctly calculate premium dividend credits and take appropriate action to recover lost premium amounts.
Recommendation 4-1	We recommend the Workforce Safety & Insurance Board of Directors comply with legislative intent and effectively govern the organization.
Recommendation 4-2	We recommend the Workforce Safety & Insurance Board of Directors formally establish its role regarding when Board involvement and/or approval is required.
Recommendation 4-3	We recommend the Workforce Safety & Insurance Board of Directors comply with the Carver Policy Governance Model.
Recommendation 4-4	We recommend the Workforce Safety & Insurance Board of Directors obtain additional education and training on the Carver Policy Governance Model.
Recommendation 4-5	We recommend the Workforce Safety & Insurance Board of Directors establish Outcomes that determine what good the organization is to accomplish, for whom, and at what cost or relative worth.
Recommendation 4-6	We recommend the Workforce Safety & Insurance Board of Directors establish detailed, measurable performance criteria within the Outcomes and Executive Limitations policies.
Recommendation 4-7	We recommend the Workforce Safety & Insurance Board of Directors establish a separate monitoring report for the purpose of determining whether board expectations, set in its Outcomes and Executive Limitations policies, are being fulfilled.

Recommendation 4-8

We recommend the Workforce Safety & Insurance Board of Directors periodically conduct an evaluation on the Board's and individual members' performance including each committee's and individual committee members' performance.

Recommendation 4-9

We recommend the Workforce Safety & Insurance Board of Directors improve the governance process used once Outcomes are established or modified. The Board should, at a minimum:

a) Timely incorporate changes into policy; and
b) Adequately monitor the organization's progress in developing a plan to accomplish the Outcomes.

Recommendation 4-10

We recommend the Workforce Safety & Insurance Board of Directors evaluate the Executive Director's performance solely on established criteria in Outcomes and Executive Limitations policies which measure the degree of organizational success.

Recommendation 4-11

We recommend the Workforce Safety & Insurance Board of Directors Executive Performance Committee provide a salary recommendation for the Executive Director after evaluating the Executive Director's performance.

Recommendation 4-12

We recommend the Workforce Safety & Insurance Board of Directors significantly increase the amount of compensation Board members receive.

Recommendation 4-13

We recommend the Workforce Safety & Insurance Board of Directors ensure necessary and pertinent information is provided to all Board members before voting on motions.

Recommendation 4-14

We recommend the Workforce Safety & Insurance Board of Directors establish a formal plan for actions it will take when the Executive Director position is vacant. The formal plan should, at a minimum:

a) Identify the Board's role and functions during the transition;
b) Establish appropriate Board committees in a timely manner;
c) Identify the payment of applicant interview expenses including expenses for second interviews; and
d) Identify how performance appraisals of employees reporting directly to the Executive Director position will be conducted.

Recommendation 4-15

We recommend the Workforce Safety & Insurance Board of Directors formally document the types of expenses intended to be included in the Executive Director's expense allowance and clearly communicate this information to the Executive Director and the individual responsible for approving all Workforce Safety & Insurance expenditures.

Recommendation 4-16

We recommend the Workforce Safety & Insurance Board of Directors review guidance on audit committees and audit committee charters provided by the American Institute of Certified Public Accountants and The Institute of Internal Auditors and establish a charter for the Board Audit Committee.

Recommendation 4-17

We recommend the Workforce Safety & Insurance Board of Directors Audit Committee ensure all information obtained from the organization's internal employee Fraud Hotline is sent directly to Internal Audit.

Recommendation 4-18

We recommend the Workforce Safety & Insurance Board of Directors Audit Committee comply with the Board's motion regarding performance related contracts or take appropriate action to have the Board pass a motion which clarifies the Audit Committee's role with performance related contracts.

Chapter 1 Supplemental Responses & Concluding Remarks

Management's Response to Recommendation 1-1

This is why in March of 2005 WSI management created the role of a dedicated Procurement Officer. The individual selected for the position had all of their duties unrelated to procurement reassigned and was given a salary increase commensurate with the new role. Additionally, all agency contracts were centralized under their oversight. Their primary role was to assure the agency followed all applicable procurement guidelines. This unit is now under the administration of a new Procurement Officer and every effort necessary continues to be utilized to assure WSI is in compliance with all applicable purchasing policies.

While, WSI concurs with the recommendation, there are several statements made within the narrative which management would like to clarify. Management readily admits there were errors within its procurement documentation; however, these errors were unintentional. Additionally, many of the identified issues relate to WSI not fully following its internally-adopted and more-stringent guidelines. It should also be noted, that many of the items referenced in the audit had been accepted purchasing practices at WSI for many years prior to the current leadership team being instituted. Numerous documents show the Procurement Officer not only supported but approved identical items. Documents from managers who held authority over the procurement process at that time demonstrate that at no time were they put on notice of any of these issues. Since many of the cited actions were practiced for years by the Organization and/or existed in WSI's Employee Policy Handbook, the current leadership was under the advisement that the practices were proper.

Finally, relating to one of the printing instances, below are quotes from a follow-up e-mail sent by the Executive Director to the project coordinator. These statements demonstrate a continued commitment to following all applicable rules/laws/policies: *"the procurement law being law and critical to obey;" … "was it not someone's obligation to assist the agency in sailing through the waters legally to fulfill its needs;" … and, "I do not see a willful attempt by anyone to break any laws here; however, what I see is poor planning and budgeting that caused individuals to react instead of act."*

State Auditor's Concluding Remarks

While WSI states the role of the Procurement Officer was created to ensure it had an adequate procurement system, this role could only be fulfilled if the Procurement Officer was properly included in all processes. A number of the problems noted with procurement relate to executive management circumventing controls and not properly including the Procurement Officer in the process. Procurement processes reviewed involving the Procurement Officer were, for the most part, handled in an appropriate manner.

Management's Response to Recommendation 1-2

Within the narrative of this recommendation, implications are made that a bid may have been artificially fragmented. The allegation assumes that the $10,500 spent on books and $16,000 spent on training should have actually been one bid. If these two expenditures were combined, then WSI should have used a formal, sealed-bid procurement process; however, the purchases were two legitimately separate purchases. WSI required both the *Counselor Salesperson* Wilson Learning training material as well as a certified Wilson Learning trainer that would customize the training for WSI's safety professionals; however, they did not necessarily have to be provided from a single vendor. Additionally, due to the fact that WSI wanted to be assured that the training material was received before the July 13, 2005, training date, as well as assure the appropriate time and steps to properly bid for the trainer were followed, the purchases were legitimately made as two separate acquisitions.

Another item discussed within the narrative referenced a vendor that was selected for an annual retainer associated with managerial consulting services. This narrative stated that the vendor should have been eliminated because of an exclusion of four specifications. The specifications section of the Request for Telephone Quote on file states that WSI bidding for: "4 days per month – total of 48/year with the following *potential* services rendered under the monthly contract. (Emphasis Added) The specifications then lists eight "potential" areas of services that each vendor then considered, weighted, and bid upon. Based on the bids provided, WSI chose the lowest vendor who was $45,600 lower that one bidder and $189,600 less than another bidder. In their bid, the selected vendor did list a cost for the other potential areas that even if added into the bid would still have been a lower bid than the other two.

As a final note, management is highly concerned about the following comments found in the preceding narrative:

> *"The apparent override of procurement processes and procedures raises concerns related to executive management. Such behavior sets a negative tone at the top regarding compliance with laws and established policies and procedures. Not only does such behavior set a negative tone at the top, but such instances also require the information to be used in assessing the potential for fraud. As indicated by professional guidance, when management is willing to override internal controls, the level of fraud risk is higher."*

WSI management takes its legal, ethical, and public trust responsibilities seriously and agrees that if such activity were occurring at WSI it would set a negative tone; however, no such activity has ever been condoned or intentionally practiced under the current management. While management readily admits that some procurement mistakes were made, they were not made willfully or intentionally. Consequently, management feels it is potentially injurious to the agency's reputation that there were apparent overrides of the procurement process. It should be noted that the entire crux of the statement rests on the word "*apparent*." The American Heritage Dictionary defines apparent as "Appearing as such but not necessarily so" and the Merriam-Webster Dictionary defines it as "manifest to the senses or mind as real or true on the basis of evidence that may or may not be factually valid."

State Auditor's Concluding Remarks

WSI states the Wilson Learning training material as well as a certified Wilson Learning trainer did not necessarily have to be provided from a single vendor. In most seminars or when training is provided, the presenter is responsible for providing materials. WSI did end up using the same vendor for both purchases which further supports our conclusion. One purpose for making the purchases separately was to avoid formal bidding requirements (when the two are properly combined, the threshold requiring formal bids is met). Another purpose for making the purchase separately was to allow WSI to receive the books in one biennium even though they were not intended to be used until the following biennium. We question whether legislative intent related to the appropriation process is complied with when an agency receives goods in one biennium which it fully anticipates not using until the following biennium.

WSI states it selected the lowest vendor for managerial consulting services. When the awarded bid is less than $15,000 and other bids are over 4 times and 13 times more, it is evident comparative bids were not obtained. WSI states eight potential areas of services were considered, weighted, and bid upon by the vendors. It is unclear how WSI came to this conclusion based on the information we reviewed in the phone quote documentation. We question whether the other two vendors were even made aware the bids could be made on certain services or that they could pick and choose what to bid upon.

WSI states it takes its legal, ethical, and public trust responsibilities seriously and agrees if such activity ("apparent override of procurement processes and procedures") were occurring it would set a negative tone. Our audit and this report identifies management did not follow established policies and procedures and this sets a poor example for the rest of the organization.

WSI provides information related to the use of the term "apparent." We attempted to explain the reason for using such terminology in our performance audit reports but management either ignored this information or did not understand our explanation. Such language has been used by our office in performance audits dating back to the early 1990's.

Management's Response to Recommendation 1-3

In January of 2005, WSI worked with the legislature to establish specific appropriation authority to assure WSI was making prudent and discretionary payments for the promotion/support of the agency. Just prior to the additional appropriation authority being amended into WSI's budget bill, OMB noted that WSI was already a "promotional agency" and thus already had this authority. As a result, the amendment for additional appropriation authority was withdrawn. In February of 2005, in order to ensure WSI strictly followed the promotional agency rules, the Executive Director wrote OMB to ask for compliance guidance:

> *"I was seeking some guidance from you on the actual guidelines and allowances of the program (meals, alcohol, travel, etc.). We want to assure that we are meeting and exceeding every guideline established for the program."*

OMB responded:

> *"You are referring to OMB fiscal policy 207 related to promotional expenses when you say WSI already has the ability to purchase meals, etc. with detailed receipts and justification . . . The policy does not state what is allowed and what is not allowed. The only guideline given is that "agencies are expected to use restraint and common sense in authorizing these types of expenses.""*

WSI welcomes the opportunity to have legislative committees as well as other public officials on-site to educate and inform legislators on the agency's legislative policy proposals and other issues relevant to the organization. The meals were provided in accordance with applicable policy guidelines. Additionally, WSI believes it is the state's best interest to provide legislators with opportunities to learn about national legislative initiatives and industry best practices and advancements affecting workers' compensation.

Under the provisions of 65-02-01.2 carnations are given to employees in appreciation for their years-of-service at WSI. This has historically been part of Human Resource's (HR) rewards and recognition program. The process of recognizing and rewarding employees with a flower on their anniversary date of employment has been in place for 2-3 years and the process of recognizing and rewarding employees with gift certificates has been in place for over 6 years.

State Auditor's Concluding Remarks

WSI references OMB Policy 207 which identifies a list of state agencies authorized to incur promotional expenses. This policy states agencies are expected to use restraint and common sense in authorizing these types of expenses. In review of expenditures incurred by WSI, we conclude WSI did not exercise prudent restraint in the use of public funds.

WSI states the purchase of carnations for employees is done so under the provisions of NDCC Section 65-02-01.2 which authorizes WSI to establish its own personnel system. While WSI is allowed to establish its own personnel system, this provision would not allow the organization to be in noncompliance with constitutional provisions that public funds be used for public purposes.

Management's Response to Recommendation 1-4

Within the narrative, though, the auditor notes a situation where they "identified WSI inappropriately changed the evaluation methodology after proposals were received" because "WSI management believed members of the evaluation team may not have been acting in good faith and thus, required the change to occur." The statement points to a situation in which WSI had concerns relating to discrepant scoring by a member of the review team. WSI could have removed the member and replaced them with a new member; however, due to the complexity of the issue and the inability to replicate the vendor presentations, this was not an available option. WSI had to take some form of action though, and chose to drop the high and low scores of the evaluation committee. The decision to drop these scores was made by the Project Sponsor in consultation with WSI's Procurement Officer who advised the Project Sponsor that they had discussed the issue with an OMB representative. As a result of this narrative, WSI again contacted a representative from OMB to verify its actions were appropriate. When the situation was explained, the representative stated the committee had a responsibility to do something. The representative stated that the procurement guidelines are devoid of guidance in a situation similar to the one referred to; however, some form of corrective action was necessary.

State Auditor's Concluding Remarks

WSI states it had concerns relating to discrepant scoring by a member of the review team and chose to drop the high and low scores of the evaluation committee. We do not conclude as to whether there was discrepant scoring or not. We are not aware of information or a review being conducted to determine whether this alleged member had actually inappropriately scored information. In addition, if one member was alleged to have discrepant scoring, we question how WSI determined the discrepant scoring involved only one member of the review team as no documentation was identified of an investigation or review being performed. While we do not imply other members of the review team could have been involved, there appears to be no determination made if other members' scoring should have been questioned.

WSI states a representative from OMB was again contacted to verify its actions were appropriate. WSI notes the representative stated the committee had a responsibility to do something. However, WSI does not state whether the OMB representative verified its actions were appropriate or not. While we agree something had to be done, we question the dropping of the high and low scores of the evaluation committee as the most appropriate action to take.

Management's Response to Recommendation 1-10

Policy 200 outlines the appropriate procedure for the receipt and payment of both of these goods or services. In part, Policy 200 specifically states:

> *The general rule is that expenditures are to be charged to the fiscal year in which the goods or services were received. Guidance can be found in the Office of Management and Budget's (OMB) Fiscal and Administrative Policy 201. According to that policy, "… all goods and services ordered and received prior to June 30 must be charged to the biennial appropriation for the period ending June 30. Goods and services received after June 30 are obligations of the biennial appropriation beginning July 1." It further states "This policy prohibits receiving goods and services in July and charging the cost to the previous biennium, as well as improperly charging a new biennium for past biennial costs."*
>
> *In certain cases, expenditures are allowed to be paid prior to the goods or services being received. One instance is when prepayment is a requirement of the contract, such as in the case of certain rental payments or insurance payments. Another instance is when a discount is offered for early payment, such as when purchasing airline tickets. However, there are very few exceptions to the general rule.*

Based upon the narrative, there were predominantly two items in question which accounted for $23,000 of the $24,600. The first item ($10,500) related to the purchase of training materials for a workshop that was to be held July 13-16, 2005. In order to assure WSI receive the necessary and required training materials in advance of the scheduled workshop, the materials were ordered and received before June 30, 2005. Per OMB Policies 200 and 201, these items were properly expensed to the correct biennium as "all goods and services ordered and received prior to June 30 must be charged to the biennial appropriation for the period ending June 30."

The second item ($12,500) was a follow-up review relating to recommendations within the 2004 Performance Evaluation. By contract, WSI agreed to pay the vendor one-half up front to cover expenses (travel, lodging, etc…) as well as some of the audit work which was to occur before June 30 of the biennium. On-site work for this review commenced on June 28, 2005. Per OMB Policy 200, the payments were appropriately applied to the correct biennium.

State Auditor's Concluding Remarks

WSI states the training materials were ordered and received before June 30, 2005. WSI had inappropriately split the purchase of the training materials and selection of the presenter into two purchases. While WSI did receive the materials before June 30, the materials were purchased for an event which was to occur in the following biennium. WSI had more than sufficient funds available in the 2003-2005 biennium. We question whether legislative intent related to the appropriation process is complied with when an agency receives goods in one biennium which it fully anticipates not using until the following biennium.

WSI states it agreed to pay a vendor one-half up front to cover expenses and believes the payments were appropriately applied to the correct biennium. The pre-payment does not comply with OMB policy. The policy identifies there are very few exceptions to the general rule and the pre-payment made by WSI would not be an acceptable exception to the policy. One reason such a pre-payment is made for this contract would be to attempt to use moneys from the 2003-2005 biennium. WSI had more than sufficient funds available at the end of this biennium.

Chapter 2 Supplemental Responses & Concluding Remarks

Management's Response to Recommendation 2-1

CONCUR (a, b, c, e): As noted in the narrative, the Board had asked the Executive Director to review the pay-for-performance system because they had some concerns that it may not be functioning as well as they had originally expected. In order to enhance the effectiveness of the pay-for-performance process, WSI began an informal bid process in January of 2006 to acquire a new performance management system. In August of 2006, WSI began the implementation of a new electronic Employee Performance Management (EPM) system. The new appraisal process includes the transition from reviewing employees on anniversary date to a single, focal-review period. This new appraisal process will also help ensure that each employee receives a timely review with an electronic signature. Additionally, it provides tools to allow employees to be more actively involved as-well-as informed about their performance. The criteria for the performance evaluations were identified in conjunction with input from WSI employees and their supervisors. Training for all employees as well as supervisors on how to effectively navigate and utilize the EPM system was conducted in August 2006.

Concerning the statement in the narrative that "Documentation related to employees' goals and objectives for the evaluation period do not appear to be completed prior to the beginning of the period under review. Evaluation criteria must be developed and communicated to employees at the beginning of the appraisal period;" it is WSI's current practice to communicate evaluation criteria with employees at the beginning of the appraisal process. The performance planning goal sheets are submitted at the time of review for filing purposes. The form would not be located in the personnel file until after the review was complete.

DO NOT CONCUR (d): While WSI agrees enhancements to the pay-for-performance appraisal process were necessary; WSI does not concur that supervisors should be evaluated by those they supervise. Peer-reviewed literature notes that 360° feedback should not be used for direct evaluation of any employee. There are a number of ways an individual may react to a 360° appraisal process. Many researchers have addressed this issue from an emotional perspective; specifically negative employee reactions which can lead to interpersonal problems. Although the use of such performance appraisal systems is on the rise (DeNisi & Kiuger, 2000), scholars have noted a number of problems with 360° performance systems and documented negative perceptions and impacts of such use.

Management's Response to Recommendation 2-3

The preceding narrative states: "We noted a question was asked during the interview of two applicants which was technically specific and we could not determine the relevancy of the question as it related to the position. We did note one of the two applicants did have a technical background and knowledge in this area and this applicant was also an acquaintance of the supervisor of the position who was involved in the interview process." Its purpose was to identify the experience and actual knowledge, skills, and abilities of the two safety professionals who were interviewed. Management felt and still feels that the question referenced was relevant to the technical safety position being filled and had nothing to do with any acquaintances of the supervisor.

State Auditor's Concluding Remarks

Regarding WSI's response, the hiring process was for the Director of Loss Prevention. A question asked during the interview was "A radio isotope has a ½ life of 1 year. How many years will it take to reduce the initial activity to less than 10%?" This question was worth 10 points on a 100 point scale and we were unable to determine the relevancy of such a specific question based on the position's job description.

Management's Response to Recommendation 2-8

The Organization (WSI) is unable to identify anything which prohibits this practice. The documented intention was properly noted as a salary adjustment in each case and all financial documentation is consistent with this practice. Black's Law Dictionary, 7th ed. West Group 1999, defines Bonus as:

> *A premium paid in addition to what is due or expected…In the employment context, worker's bonuses are not a gift or gratuity; they are paid for services or on consideration in addition to or in excess of the compensation that would ordinarily be given.*

In no respect can it be alleged the identified employees were paid "in addition" to what was "due or expected." In fact, they received less than what was due, expected or ordinarily given. Consequently, based on the way these salary adjustments were accounted for and documented, WSI is without basis for any characterization of the payments other than salary increases based upon WSI's pay-for-performance system. Any form of payment, whether salary or otherwise, are "payments made for retaining employees or to reward performance."

State Auditor's Concluding Remarks

WSI states any form of payment would be for "payments made for retaining employees or to reward performance." While we do not disagree with this statement, when such payments are retroactively applied, we categorize such payments as bonuses.

Management's Response to Recommendation 2-9

When the following e-mail chain is reviewed, it outlines the reasoning and the justification for this directive:

From: (Executive Director)
Sent: Thursday, May 26, 2005 10:45 AM
To: (Chief of Support Services)
Cc: (HR Employee)
Subject: FW: XXXXXXX Funeral

As you know, an anonymous allegation of time falsification was raised against (Employee), (Employee), (Employee), (Employee), (Employee), and (Executive Director). I am now of the understanding that the initial allegation was filed with WSI's Human Resources department and then routed to Internal Audit. I am writing to request a copy of the final investigation report. If one does not exist, then I am asking that a full and formal investigation be opened into the issue and that it be appropriately documented and filed. The policies and the integrity of the organization as well as the integrity of those accused requires that this be done. If appropriate action is to be taken then it should be enacted and documented. A full investigation should included how and why the concerns came about as well as who made the public request to review the documentation that led to the investigation. Simply because I am involved should not stop us from following every formal policy and procedure. Thank you for your assistance in this investigation.

From: (Executive Director)
Sent: Thursday, May 26, 2005 11:51 AM
To: (Board Member); (Board Member); (Board Member)
Cc: (Internal Audit Manager)
Subject: FW: XXXXXXX Funeral

FYI - I am not asking to be treated any differently (positively or negatively) than anyone else. As per our operating procedures, a full and final investigation with findings should be conducted and filed with the organization.

From: (Internal Audit Manager)
Sent: Thursday, May 26, 2005 12:03 PM
To: (Executive Director); (Board Member); (Board Member); (Board Member)
Subject: RE: XXXXXXX Funeral

Because of the staff involved and their reporting relationships, I think the proper procedure will be for the Internal Audit Department to do a follow-up with all the individuals involved in this matter. In order for WSI staff to feel safe that they can report, it is imperative that the anonymity of the person reporting the concern remain confidential with myself and the HR department. Unless I hear differently the investigation will start immediately. Please let me know your thoughts.

(Internal Audit Manager)

From: (Executive Director)
Sent: Thursday, May 26, 2005 12:10 PM
To: (Internal Audit Manager); (Board Member); (Board Member); (Board Member)
Subject: RE: XXXXXXX Funeral

I disagree, that is not the protocol & procedure of the agency. It is HR's responsibility to conduct all such investigations. If anyone feels that my integrity is such that I will intentionally attempt to influence the outcome to my or anyone else's advantage, then I should be asked to tender my resignation immediately because I can not be trusted. If asked such I will do so today.

I have grave concerns (not for me by the integrity of the organization) about who was looking at records prior to the allegation. All records are public, but do require a public request to review. I do not want other employee's records privately poured over and then anonymously thrown out. Unless otherwise directed by the Board, it is (Chief of Support)'s and (HR Employee)'s responsibility to independently conduct this investigation and report on it. I am concerned about the bleeding over of functions.

When this issue is taken fully within the context of the request, it is apparent that the Executive Director was asking for a timely, documented, unbiased investigation be conducted because of concerns that the original reviewing party may have failed to do so. Had it not been for the Executive Director's directive, such a detailed record of investigation would never have existed for review.

State Auditor's Concluding Remarks

WSI states when the issue is taken fully within context, it is apparent the Executive Director was asking for a timely, documented, unbiased investigation. We disagree with such a conclusion. If an actual unbiased investigation was to be conducted, the Executive Director should not have specifically identified what the investigation was to entail. Also, the Executive Director should have ensured the investigator was independent and free of conflicts of interest, either apparent or actual. The Executive Director did not take such action and instead demanded his direct report conduct the investigation. We do not state or want to imply the direct report conducted a lesser investigation or modified their process in conducting the investigation. This employee was put into an uncomfortable position and should not have been the individual conducting the investigation due to the reporting relationship with the Executive Director.

WSI states had it not been for the Executive Director's directive, a detailed record would never have existed. When this issue was first addressed, Internal Audit contacted the Chair of the Audit Committee of the Board of Directors and was instructed to discuss the situation with the Executive Director. The next day and prior to any chance for Internal

Audit to conduct an adequate review, the Executive Director emails the employees involved in the incident addressing the issue. Six days later the Executive Director makes the request for a formal investigation. In review of this timeline, it does not appear sufficient time was allowed for Internal Audit to conduct such a review. The investigation performed was requested on May 26 and the final report is completed June 10.

Management's Response to Recommendation 2-10

Management would like to clarify the facts relating to each of the investigations noted in the narrative:

- In the case of the inappropriate use of WSI resources, the investigation was completed and the appropriate discipline was issued. The allusion to the fact that "this employee reports directly to the Executive Director" was somehow the reason for the non-collection is incorrect. In early April of 2005, the individual in question had brought in their checkbook to make the payment, however, no one was sure how to process the check and they wanted to see if the time could be donated to a party in need instead of just forfeited. Unfortunately, the appropriate follow up was not conducted to assure both recommendations were fulfilled. Upon being notified of the oversight in June of 2006, the Executive Director asked to see the proof of payment and surrendered time. No proof could be presented, so he directed that the issue be immediately addressed and documented.
- The second investigation noted was an incident that happened on and off of WSI property. The Executive Director felt there existed recorded statements that mitigated the issue to some degree. As with all investigations, the recommendations presented are the investigator's opinion of what should be done; however, it still remains management's right and responsibility to determine whether or not to follow such recommendations or be accountable for an alternative action. The recommendations in this case were for the Executive Director to conduct a counseling session, require a written apology, and encourage the individual to volunteer to attend an Alternative Dispute Resolution session. *The only recommendation not followed was the issuance of a written apology.* He had recommended a verbal apology instead because he felt it carried a higher level of meaning. The Executive Director did counsel the direct report about the incident and about his expectations of their continued professional decorum. The Executive Director also recommended that they consider voluntarily attending an ADR session with the requestor. With the recommendation of a verbal apology, one could interpret that the Executive Director took a higher level of action than recommended.
- The final case noted an outside contractor that had allegedly made an inappropriate comment where the final action was a lesser penalty than the one recommended. This was the one and only comment which required an investigation. Upon being made aware of the contractor's alleged comments, the Executive Director

immediately directed that an investigation be initiated. As noted in the case above, recommendations presented are the investigator's opinion of what should be done. The continued innuendo that the Executive Director appeared to be attempting to influence the outcome of an investigation is incorrect. If the Executive Director had wanted to influence the outcome of the investigation as alleged, he could have simply pressured the investigator to present his recommendation as the final action rather than allowing the investigator to make their own independent recommendation. Instead, he wanted it clearly noted on the record that he had no intention of ever asking the investigator to alter their recommendation(s). The following chain of e-mails regarding the issue demonstrates such:

From: (Executive Director)
Sent: Wednesday, November 30, 2005 9:18 AM
To: (HR Manager.); (Chief of Support Services)
Subject: FW: XXXXX investigation
Importance: High
Sensitivity: Confidential

Thank you for your quick review and thorough reporting of this issue. I have read the documents and have noted a couple questions in the document summary. I also would not agree with the depiction that I said (as is noted in (Employee's) statement) (Employee) conducts this type of behavior all the time. Instead, I would say the way it is noted in my statement is how I have consistently expressed the topic.

Based on the two coin having two sides and seeing that they both felt uncomfortable, an outright termination of XXXXX's contract is too aggressive in my opinion. I am in no way asking that your recommendation be altered to adjust my feelings --I simply wanted to note on the record that I am looking for a middle ground. As XXXXX did immediately note his statements to (Employee) and me, there appears to be no attempt to hide nor an appearance that the comments were malicious or intentional sexual harassment. Nevertheless, his comments to (Employee), while not sexual harassment, were inappropriate. As an HR professional and a consultant hired by this organization, XXXXX is held to a higher bar of accountability. Consequently, I will recommend a 3 month suspension (Nov., Dec., and Jan.) of his contract and associated fees and then review his contract in February of 2006 for the resumption of executive coaching and consulting services.

From: (HR Manager)
Sent: Tuesday, November 15, 2005 5:09 PM
To: (Executive Director)
Cc: (Chief of Support Services)
Subject: XXXXX investigation

Importance: High
Sensitivity: Confidential

(Executive Director),

I have attached the investigation summary with my recommendations regarding the incident with XXXXX. I also included all of the supporting statements so that you can review the information. Please let me know if you would like me to clarify any of these items.

Thank you,
(HR Manager)

In this case, with all the facts, the Executive Director made the final determination as recorded.

State Auditor's Concluding Remarks

Regarding the inappropriate use of resources, WSI states the allusion to the fact an employee reports directly to the Executive Director was somehow the reason for the non-collection is incorrect. There is no allusion to facts. The facts are this employee does directly report to the Executive Director and recommended action to be taken did not take place.

In relation to the second investigation, WSI states the only recommendation not followed was the issuance of a written apology. This is an inaccurate statement. Within the recommendation section of the investigation report, there is a statement that the letter is to be delivered to the employee who had requested a review be performed. This was not done. The investigation report had recommended an employee receive a counseling session emphasizing the disparity between WSI's Core Values and the documented alleged misrepresentation. It is unclear whether this did take place. WSI's response states the Executive Director did counsel the direct report about the incident and about his expectation of their continued professional decorum. While WSI states the Executive Director recommended a verbal apology instead of written apology, WSI does not address whether such an apology occurred.

For the final case noted, WSI states there was one comment which required an investigation. This audit report notes this was the second time we had noted the contractor had made inappropriate comments. The first instance relates to the contractor emailing the Executive Director making inappropriate references to certain employees. When asked about this comment, the Executive Director stated he had called the contractor and informed the contractor these comments were not acceptable. We note this first instance to identify this contractor had already been contacted by the Executive Director regarding inappropriate comments prior to the comments being made which resulted in an investigation.

WSI's final statement is the Executive Director made the final determination as recorded. There is no documentation as to what WSI communicated to the contractor so we are unsure as to what final determination was recorded and provided to the contractor.

Management's Response to Recommendation 2-13

While WSI did conduct a formal evaluation of the position, it did not formally document the evaluation conducted. WSI personnel met and discussed the issue in detail in order to assure that the addition of the new range fit within WSI's compensation philosophy. While the previous Loss Prevention Director had worked in the safety and workers' compensation field, he was neither degreed nor certified as a safety professional. For these reasons, the initial Loss Prevention Director's compensation range was established for a non-degreed, non-certified Director. The referenced Loss Prevention Director candidate was both degreed and certified as a workplace safety professional. The candidate also held (holds) the Board of Certified Safety Professionals Certified Safety Professional (CSP) designation. As a result of the review and eventual hiring of the candidate, WSI now has two pay ranges for the Loss Prevention Director; one for a safety degreed and certified Director, and one for a non-degreed and non-certified Director. Additionally, this distinction was expanded to more than just the Director's position. An adjustment was also made to the Safety Consultant (SC) position to delineate between a SC1 (non-degreed and/or non-certified) and a SC2 (degreed and/or certified). In order to assure that WSI acted in accordance with the philosophy and training provided by the Hay Group, WSI contacted the Hay Group. All of the theories, actions, and justifications for the range adjustment were presented during the conversation. The Hay Group concurred with WSI's actions and agreed they were completely within the agency's compensation philosophy and market application. The Hay Group further noted that when you hire/recruit you have to routinely consider if the new candidate "will do the job differently and bring different skills that bring a higher value to the job."

State Auditor's Concluding Remarks

WSI states it did conduct a formal evaluation of the position. While WSI appears to have discussed information regarding the position, there was no evidence WSI had evaluated the eight factors used to determine a proper classification of a position (points are to be assigned to factors and the total points correspond to a relevant pay grade). Without a position going through such a documented process, we question whether WSI did conduct a formal evaluation.

WSI states it contacted the Hay Group and provided information. This is irrelevant as the contact occurred with the Hay Group during this audit after we brought this issue to management's attention and was not done at the time the change was made.

Chapter 3 Supplemental Responses & Concluding Remarks

Management's Response to Recommendation 3-1

The following are examples that substantiate management's assertion that these issues did not occur in a manner described in the narrative.

Concerning the Executive Director providing increases to seven of his eight direct reports in excess of what WSI had computed:

- In order to fully understand why the increases were provided, one must first understand the purpose of the increases. At the August 11, 2005, Board Meeting, the Hay Group representative explained the findings of its study. One of the findings was that there was an internal equity gap in what was expected of management as compared to what was being compensated.

  > *"Why would I want to take on more responsibility if I am going to make the same amount of money? No one is going to do that." … "It is a concern because if you look at it (Internal Equity) a lot of Executives and Managers make what senior staff members make so they are saying, 'Why would I take on the additional responsibility for the same pay?'" … "We have some significant concerns at your Internal Equity basis but that is not surprising because your previous pay plan effectively did not address internal equity issues at all." … "The current practice at WSI relative to like positions in the Executive market means, quite frankly, you are at risk of losing your senior positions if they are marketable because of what they could earn in this market today."*

  In order to slowly bring the agency in line with what the market will pay for similar skill sets, the increased expectations, and increased leadership expectations, the increases above the minimum level of the range were provided to the senior leaders (NOTE: the highest increase did not rise higher than the midpoint of the range and the others were in the first 25% of their ranges or lower). Additionally, to have seen such an action would not have been a surprise because the Executive Director stated at the August 11, 2005, Board Meeting, "Some people are not simply minimum performers, they are above minimum performers and we have to address that in this as well." Consequently, WSI has provided almost 15 employees (seven of which were direct reports) increases above the amounts originally arrived at based on the projected computation. Additionally, the Board supported the insertion of $600,000 into WSI's 2007/09 proposed biennial budget to continue to make above minimum market adjustments for WSI staff. When viewed in context of the total changes and purpose, there is no pattern of preferential treatment or favoritism being exhibited.

Concerning certain employees receiving their increase early and retroactively:

- The first employee had not received an increase since December of 2002. Their next increase was postponed until the Hay compensation range data was available. The back pay of their adjustment was made to the start of the fiscal year in order to provide a minimal level of equity for not receiving an increase for almost three years. Management considers making up for not receiving an increase for almost three years equitable not preferential treatment or favoritism. The only link to the Hay Group study in this case was that management was waiting to see the new compensation range data in order to assure any adjustment was appropriate under the new system.
- The second employee had not received an increase since March of 2003. Their next increase was postponed until the Hay Compensation study data was available. The back pay of their adjustment was made to the start of the fiscal year in order to provide a minimal level of equity for not receiving an increase for almost two-and-a-half years. Management considers making up for not receiving an increase for almost two-and-a-half years equitable not preferential treatment or favoritism. As above, the only link to the Hay Group study in this case was that management was waiting to see the new compensation range data in order to assure any adjustment was appropriate under the new system.
- The third member was given a promotion in the last quarter of calendar year 2004 and was informed that their salary range would be based on the final Hay Compensation study data once it was available. The final data was not available until the summer of 2005. The salary increase as well as the back pay were tied to the 2004 promotional commitment. Management considers honoring a commitment equitable and not preferential treatment or favoritism. As above, the only link to the Hay Group study in this case was that management was waiting to see the new compensation range data in order to assure any adjustment was appropriate under the new system.
- The fourth member was given additional duties and changed their FLSA classification from non-exempt to exempt. At the time of their next performance evaluation, they were advised that their final salary would be based on the results of the compensation study that was to be conducted. The rate and back pay were tied to a promotional commitment. Management considers honoring a commitment equitable not preferential treatment or favoritism. As above, the only link to the Hay Group study in this case was that management was waiting to see the new compensation range data in order to assure any adjustment was appropriate under the new system.

Concerning the noted lack of action taken and results/recommendations of investigations being changed involving direct reports of the Executive Director or a contractor who was providing executive mentoring services:

- See management's response to recommendation 2-10. It should again be noted that the detailed facts of each investigation exist because once management was notified of the issue; WSI immediately initiated and conducted a thorough investigation in each case.

Concerning the survey results that, of the 192 employees responding to the statement "Favoritism is not an issue in raises or promotions," 50% selected "Strongly Disagree" or "Disagree:"

- It should be noted that this was a perceptional-based survey question that categorized all managers as a group. No facts of founded, routine favoritism are presented and favoritism is not practiced within WSI. While the agency appears to be split 50/50 on this perception, it is still a troubling number. WSI management agrees that it is important to work to alleviate this perception.

Concerning the issue of the promised updates:

- The Executive Director had drafted an e-mail to send as a final update on the matter of the spammer (see below), but it was never sent due to a desire to take the higher road and because of counsel from WSI employees. At no time was it simply a case of where he "saw no need to notify employees." This information was not presented because the Executive Director does not keep his commitments; it was not presented because the agency wanted to move on. The senior team was advised of the limited information so they could dispel growing rumors to the extent possible when asked about the issue. WSI disagrees that this is a significant example of a failure to keep commitments and instead is an example of discretionary leadership. (NOTE: Any innuendo that the reasoning changed from one day to another is an incorrect allegation. Additional context and clarifying questions were asked in the follow up interview that lead to additional information being discussed.)

  Good afternoon. As promised, I am writing to keep you up to date on any relevant information related to the anonymous "j runnings" release of WSI's salary history. I am providing this information because it relates to the top questions I have been asked over the last week ("Who would do such a thing to us?" and "If you get a name you will share it with everyone, yes?").

  The Forum has confirmed that (the reporter) did in fact release his electronic version of the document to a source:

  "As for (the reporter) forwarding an e-mail to a source . . . He said he did so to give the source updated and otherwise public information, <u>of which the source already had an earlier version</u>, to aid in receiving an educated response."

> *The next question one would ask is "what is the name of the source that already had an earlier version." You may recall in a earlier e-mail to Forum officials we noted the following facts:*
>
> *"In the investigation of this story, (the reporter) was advised by one of his sources to request a specific salary file from the Office of Management and Budget (OMB). OMB recorded two public requests for the same document –one in paper and one electronically."*
>
> *We know by the public information requests noted above the exact and only name that possessed the earlier "paper" version of the same information. It is only to this person that (the reporter) could have released it if the statement by the Forum officials is factual (and we believe that it is). It is with great disappointment that I give you the name of the person at the heart of this personal attack –(X X). While we can not confirm that is was in fact (X) who "sent" the anonymous e-mail and mailings, it is clear (he/she) was at the heart of the release. Because if (he/she) did not personally send it, then (he/she) had to provide it to someone who did and that means (he/she) was at least involved in its orchestration.*
>
> *I promised I would share what I knew and that is why I write today –to fulfill a promise. I take no joy in telling you this information; in fact, it greatly saddens me to see how little a former co-worker thinks of us. Maybe now knowing will help us move on.*
>
> *Thank you again for all you do every day in spite of the very few who wish to stop us.*

Concerning the Executive Director not meeting with everyone in the first 90 days:

- When originally proposed it did not appear to be an unattainable goal to meet with every employee in the first 90 days, as the visits were originally intended to be 5-10 minutes per employee. However, over time these meetings slowly grew to be up to 45-60 minutes per visit. These meetings were extremely valuable and informative, but ended up throwing the 90 day schedule off balance. The meetings continued past the 90 days and some continued as small teams in one hour meetings. It was the Executive Director's belief that he had eventually met with every employee (while not in the first 90 days). Some period of time later the issue that he missed some employees surfaced and he sent out the referenced e-mail stating that if he missed someone, please set up a meeting and he would take the time necessary. There was no intent to not fulfill the commitment –and it eventually was fulfilled, but not as effectively and orderly as originally planned. As recommended, future commitments will be better weighed for appropriateness.

Finally, concerning the indications of low employee morale, problems with communication, and employees fearing retaliation:

- Issues with morale plague many organizations around the world. It is WSI's goal to provide an environment in which employees are proud of what they do and have a high degree of pride when doing it. As noted, there are areas in which improvement can be made. WSI management heard morale was an issue, but could not get a clear, concrete answer on exactly what the issue was; this is why the cited Denison study was to be conducted in February of 2006. However, with the audit survey being a priority, the Denison study was placed on hold. In September of 2006, WSI conducted the Denison study in order to get concrete examples of exactly which areas to improve first, and why. As noted, the top areas were the following. There is a clear agreement about the right way and the wrong way to do things; The leaders and managers "practice what they preach;" We respond well to changes in the business environment; Our approach to doing business is very consistent and predictable. Under heavy times of change and uncertainty, these would appear to be very natural concerns. Culture change is a part of any organization's continued growth. One of the primary components of this change is morale. This small word challenges companies to find innovative and creative ways to raise its level. There is no one approach to this topic that has proven to be successful across the board. What leaders are tasked to do is identify, confront, and deal with the issues affecting morale. History or baggage carried over from one leader to another can cause a perpetual cycle of up and downs. The only true remedy for dealing with this subject is to work toward open, honest communication across all lines in an organization –something which WSI is now actively addressing. WSI is at that point in time when the old, lingering issues must be faced so the organization can move to its new future. Culture change in any business can easily take from four to six years to accomplish. WSI is at a breakthrough stage and (as noted in the audit) it is critical that the organization continue to keep its focus on what we do by serving our customers and continuing to develop the culture of WSI into a strong sense of enthusiasm and dedication to a commonly shared goal that unifies the team.

State Auditor's Concluding Remarks

When WSI was provided a copy of the draft audit report for their review, they were requested to provide management responses to each recommendation and we stated these responses should be concise. When we met with WSI representatives to discuss their draft responses, we noted their response to this recommendation was very lengthy and was not concise. As can be seen by the length of the response, WSI's final response is not concise and is even longer than their drafted response.

WSI stated it provided approximately 15 employees (seven of which were direct reports) increases above the amounts originally arrived at based on the projected computation (for the Hay Group analysis). This is a further indication of preferential treatment. Of the 8 direct reports of the Executive Director, 7 received larger increases than computed. Approximately 8 of the remaining 200 other employees received larger increases than computed.

WSI states the employee survey conducted by us categorized all managers as a group. This is an inaccurate statement. The survey specifically identified the question regarding favoritism in a section related to "upper/senior management of WSI." Another section of the survey asked questions related to employees' immediate supervisors.

WSI provides information related to an email drafted by the Executive Director to send to all employees regarding the matter of the spammer. We do not understand the relevancy of including this draft email since it was a draft and was never provided to employees. WSI states that any innuendo the reasoning changed from one day to another is an incorrect allegation. We do not make such an allegation and make no such innuendo. The report notes a timeline of events only.

Management's Response to Recommendation 3-2

In the case where the Executive Director requested that the investigation include the party who made the initial allegation, this was not done to heighten the fear of retaliation. In fact, the following is the actual language of the request and the reasoning:

> *"A full investigation should include how and why the concerns came about as well as who made the public request to review the documentation that led to the investigation." … "I have grave concerns (not for me by the integrity of the organization) about who was looking at records prior to the allegation. All records are public, but do require a public request to review. I do not want other employee's records privately poured over and then anonymously thrown out."*

WSI understands the perception of the request and will work to reduce as much concern during future investigations to the extent that it does not jeopardize the integrity of the investigation. However, simply having an open door policy does not mean employees will come to your door or immediately feel free from retaliation.

Additionally, prior to the existing leadership, WSI as an organization had years of distrust passed from one leader to another. As reported recently in the November 3, 2006 edition of the Fargo Forum, "…in October 2003, documents that news reporters and others obtained through open records requests described (Executive Director's) management style as mercurial and hostile ... Staff evaluations and letters, both signed and unsigned, used terms including 'outbursts of anger,' 'impulsive,' 'irrational,' 'fear,' 'low morale,' 'temper,' 'intimidation,' 'hostile behavior,' 'retaliation,' 'rage,' 'vindictive,' 'hostile work environment,' 'harassment' and 'retribution.'"

These statements can not be overlooked when considering the cited survey results. The organizational trust level will take years to earn back. Consequently, absent comparative data, management is unable to conclude whether the survey results are more or less favorable than they would have been in prior periods.

To transform an organization's culture is a long-term commitment. In a peer-reviewed article entitled *Transforming Local Government: Practical Experience Building a Program-Based Organization* by William S. Chiat, Chiat notes that it can take four to six years to change an organization's culture. This article also alluded to the importance of investing time in this process of cultural change. "Don't become discouraged when anticipated change does not occur as quickly as expected."

Considering that WSI has had four different Executive Directors in the last seven years and that it takes four to six years of steady leadership to change an organization's culture (the current leadership team had only been together about one year at the time of the SAO survey), one can understand the reduced level of trust and uncertainty pointed out in the survey results. Consequently, under these circumstances, to have more than 50% of the organization responding neutral or better to the noted questions is a good start but certainly not a great result. WSI and/or its Board are committed to continuing to provide an environment of stable leadership and open doors.

State Auditor's Concluding Remarks

WSI states it will work to reduce concerns during future investigations to the extent it does not jeopardize the integrity of the investigation. We are confused by WSI's statement. While their response notes a concern regarding jeopardizing the integrity of the investigation, they appeared to have no problem with a direct report of the Executive Director conducting an investigation involving the Executive Director. Also, the fact the Executive Director is specifically identifying what an investigation is to include raises questions as to whether the investigator is free of conflicts.

WSI states to have more than 50% of the organization responding neutral or better to the noted question is a good start but certainly not a great result. The question identified was to have employees respond to the statement "I am able to take issue to or can disagree with senior management without fear of consequences." Only 28% of respondents selected "Agree" or "Strongly Agree."

Management's Response to Recommendation 3-7

Following the November 2004 Board retreat WSI undertook a number of necessary preliminary steps to properly lay the foundation for the successful implementation of a strategic plan. Beginning in January 2005, a team was formed to put the outcomes into action. The team was tasked with developing strategies that would help fulfill the mission and outcomes established by the Board. This process continued through May 2005 which resulted in the outline for the foundation of the plan. In August 2005, functional units began drafting business plans. A strategic visioning and planning session for executive management was conducted in September 2005 wherein the elements of the draft structural framework were created. In October 2005, the second employee summit was held for WSI staff to validate the various elements of the structural framework document including the re-formulation of the previously identified strategies. In November 2005, a strategic core team was ultimately developed to facilitate strategy implementation and monitor progress of the strategic plan. The narrative preceding the recommendation notes that the CEO membership organization WSI pays $12,000 a year to be a member of, identifies that prior to undertaking a strategy planning process, ownership must understand unless it is committed to involving the entire employee staff, the plan won't work. As can be seen in the comments above, WSI extensively involved employees in the process in order to assure it was developed and validated by those who did the job and would be responsible for its implementation. After gathering staff input and direction for an extended period of time, management was tasked with creating a draft structural framework document at an offsite retreat which was again subsequently validated by staff at the second employee summit.

Management's Response to Recommendation 3-9

Within the narrative are examples in which management would like to provide its perspective in order to provide a more accurate perspective relative to the frequency and severity of these issues.

- Point one ... Although WSI cannot confirm or deny what any employee of the Hay Group might have said about the scope of what was performed within the analysis, WSI refutes the allegation that a validation of the system was not performed. Within the actual proposal provided by the Hay Group it was stated that, "Hay will combine its expertise in compensation and performance management with the skills, expertise and inputs from WSI to ensure that outcomes of the project are based on legal compliance with all appropriate laws and regulations." WSI stands by this statement as accurate since the Hay Group was partnered with to ensure a valid and reliable pay-for-performance system.

- Point two …The narrative notes that WSI received continuing appropriation authority for safety programs and did not remove the $1 million grant request from its biennial budget request. The funding then appeared to be used for pay increases and information technology needs. These are correct statements and management is not sure how they demonstrate a pattern of inaccurate information. WSI placed the $1 million request in the budget submitted to OMB by July of 2004. The continuing appropriation request was submitted in a separate bill. When WSI submitted its budget to OMB, it was unaware of the possible continuing appropriation bill. WSI also had no assurances that the continuing appropriation request would be approved. Consequently, the provisions of both bills were kept. WSI never hid these facts and even openly noted during the session that both provisions existed. Once both bills passed, the authority and accounting for the safety grants switched to the continuing appropriation. WSI then discussed with its Board the possibility of using its single line appropriation authority to support WSI employees with compensation increases and some unexpected computer system issues. The utilization of these funds was done legally and within WSI's authority. WSI management had been very open and public about these actions; thus, they are unsure of how this supports the assumption of inaccurate statements.
- Point three … The narrative notes that WSI stated the Executive Director informed the Board of Directors that some WSI employees would receive performance increases greater than what was initially recommended by the Hay Group analysis. This is an accurate statement. In fact, as noted in management's response to Recommendation 3-1, the Executive Director stated at the August 11, 2005, Board Meeting, "Some people are not simply minimum performers, they are above minimum performers and we have to address that in this as well." Management is unaware of where the statement "actually did not occur" was derived unless it was a clarification of the "exact" words used rather than a summary of the statement.
- Point four …The narrative notes "there was information not provided to the Attorney General's Office which was necessary to make an accurate and informed decision." Of the thousands of sheets of requested information over ten months, one single document was unintentionally missed. Once the issue was brought to management's attention before the meeting, the document was immediately provided to the Attorney General's office for their review. In the end, the proper determination still was made.
- Point five …The Executive Director responding to a question about how many employees did not receive an increase. His response was "…somewhere in the neighborhood of –I would say—6-10 people." Phrases such as "in the neighborhood of" and "I would say" are not substantive examples of inaccurate information. Instead, they are generalized statements to notify the members that

they are a best estimate without the exact facts being readily available.

- Point six …The narrative notes "the hired consultant had identified a few errors with information in some of the quarterly operating reports." Whereas, WSI does agree that there were a few errors in some of the operating reports, management feels that the frequency of these errors do not rise to the level of a pattern of inaccurate statements. The consultant referenced, seems to agree with management's perspective on this issue when they stated. "We noticed a few errors in some of the operating reports. For instance, some of the legal projections in the December 2005 operating report had not been updated when compared to the September 2005 report. We don't believe a recommendation is necessary for this finding, but would encourage WSI staff responsible for each segment of the operating report to validate carefully its contents before the report is published." (emphasis added)
- The last narrative note states: "While WSI has noted such information was not provided to be misleading and they did not intentionally make errors, we noted a trend with information provided which appeared to be incomplete or was inaccurate." Without hyperbole, over nearly the last 10 months of this Performance Audit WSI has: provided thousands of WSI staff hours to support it; pulled and compiled thousands of documents; directed to turn over more than 37,000 e-mails from 13 specified people; and provided hundreds of staff hours of electronically recorded interviewing time. Management feels that WSI is not dissimilar than other agency if scrutinized to this degree. With enough time and resources, unintended inconsistencies can be found. Management believes that a limited number of isolated inconsistencies can not be labeled as a trend of inaccuracies.

State Auditor's Concluding Remarks

In point one, WSI states it cannot confirm or deny what any employee of the Hay Group may have said. The representative of the Hay Group contacted was the individual WSI specifically identified for us to contact. In discussing WSI's written comment regarding validation of the pay for performance system operating in appropriate manner, WSI changed its information about what the intent was of this written statement at least twice.

In relation to point two, WSI had provided information that their appropriation request included $1 million for safety partnership grants. The $1 million was not spent in accordance with what WSI had identified in written documents. We conclude it is misleading to inform the Legislature about how funds are intended to be used for a certain purpose but then are not used for such a purpose.

Within point three, WSI states it is unaware of where the statement "actually did not occur" was derived. The phrase "did not occur" comes directly from a response WSI provided to us when WSI appears to admit previous information provided was not accurate.

In point four, WSI states of the thousands of sheets of requested information, one single document was unintentionally missed. Nobody requested WSI provide information to the Attorney General's Office.

In point five, WSI states it provided generalized statements in relation to a question about how many employees did not receive an increase. The Executive Director's actual response to the question begins with him identifying himself and only those new employees who were at WSI less than 6 months that were in an orientation period. This is not a generalized statement. There were other categories of employees who did not receive increases and were not identified by the Executive Director.

Regarding WSI's last bullet, in the last 15 years of conducting performance audits, our office has not encountered the degree of inaccuracy we noted in this audit and information being changed by WSI. As a result, a substantial additional amount of time and work was invested to verify the accuracy of information provided. This also resulted in our office recording meetings with WSI representatives which is not routinely done in performance audits conducted by our office. However, the amount of recorded time did not equate to "hundreds of staff hours of electronically recorded interviewing time " as WSI states.

WSI states it was directed to turn over more than 37,000 e-mails from 13 specified people. This is a misleading statement. WSI was directed to provide emails of 13 employees involving correspondence to other WSI employees, WSI Board of Directors, employers, injured workers, contractors/vendors, and other government officials and entities. WSI decided, as a means to save time, to provide all emails of the 13 employees. This was more than what our office had requested.

Management's Response to Recommendation 3-11

Management does agree that the pace of change did begin to grow too fast and felt unwieldy and was consequently slowed down. Additionally, WSI created a new training division and hired a training and development professional to assist in better planning and execution. WSI also formed a Core Strategic Team whose role was to facilitate strategy implementation and monitor progress of the strategic plan. The critical success factor is to involve those who do the job in the planning and implementation of the change and TQM is a powerful tool to assist with this task. The TQM program entitled Strategically Taking Action Relying on Teams (START) was started with a pilot team of WSI staff. The START program had a fully developed plan and implementation schedule, yet the pace of change grew too fast.

As noted, at the request of the staff, the TQM implementation was temporarily suspended. With the decision to incorporate the compensation plan recommendation from the Hay Group, all discretionary and training spending was reduced in order to fund the salary increases. This was a decision that was supported by the agency members at an All Employee Meeting. This is why the "training appears to have been put on hold in the fall of 2005 which is relatively early in the biennium."

Management's Response to Recommendation 3-15

Premiums are billed at the beginning of the policy year using estimated payroll information from the prior year. At the conclusion of the policy year, premiums are then reconciled using actual payroll information. The billing system is programmed to automatically reconcile the information and process the adjustments accordingly. When premium dividend credits are declared, the same concept holds true. Dividend credits are applied to the estimated premium at the beginning of the policy year and reconciled at the end of the policy year. Consequently, estimated payroll may be higher than actual causing an over credit for the dividend. As with premium, this is adjusted for active employers at the time of their annual policy renewal.

After preparing the 2005-06 dividend file at the request of SAO, Employer Services conducted an analysis of the dividend credits that were issued for the 2005-06 year. As a result of this review, three primary issues were identified relating to the issuance of dividends including:

1) the issuance of dividends to a limited number of minimum premium accounts;
2) premium adjustments with no corresponding adjustment to dividend credits; and
3) the overstatement of dividends to a limited number of accounts that cancelled coverage during the course of the year.

For groups (1) and (2) outlined above, the current billing system was already programmed to automatically reconcile the dividend calculation at the time of policy renewal. In regard to cancelled accounts, group (3) above, 41 accounts with overstated dividends were identified. These 41 accounts totaled $17,772 of the estimated $52 million of premium dividend credits that were issued for the 2005-06 policy year. WSI is in the process of calculating the correct dividend credits for these cancelled accounts. Once calculated, WSI will issue the appropriate premium adjustments and follow normal collection protocols to recoup these amounts.

Chapter 4 Supplemental Responses

Management's Response to Recommendation 4-1

Additionally, to infer that the Board is not fulfilling its governance role unless it is meeting as a whole is misleading and inaccurate. *"Beginning with the November 2003 quarterly meeting and going forward, we identified the 11 quarterly board meetings lasted, on average, 3 hours. Thus, the Board spends approximately 12 hours a year meeting as a full Board."*

If the information presented in the narrative was all that one had on the level of the involvement of the Board in the fulfillment of its duties, one would truly believe that the Board was not involved. However, the information presented is incomplete. For example, from February 8, 2006, until November 17, 2006, the Board and its committees held 22 publicly noticed meetings --of which only three appear to be attended in full or in part by representatives from the State Auditor's Office. For had the reviewers been in attendance at the meetings, they would have heard significant discussion, debate, and seen detailed preparation material presented over numerous meetings. Additionally, the information as presented does not address the Audit, Executive Performance, Legislative, and Nominating Committee meetings as well as any Special Board meetings. The information as presented also did not consider the significant amount of preparation and community representation time that each Board member must conduct as well. Nor does it consider that during a legislative year, the full Board may meet weekly, if not more, to monitor and timely address ongoing legislative issues.

Yes, each Board member has a full-time job in addition to their role as a board member; however, as alluded, this does not mean that they do not take their duties seriously. It should also be noted that the role as a Board is to govern and not attempt to manage the day-to-day activities of the organization. Thus, the fact that they do have other jobs is not inconsistent with this charge.

By law, the two employee representatives of the Board are appointed by the Governor alone. While the Board may support the reappointment of an existing member, the Board does not provide a list of candidates to the Governor for either of these positions as it does with the other members. Nevertheless, while the appointment authority is solely the Governor's, the Board does differ with the Attorney General's opinion and feels that each Governor has appropriately followed the law as written and has voted to seek a legislative clarification to this opinion from the 60th Legislative Assembly.

Lastly, while the audit references the Board was formed in 1997, it neither references the state of the organization at that time nor why the Board had to be formed. Additionally, the audit does not consider the significant performance achievements that have occurred under the Board's leadership. Absent more sufficient support for this recommendation, the Board maintains it has, and continues, to govern effectively.

Management's Response to Recommendation 4-6

Within the direction of the Carver Model, it is stated that the organization's senior executive performance should be evaluated based on the organization's achievements. An often referred to milestone that can be used as a benchmark when ascertaining this executive's level of performance is the strategic plan. WSI staff has made a concerted effort to engage an effective strategic plan that will serve as a method to achieve the board's outcomes. In addition, staff has ensured that the board is informed of progress in relation to this strategic plan. Further, the Executive Performance Committee of WSI's Board regularly measures the organization's Executive Director regarding the ability to achieve the strategic plan. One criterion that the Executive Director is measured on annually is the following. "Provides a high level of oversight in accomplishing the six expected outcomes of the plan. Presents clear and meaningful performance indicators in which to continually monitor and measure its success." Based on this performance criterion, it is evident that WSI's Board is measuring the Executive Director congruent to the organization's strategic plan.