



An Informational Summary of
**Internal and Independent
Audit Reports for the
Texas Mutual Insurance Company**

December 3, 2001

Members of the Legislative Audit Committee:

The Texas Mutual Insurance Company (Company), formerly the Texas Workers' Compensation Insurance Fund, received an unqualified opinion on its financial statements for the year ended December 31, 2000, from its independent auditor. The Company's independent auditor did not issue a management letter. Management letters are issued when identified findings are significant enough to bring to management's attention.

While the Company's independent auditor brought no financial findings to management's attention, the Company's internal audit division (internal audit) identified significant operational findings during fiscal year 2000. The operational findings were in the areas of regulatory compliance, claim payments, third-party collections, and accounts payable. These findings, detailed in the attachment to this letter, could have increased the Company's risk for fraud, penalties and fines, and incomplete and/or inaccurate financial information.

- **Regulatory Compliance** - The Company was not consistently complying with Workers' Compensation Commission regulations regarding the payment of attorney fees and impairment income benefits. As a result, the Company could have been subject to fines of up to \$5,000 per occurrence of late or inaccurate payment.
- **Claim Payments** - There was a risk that company staff could have processed fraudulent claim payments.
- **Third-Party Collections** - The Company was exposed to the possibility of fraud by third-party collection agencies and law firms because there was no method to ensure third parties submitted all funds they collected on behalf of the Company.
- **Accounts Payable** - Communication issues between the information technology and accounts payable departments resulted in an unbalanced general ledger on at least two occasions in 1999 and the preparation and mailing of inaccurate IRS Form 1099s.

Overall, management agreed with internal audit findings and agreed to take corrective actions. Follow-up reports provided by internal audit revealed that all findings were resolved by management and closed by internal audit. In addition, management resolved some findings prior to the completion of internal audit fieldwork.

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If you have any questions regarding this statutory review or the findings identified, please contact Sandra Vice, Audit Manager, at (512) 936-9500. We extend our appreciation to the Company's internal audit division for its cooperation and assistance.

Sincerely,

Lawrence F. Alwin, CPA
State Auditor

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Attachment

Objective, Scope, and Methodology

Our project objective was to summarize the Texas Mutual Insurance Company's internal and independent audit reports to provide the Legislature with an overview of significant findings resulting from the Company's financial and operational audits. This project was conducted in accordance with Texas Insurance Code, Article 5.76-3, Section 17(a).

The scope of this project included reviewing 17 internal audit reports and one independent audit report to identify and summarize the most significant findings. We reviewed audit reports issued between January 1, 2000 and December 31, 2000.

We used the following criteria to determine whether a finding was significant: material weakness, noncompliance, increased risk of fraud, indication of management problems the Legislature should be aware of, and the potential for causing financial loss.

This report is informational in nature and is not an audit report.

cc: Board of Directors of the Texas Mutual Insurance Company
Mr. Martin H. Young, Jr., Chair
Mr. Richard A. Cooper, Vice Chair
Ms. Marion Luna Brem
Ms. Judy Broussard
Mr. Jose Cuevas
Ms. Brenda Pejovich
Mr. James D. Ross
Mr. George Wesch, Jr.
Mr. Charles H. Whiteside
Mr. Russell R. Oliver, President, Texas Mutual Insurance Company

The State Auditor's Office reviewed internal and independent audit reports issued between January 1, 2000 and December 31, 2000 at the Texas Mutual Insurance Company as required by Texas Insurance Code, Article 5.76-3, Section 17(a). We identified and summarized the most significant findings, which are listed below. Follow-up reports provided by the internal audit division (internal audit) revealed that all findings were resolved by management and closed by internal audit.

Regulatory Compliance

Source: *Texas Mutual Insurance Company report on the Regulatory Compliance Audit* issued November 30, 2000.

Internal Audit Finding The Company's payments of attorney fees were not consistently accurate. As a result, the Company could have been susceptible to Workers' Compensation Commission (WCC) fines of up to \$5,000 per occurrence of inaccurate payment if any of the parties involved had identified and submitted an erroneous payment to WCC. Tested claims revealed habitual noncompliance that resulted from Company staff deducting too much or too little from the injured worker benefits to pay attorney fees.

Management's Response - Management agreed there were difficulties regarding payment of attorney fees. Management said it would explore and prioritize a system trigger or flag to let users know whether an attorney is involved, there are outstanding fees, or fees are being deducted at an incorrect rate. Management also responded that staff would receive training on paying attorney fees and would be required to use an attorney fee worksheet.

Management's Follow-up Actions - Internal audit issued a follow-up report on March 30, 2001, and reported that management had resolved this finding. Internal audit closed this finding.

Internal Audit Finding The Company had not paid some impairment income benefits (IIB) on time. However, late payments identified in the tested files did not represent a pattern of noncompliance with payment requirements. Internal audit thought the Company was not likely to incur large WCC fines considering the non-habitual nature of the errors.

Management's Response - Management agreed with the finding, which was consistent with the results of a self-audit conducted using WCC methodology to determine compliance with timely and accurate payments of IIBs.

Management's Follow-up Actions - Internal audit issued a follow-up report on March 30, 2001, and reported that management had resolved this finding. Internal audit closed this finding.

Claim Payments

Source: *Texas Mutual Insurance Company report on the Claims Disbursement Process* issued November 30, 2000.

Internal Audit Finding

There was a risk that company staff could have processed fraudulent claim payments. Company staff had the ability to manually change claimant addresses without the system tracking any activity or identifying that information changed. In addition, Company staff could have used generic vendor codes to process a payment and the system would have accepted this payment request without further authorization. Since 1997, the Company has used generic vendor codes to process more than \$77 million in claim payments.

Although internal audit did not identify any fraudulent claim payments, the risk of fraud could have been significant over time because Company staff could have generated claim payments to themselves or other inappropriate recipients without internal control checks.

Management's Response - Management agreed with the recommendations. Management responded that it would immediately emphasize the importance of reviewing payments for authorization and would work with internal audit to use queries developed during the audit to generate quarterly reports and evaluate payments. In addition, management planned to establish a procedure for documenting payments to Company staff for out-of-pocket expenses related to claim files.

Management's Follow-up Actions - Internal audit issued a follow-up report on February 28, 2001, and reported that management had partially resolved this finding. Internal audit issued a second follow-up report on March 29, 2001, and reported that management had resolved this finding. Internal audit closed this finding.

Third-Party Collections

Source: *Texas Mutual Insurance Company report on the Premiums Billing and Collecting Processes and the Interim Collections System* issued August 22, 2000.

Internal Audit Finding

The Company did not have a method to ensure third-party collection agencies and law firms submitted all funds they collected on behalf of the Company. As a result, there was a risk that fraudulent activity by third parties could have gone undetected because there was no way for the Company or customers to know if collection agencies or law firms misappropriated customer payments.

Management's Response - The Company's legal department partially agreed with this finding. The Company's legal department believed compensating controls minimized the risk of law firms misappropriating customer payments. These compensating controls included a segregation of duties (the support staff member who received the money was separated from the attorney who monitored the account). The Company's legal department responded that third-party law firm attorneys would readily detect embezzlement by support staff; only attorney fraud could not be detected promptly. According to the legal department, ethical constraints imposed by the State Bar of Texas lessen the risk of attorney fraud.

The Company's legal department also responded that collection documents generated by an attorney were sent to the Company for review before accounts were written off. To pose a significant risk of loss to the Company, theft would have to have been systematic and longstanding because individual account balances were small. Finally, third-party law firms providing collections were audited by internal audit and they have complied with suggestions for cash handling.

The Company's legal department had no comment on the portion of the finding pertaining to third-party collection agencies.

The Company's legal department responded that it would explore IRS requirements for submitting IRS Form 1099s to delinquent policyholders for the forgiveness of debt. The Company's legal department stated it would develop cash control procedures for use with third-party law firms.

Management's Follow-up Actions - Internal audit issued a follow-up report on November 30, 2000, and reported that management had resolved this finding. Internal audit closed this finding.

Accounts Payable

Source: *Texas Mutual Insurance Company report on the Integrated Audit of the Accounts Payable and Employee Expense Reimbursement Processes* issued March 31, 2000.

Internal Audit Finding

The accounts payable department (accounts payable) could have benefited from a structured approach for communicating with other departments. In September 1999, after a system conversion, the Company's financial reporting department identified that the general ledger was out of balance by approximately \$864,000. Information technology management and accounts payable management disagreed as to whether the discrepancy was caused by user or system error. Both parties agreed the error occurred because a batch of accounts payable checks were deleted from the new system before they were posted. However, the parties did not agree on why the batch was deleted. Although identifying and posting the missing batch resolved this error, a similar error occurred again in December 1999. Information technology and accounts payable have not agreed on why the December 1999 balancing error occurred.

Internal audit discovered a second issue relating to this finding. At accounts payable's request, information technology generated IRS Form 1099s. The information included in the 1099s was inaccurate; however, accounts payable did not identify the mistakes during its review of information technology's work. As a result, accounts payable mailed out approximately 4,000 inaccurate IRS Form 1099s. Accounts payable had to correct and reissue the 1099s.

Management's Response - Management responded that it had developed a task force to address system and systems-related issues. In addition, a user group has been created to provide oversight and direction for the Company's general accounting, purchasing, and personnel systems.

Management's Follow-up Actions - Internal audit issued a follow-up report on May 31, 2000, and reported that management had resolved this finding. Internal audit closed this finding.

Other Findings Identified by Internal Audit

Source: *Texas Mutual Insurance Company report on the Review of the Wire Transfer Controls* issued January 31, 2000.

Texas Mutual Insurance Company report on the Integrated Audit of the Accounts Payable and Employee Expense Reimbursement Processes issued March 31, 2000.

Internal Audit Finding A lack of segregation of duties in the wire transfer process was identified. Details for wire transfers were created, wired, confirmed, and booked to the general ledger by one staff member in the investment department.

Management's Response - The investment department concurred with internal audit findings and agreed to adequately segregate wire transfer duties.

Management's Follow-up Actions - Internal audit issued a follow-up report on March 24, 2000, and reported that management had not resolved this finding. Internal audit issued a second follow-up report on April 30, 2000, and reported that management had resolved this finding. Internal audit closed this finding.

Internal Audit Finding Internal audit discovered that most expense reimbursement requests had a poorly documented or no documented business purpose, increasing the risk that inappropriate expenses may have been reimbursed.

Management's Response - Management agreed to reacquaint and educate all staff on proper documentation of business trips. Management responded that expense reports will not be processed if the purpose of the trip is not adequately addressed. Management did note, however, that determining the adequacy of documentation is subjective.

Management's Follow-up Actions - Internal audit issued a follow-up report on May 31, 2000, and reported that management had resolved this finding. Internal audit closed this finding.

Resolved Findings

During fiscal year 2000, management resolved several findings prior to the completion of internal audit fieldwork. These findings included the following: inadequate segregation of duties in accounts payable, instances of inappropriate access for information technology staff, and inadequate user documentation for policy and technical services. Internal audit applauded management of accounts payable and information technology for resolving these findings quickly.