

Analysis of the Performance Audit of Workforce Safety and Insurance

The 2006 Performance Audit of Workforce Safety and Insurance (WSI) was the first to have not been initiated by direction of the North Dakota Legislature.

Two audits were the direct result of legislature initiated Risk Analysis. All audits therefore, initiated by legislative direction except WSI.

The Performance Audit was Implemented Without Logical Basis

WSI staff attempted to keep RFP for Performance Evaluation on those areas specified in Century Code 65-02 that were specialized areas related to workforce insurance.

WSI points out that the elements ND Office of State Auditor (NDOSA) was insisting upon being included in the RFP were being addressed at that time and were support issues and not core function areas that required specifically the workers' compensation expertise.

NDOSA had decided months in advance that there would be a performance audit (Why is Robert Peterson smiling so hard that his face might crack?) and that the pretext would be disagreement about subjects included in the Performance Evaluation RFP.

There is no evidence that any established pre-audit procedure was undertaken by NDOSA

The "WORKFORCE SAFETY AND INSURANCE Planning and Administrative File Client Acceptance Questionnaire" make unsubstantiated assertions.

There is no NDOSA documentation (emails, meeting notes, personal notes, etc.) showing how it was established "any reason to doubt the integrity of the entity's management or officers?"

Because of documented sibling/spouse/former employee relationships to WSI within NDOSA, NDOSA did not accurately claim that they were not "aware of any independence problems or conflicts of interest because of relationships with clients, management, or staff".

Conflicts of Interest: NDOSA/WSI Staff Connections

Joanne Maher, sister of NDOSA Director **Ed Nagel's** was a WSI Information Services Division (IS) manager at the beginning of the Blunt administration, after evaluation she was reassigned to the position of Business Analyst, and quit WSI on May 11, 2007.

Angie Scherbenske wife of NDOSA Auditor Kevin Scherbenske was the WSI Procurement Officer until quitting in October 7, 2005.

Tammy Dolan, former NDOSA employee, had been a WSI Vice President of Finance became lower paid WSI Director of Quality Assurance. Tammy Dolan left WSI in the spring of 2006.

Auditor Peterson the Fargo Forum for a December 7, 2007 article that "the wife of his assistant, Ed Nagel, once worked for the agency, but left a year before the review". There is no evidence of Nagel's wife working at WSI.

Angie Scherbenske Procurement Officer Catalyzes Scrutiny of WSI Purchasing

Angie Scherbenske claims “failure by WSI to follow the state of North Dakota procurement practices” October 14, 2005. Brady Martz and Associates (BM&A) contracted to review WSI contracts only during Blunt administration (July 2004 through October 2005).

Angie Scherbenske made no documented assertions of impropriety prior to October 14, 2005 to anyone although she had been involved in procurement since 2002.

Many of the exact purchasing practices were continued from the previous WSI CEO administration. Those purchases were not reviewed.

Result of the BM&A review was assertion of various policy and designated authorization criteria for purchasing not being adhered to. In the BM&A transmittal letter to the North Dakota Office of Management and Budget (OMB) there was no proof nor assertion of illegality, misuse or fraud on the part of WSI.

Performance Audit Did Not Follow Government Standards Pertaining to Familial Relationships and Audit Objectivity

The 2003 GAGAS, best known as the Yellow Book Standards, state (in part)...

3.03 The general standard related to independence is: In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, should be free both in fact and appearance from personal, external, and organizational impairments to independence.

3.07Auditors are responsible for notifying the appropriate officials within their audit organizations if they have any personal impairments to independence. Examples of personal impairments of individual auditors include, but are not limited to, the following:

a. immediate family or close family member¹⁸ who is a director or officer of the audited entity, or as an employee of the audited entity, is in a position to exert direct and significant influence over the entity or the program under audit;

¹⁸ *Immediate family member is a spouse, spouse equivalent, or dependent (whether or not related). A close family member is a parent, sibling, or nondependent child*

Scope of the WSI Audit Was Limited To Blunt Administration Period

The time period that was being audited almost exclusively covered the Blunt administration. Activities that were common immediately prior to the Blunt administration under CEO Brent Edison were not scrutinized in any manner.

NDOSA Investigates Ohio Blunt Connection By Contacting Newspaper Reporter

Rather than contacting law enforcement officials regarding Blunt’s involvement in Ohio Bureau of Workman’s Compensation scandal in which Blunt was designated “friend of the court”, or the Ohio State Auditor’s Office, or any other official channel, NDSOA instead contacts a newspaper reporter who at best can supply third-party hearsay information and not absolute facts.

NDOSA acted in a liaison capacity, by providing a Toledo Blade reporter with the newspaper web address of the Fargo Forum as well as the email address of reporter Patrick Springer who had written a series of articles highly critical of WSI.

NDOSA Only Asks For AG Opinions Only In Case of WSI/Blunt Jeopardy

WSI made several documented claims of legal authority for activities under scrutiny by NDOSA.

WSI cited OMB Policy 207 (Promotional Agency Designation), and various sub-sections of NDCC 65 (1997 WSI establishment legislation) regarding personnel system, salary establishment, purchase criteria, authority to undertake official investigation, etc. There is no record that the NDOSA ever asked the NDAG to clarify or render an opinion on any legal claims made by WSI management that would have substantiated the position of WSI.

NDOSA went to the NDAG on numerous occasions when they questioned issues that if true, would prove damaging to WSI, WSI management, or Blunt. NDAG provided no opinion of unlawful or fraudulent activity on the part of WSI.

NDAG billing records show that between March 6, 2006, and November 22, 2006, the Auditor's Office was officially provided 108.9 hours of counsel over a nine month period for an average of 12.1 hours per month.

NO WSI Performance Audit Findings of Wrongdoing

After very extensive review and elevated audit level and unsubstantiated concern of illegal activity, at no time were any fraudulent or illegal acts presented (as required by U.S. Government auditing standards) to the WSI Board of Directors, WSI Leadership Team, or the North Dakota Legislature in the audit.

In his November 29, 2006, testimony before the Interim Legislative Audit and Fiscal Review Committee, Audit Manager Gordy Smith stated in response to a question from Committee Chairman Frank Wald that, "There was no fraud committed by the Board or anyone at WSI that we are aware of."

After Audit Problems: NDOSA Involvement in Blunt Prosecution

There was an open discussion among the attendees at one of Blunt's court hearings that Jason Wahl had been plainly seen entering and exiting the Burleigh County State's Attorney (BCSA) office prior to the hearing. As discussed previously, it has been established that Blunt had not done anything fraudulent, let alone illegal. Auditing criteria demanded the recording and reporting of fraudulent or illegal activity found by an audit. To what degree then, if any, was the Auditor's office involved in the criminal prosecution of Blunt?

Kay Grinsteinner and the Secret Audit

In Ms. Grinsteinner's November 5, 2007, email she clearly states: "I have been urged by my attorney to bring this to the Board's attention." It does not say at the urging of the State Auditor's Office (Smith, Wahl and/or Tolstad) or Brady Martz, but rather by her attorney. Did not each CPA in this case have a professional obligation to notify the governing authority --the WSI Board-- immediately upon being made aware of the stated concerns?

This group of CPAs was each well aware of Ms. Grinsteinner's lack of notice or responsibility to the Board about her concerns and well aware of Mr. Tolstad's directive that "Well, you knew this was a high risk audit. ... I've got a feeling more crap is about to hit the fan. Do what you have to do to, but be as discrete as you can be."

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of
Workforce Safety and Insurance**

March 2008

Never before in the history of ND Office of the State Auditor (NDOA) has that office independently decided to implement the Performance Audit of a state agency without any prior direction of the legislature or the Legislative Audit and Fiscal Review Committee. Two audits were conducted as the direct result of requests of the Legislative Audit and Fiscal Review Committee for risk analysis of agencies (Child Support Enforcement Program, September 2000; and Service Payments for the Elderly and Disabled, October 2001).

Publication Date	Audit Title	Official NDSAO Enabling Directive	Directed By Legislature	Result of Risk Analysis
12-Sep-97	State Procurement Practices - Information Technology Projects	The performance audit of Statewide Procurement Practices was conducted at the request of the Legislative Audit and Fiscal Review Committee.	YES	
18-Aug-97	State Procurement Practices - State Agencies	The performance audit of Statewide Procurement Practices was conducted at the request of the Legislative Audit and Fiscal Review Committee.	YES	
11-Dec-97	State Procurement Practices - North Dakota University System	The Performance audit of Statewide Procurement Practices was conducted at the request of the Legislative Audit and Fiscal Review Committee.	YES	
31-Aug-98	State of North Dakota's Personnel System - Central Personnel Division	The performance audit of the State of North Dakota's Personnel System was conducted at the request of the Legislative Audit and Fiscal Review Committee.	YES	
07-Jan-99	State of North Dakota's Personnel System - North Dakota University System	The performance audit of the State of North Dakota's Personnel System was conducted at the request of the Legislative Audit and Fiscal Review Committee.	YES	
25-May-99	Risk Analysis of the Department of Human Services Programs	The risk analysis was conducted at the request of the Legislative Audit and Fiscal Review Committee and under the authority of Chapter 54-10 of the North Dakota Century Code.	YES	
27-Mar-00	Contracts for Services	The performance audit of Contracts for Services was conducted at the request of the Legislative Audit and Fiscal Review Committee.	YES	

Publication Date	Audit Title	Official NDSAO Enabling Directive	Directed By Legislature	Result of Risk Analysis
14-Sep-00	Child Support Enforcement Program	("The risk analysis was conducted at the request of the Legislative Audit and Fiscal Review Committee...") Based on the results of a risk analysis performed on all programs within the Department of Human Services (DHS) and through discussions with management of DHS, the North Dakota Child Support Enforcement Program was selected for a performance audit.		YES
26-Oct-01	Service Payments for the Elderly and Disabled (SPED)	("The risk analysis was conducted at the request of the Legislative Audit and Fiscal Review Committee...") Based on the results of a risk analysis performed on all programs within the Department of Human Services, the Service Payments for the Elderly and Disabled (SPED) and Expanded SPED programs were selected for a performance audit.		YES
24-Jun-02	North Dakota Veterans' Home	The performance audit of the North Dakota Veterans' Home was conducted pursuant to Chapter 32 of the 2001 Session Laws.	YES	
11-Jul-03	Office of Driver and Vehicle Services	The performance audit of the Department of Transportation's Office of Driver and Vehicle Services was conducted at the request of the Legislative Audit and Fiscal Review Committee.	YES	
22-Mar-04	Administrative Committee on Veterans' Affairs and Department of Veterans' Affairs	The performance audit of the Administrative Committee on Veterans' Affairs and the North Dakota Department of Veterans' Affairs was conducted by the Office of the State Auditor pursuant to Chapter 7 of the 2003 Session Laws.	YES	
18-Nov-05	911 Fees - Collection and Use	The performance audit of aspects of the collection and use of 911 fees was conducted pursuant to Chapter 16 of the 2005 Session Laws.	YES	

Publication Date	Audit Title	Official NDSAO Enabling Directive	Directed By Legislature	Result of Risk Analysis
18-NOV-05	Division of Emergency Management Including State Radio	The performance audit of aspects of the Division of Emergency Management (DEM) including state radio was conducted pursuant to Chapter 16 of the 2005 Session Laws.	YES	
26-Oct-06	Workforce Safety and Insurance	The audit was conducted pursuant to and under the authority of North Dakota Century Code Chapter 54-10.	NO	NO
22-Aug-07	University of North Dakota School of Medicine and Health Sciences	The audit was conducted at the request of the Legislative Audit and Fiscal Review Committee.	YES	
12-Sep-07	State Procurement Practices - Information Technology Projects	The performance audit of Statewide Procurement Practices was conducted at the request of the Legislative Audit and Fiscal Review Committee.	YES	

WSI is by statute to have a Performance Evaluation conducted every two years by workers' compensation experts. The evaluation would be done by a consulting firm with workers' compensation expertise after a request for proposal was constructed, released, potential firm vetted, relative costs of evaluation examined, and contracting firm hired. A Performance Audit is more focused on the internal processes of an agency rather than related to the specialized function of that agency. Performance Audits are conducted by NDOSA.

The Performance Audit Was Implemented Without Logical Basis

September 14, 2005 8:37 AM: Gordy Smith writes to Tammy Dolan (under the subject "yo!"):

Good morning Tammy.....say it's that time of the year again.....yes, time to start working on the RFP for the performance evaluation. The law says "biennially the director shall request the state auditor.....". I was wondering if the Director is going to make a formal request that we start the process or if we should just go ahead. I believe in the past, no formal request was made.....but I thought I should ask. What do you think? Also you guys should start brain-storming to see if you have any suggestions to include for the consultants to review. Thanks.

September 15, 2005 6:49 PM: Sandy Blunt writes to Tammy Dolan (under subject "RE: Request from State Auditor"):

Thanks. I am guessing that it will be coordinated by IA. I really like the letter requesting the audit. Do you mind taking a stab of a short draft request letter that I can send?

Shortly after this exchange, Blunt sent a formal letter to the ND State Auditor's Office formally asking for the 2006 Performance Evaluation to be conducted.

October 7, 2005 WSI Procurement Officer Angie Scherbenske resigns.

October 14, 2005 WSI Board of Director's asks the Office of Management and Budget to review Scherbenske's allegations of impropriety by Blunt.

October 31, 2005 01:01 PM: Ed Nagel writes to Gordy Smith (under subject "WSI RFP, and exhibits A through E"):

The attached file contains the RFP, and Exhibits A through E.

October 31, 2005 2:47 PM: Gordy Smith writes to Barry Miller (under subject "WSI RFP, and exhibits A through E"):

Good afternoon Barry. I've attached a file with the DRAFT RFP. Please review and make any comments or suggestions you would like. We will take them into consideration when we decide what the final RFP will look like. I would like your comments back within one week so we can proceed with this process. THANKS for your help.

October 26, 2005 10:17 AM: John Halvorson writes an email to WSI senior staff members Blunt, Armstrong, Bjornson, Hutchings, Long, Marthaller, Nallie, and Spencer regarding the impending Performance Evaluation. Halvorson wrote:

My understanding is for this biennium, the statute will require these areas at a minimum:

- A) 65-02-30--the effectiveness of safety and loss prevention programs under section 65-03-04
- B) 65-02-30—evaluate the board to determine whether the board is operating within section 65-02-03.3 and within the board's bylaws
- C) 65-02-30—performance measurements maintained by the organization
- D) 65-02-23—effectiveness of fraud expenditures

Additionally, at least every other biennium the evaluation must report on the effectiveness of the departments of the organization. Areas reviewed during the last evaluation were Claims, Legal, SIU, OIR, and Prescription Drugs. Possibilities for this biennium could be: Med Bill Audit procedures and process and overall effectiveness.

Utilization Review procedures and process and overall effectiveness.

PHS—E-mod caps, premium billing process (billing after policy renewal versus before), premium audit, collections

October 31, 2005, 9:13 AM: Barry D. Miller forwards John Halvorson's email (above) to Gordy Smith of NDOSA.

November 02, 2005 7:24 AM: Sandy Blunt (who highlighted elements three, four, and six) writes to Robert Peterson (North Dakota State Auditor):

Good morning Auditor Peterson. I hope this e-mail finds you well and not on a post Halloween candy high.

I just wanted to give you a head's up that by the end of the week we will be making a formal request to alter some of the areas of review in the pending **WSI Performance Evaluation RFP**. WSI's Internal Audit Director, Barry Miller, has presented to the agency the areas that the State Auditor's Office would like to see reviewed. The areas presented were:

- Element One - Evaluation of WSI Performance Measurements,
- Element Two – Evaluation of Safety and Loss Prevention Programs
- Element Three – Evaluation of Information Technology Section
- Element Four – Evaluation of Consulting Contracts
- Element Five - Evaluation of WSI Audit Committee and Internal Audit Division
- Element Six - Evaluation of Human Resource Management
- Element Seven - Review of North Dakota Workforce Safety and Insurance Board
- Element Eight – Fraud Unit
- Element Nine – Status of Prior Recommendations

The areas that we may be possibly asking to replace are highlighted. We agree that these are good areas to evaluate in an audit; however, this may not be the best vehicle in which to do them. (Two of these areas are being addressed in other current reviews and the third is under construction for review as we write.)

This audit provides us the opportunity to have qualified workers' compensation experts review and advise on areas of improvement. My main concern is that the highlighted areas are support issues and are not core function areas that require specifically the workers' compensation expertise. We will be meeting internally on Thursday to re-propose some alternative areas such as a thorough review of the manual code system, the experience modification system, the collection system, medical system, fee schedules, etc.

I appreciate your willingness to consider some alterations to the RFP. I know we both want to see the best review possible.

November 02, 2005 8:07 AM: Robert Peterson writes to Gordy Smith and cc to Ed Nagel, Subject: FW: WSI Performance Audit:

I'm smiling so hard as I type this I think my face is going to crack. A sure way to include these elements in a performance audit is to highlight them and say you don't want them included. J ☺

November 02, 2005 11:07 AM: Gordy Smith writes to Robert Peterson and cc to Ed Nagel, Subject: FW: WSI Performance Audit:

Thanks for your support Bob.....all of the highlighted areas are valid and worthwhile areas to examine and try to make improvements in (if needed)!

AND THERE IT IS! ON NOVEMBER 2, 2005 ROBERT PETERSON STATES SOMETHING THAT IS OBVIOUSLY KNOWN TO GORDY SMITH AND ED NAGEL. NDOSA HAS DECIDED IN ADVANCE OF THAT DAY THAT BEFORE COMPLETING THE PERFORMANCE EVALUATION REQUEST FOR PROPOSALS THAT THEY WOULD BE MOUNTING A PERFORMANCE AUDIT OF WSI!

The process of preparing the scope and RFP for the Performance "Evaluation" begins in mid September, 2005. However, the contract for the Performance Evaluation is not issued until March, 2006, with work to begin in late March or April (more than 6 months after the biannually established process was initiated). Yet, oddly, the Performance "Audit" —which was theoretically never contemplated at the start of the Performance Evaluation RFP design process— is outlined, established, announced, and started a month before the Performance Evaluation contract is even issued and almost two months before the Performance Evaluation audit is ever started.

There Is No Evidence That Any Established Pre-Audit Procedure Was Undertaken or Completed by NDOSA

At the beginning of researching this Performance Audit, I requested in writing "pertinent paper documents that were the precursor information that would help to understand the initiation of the audit would be the first order of business." I expected notes, meeting minutes, formalized documents discussing the reasoning for a proposed audit. Mr. Jason Wahl of NDOSA provided me with 12 pieces of paper. These papers were a combination of emails and text primarily discussing the design of the Performance Evaluation Request for Proposal (again not the Performance Audit). None of these documents had any specific or evident bearing on the work that one would expect of the NDOSA prior to the initiation of an audit that would cost hundreds of thousands of dollars.

Dated January 17, 2006, one sheet that was provided was the "WORKFORCE SAFETY AND INSURANCE Planning and Administrative File Client Acceptance Questionnaire" which seemed to serve as the documentation of the reasoning for the audit initiation. This document had six questions related to the criteria for doing an audit. The number 1 question was "Is there any reason to doubt the integrity of the entity's management or officers?," next to this was an "X" in the YES column. There are no emails, meeting minutes, notes, nor any other evidence of any kind indicating how the assertion of integrity was established nor what process or criteria was used.

Question number 2 was “Are we aware of any independence problems or conflicts of interest because of relationships with other clients, management, or staff?” Again, there are no notes, no meeting minutes, or formal text to explain how the “X” in the NO column was ascertained.

Question number 5 was “Is there anything about the engagement that causes us to be uncomfortable about being associated with the engagement?” Again, there are no notes, no meeting minutes, or formal text to explain how the “X” in the NO column was ascertained.

Conflicts of Interest: NDOSA/WSI Staff Connections

NDOSA Director Ed Nagel’s sister Joanne Maher was a WSI Information Services Division (IS) manager at the beginning of the Blunt administration, after evaluation she was reassigned to the position of Business Analyst, and quit WSI on May 11, 2007.

NDOSA Auditor Kevin Scherbenske is the husband of **Angie Scherbenske** who was the WSI Procurement Officer until quitting in October 7, 2005.

Tammy Dolan, former NDOSA employee, had been a WSI Vice President of Finance before Blunt. After a redesign of the agency, she was not selected for the Chief of Support Services (senior staff position) and was allowed to create her own new position as WSI Director of Quality Assurance that paid less than her former position. Tammy Dolan left WSI in the spring of 2006.

- As stated by Jason Wahl in an audio recording, NDOSA Director Ed Nagel Jr. was a member of the audit management team who was responsible for final reviewing and signing off on the audit as well as any felony reviews to be submitted to the North Dakota Attorney General’s Office (NDAG). A public records request from the NDAG indicates that on October 25th and 26th of 2006, the NDOSA sought legal services from NDAG office regarding possible bribery and obstruction of audit concerns. No such charges were ever filed, but would have had to have had Nagel’s support to be sent to the NDAG for review.
- Abnormal bidding procedures relative to the procurement of computer software are mentioned in the Performance Audit final document on page 6. It seems that the evaluation process for awarding a contract in excess of \$500,000 was tainted when in the words of WSI management, “WSI had concerns relating to discrepant scoring by a member of the review team.” A very rigorous examination was undertaken by NDOSA regarding a \$3.69 condolence cards, a bottle of water, and various minor items. It seems to me odd that irregularities of the magnitude of more than a half a million dollars are apparently dismissed. As Ed Nagel’s sister was a IS manager at the time of the bid, one must wonder if that relationship had any bearing on the level of scrutiny applied by NDOSA to the matter or if there was any potential she was involved with the bid review. I am not aware that Maher was involved with the issue, but it is a question that deserves asking.
- While Kevin Scherbenske is listed by the NDOSA as an Auditor in the State Agency Audit Section and not the Performance Audit Section, he is nevertheless still an employee of the NDOSA and the husband of WSI’s former Procurement Officer Angie Scherbenske. The NDOSA is not a large office and anyone who has worked anywhere knows that no matter what promises are made about organizational firewalls between units, there is always talk between the units about personal and professional issues. And when your wife quits her employment and alleges procurement concerns that are eventually deeply and not so randomly reviewed by your employer (the Auditor), then there are very naturally skeptical concerns that professional and personal lines may have been blurred. The majority of Scherbenske’s allegations are the basis of the criminal charges against Blunt and the \$18,000 that “just happened to be sampled” as part of the audit, yet the Office of the Auditor and now the Burleigh County State’s Attorney have failed to note the sizeable link between this issue and Mr. and Mrs. Scherbenske.
- Prior to joining WSI, Tammy Dolan was employed at the Office of the State Auditor. While she was not the sibling or spouse of an NDOSA employee, she was actually an employee of the office. When Blunt arrived at WSI, Dolan was one of eight Vice Presidents at the organization with wide ranging authority and the compensation to match the position. Working with the employees of WSI, Blunt drew up a new organizational structure that placed the majority of the management authority in three Chief positions. As a result of this new structure, Dolan’s Vice Presidential position was eliminated. She applied and interviewed for the position of Chief of Support Services; however, Jim Long was eventually hired by the interview panel. Dolan was retained in a new position at WSI, but with a cut in pay and

authority. I can not attest to how Dolan felt as a result of losing power and money; yet I know if it were me, I would have been less than pleased with my employer. Now combine this potentially unpleasant feeling with the fact that she held a former working relationship with the same Office of the Auditor that was auditing WSI, and a question of objectivity could be raised. Add to this scenario that Dolan's name can be found on audio recordings provided by the NDOSA in numerous places as well as the basis of series of recommendations in the audit, and the question of truly absolute objectivity again surfaces. In and of itself the Dolan connection to the NDOSA could possibly be just an inconsequential piece of the puzzle.

The NDOSA had a number of very significant personal ties to the WSI organization and as documented here, those people had possible motive to influence initiation of the audit. In light of that recognition, it seems impossible that when Gordy Smith signed the Planning and Administrative File Client Acceptance Questionnaire to initiate the Performance Audit that it was not correct to claim "NO" for question 2, "Are we aware of any independence problems or conflicts of interest because of relationships with other clients, management, or staff?"

Seven months after the relationship between NDOSA Director Ed Nagel and his WSI employee sister Joanne Maher and her involvement in computer software procurement process, somehow State Auditor Peterson is either mistaken or untruthful when he tells the Fargo Forum in a December 7, 2007 article that it was Ed Nagel's wife that worked at WSI and that she left a year before the audit:

From a December 7, 2007 Fargo Forum article, "Blunt also criticized the Office of the State Auditor, whose auditors have closely scrutinized the agency in biennial performance reviews. He claimed the office had conflicts of interest, including family ties between audit staff and employees who had left WSI, but was not specific.

State Auditor Bob Peterson said the wife of his assistant, Ed Nagel, once worked for the agency, but left a year before the review."

To anyone's knowledge, Ed Nagel's wife never worked at WSI.

Angie Scherbenske Procurement Officer and Wife of NDOSA Auditor Catalyzes Scrutiny of WSI Purchasing

As a result of Angie's allegations of WSI purchasing impropriety:

An incident report was filed with the Risk Management Division of Office of Management and Budget (OMB) on October 14, 2005 alleging failure by WSI to follow the state of North Dakota procurement practices. The Risk Management Division contracted Brady Martz and Associates (BM&A) to conduct a review of WSI contracts and expenditure procedures from July 1, 2004 through October 2005.

You will note that the time period which Scherbenske claimed needed scrutiny is only during the Blunt administration. Scherbenske had the job title of Purchasing Agent/Bill Input Unit Supervisor beginning in August of 2002 until becoming Procurement Officer in March of 2005. In her capacity as Purchasing Agent she was familiar with the purchasing practices of the prior WSI CEO Brent Edison. Blunt made no substantive changes in purchasing protocol (BM&A report). Angie Scherbenske also failed to inform BM&A auditors that she had authorized many purchases of the exact type and nature while serving the prior Edison WSI administration. Why did Angie Scherbenske make --in her capacity as WSI Procurement Officer-- purchases in a manner that only after she left WSI would she tell BM&A were suspect when her very job description required her mastery of all types of purchase guidelines? Was it the job of Sandy Blunt to understand the intricate details of purchase authority? Is there any relationship between the fact that Angie Scherbenske was married to NDOSA auditor and the subsequent Performance Audit initiated by that agency? Gordy Smith claims no conflict of interest when he signs the document that initiates the Performance Audit.

Even after nearly four months of investigation, the BM&A investigation findings do not state to the WSI Board or WSI leadership that WSI was in fact "not spending moneys as it should." According to 8.19 of the United States General Accounting Office Government Auditing Standards (GAGAS): "When auditors conclude, based on evidence obtained, that fraud, illegal acts, significant violations of provisions of contracts or grant agreements, or significant abuse either has occurred or is likely to have occurred, they should include in their audit report relevant information." BM&A never ever made any assertion of fraud or illegality.

The only reference to such an issue were comments by Director Zschomler in her February 1, 2006, letter where she stated, "...it is Risk Management's recommendation that: 1) All expenditures not authorized by statute be immediately stopped." In fact, Director Zschomler's February 1, 2006, comments were the first official notice to the agency that WSI's historical practices related to these types of procurement practices were questionable."

On February 16, 2006, -- after receiving Director Zschomler's February 1, 2006, letter-- Blunt wrote to all senior WSI officials who were over the purchasing functions during the timeframes in question:

In the process of validation of statements made regarding our procurement activities, it was alleged that there have been violations of statute. As you know, we operate under strict adherence to any applicable law and violations are not acceptable.

Consequently, I am asking each of you if Angie Scherbenske ever alerted you to any allegations she may have had associated with unethical procurement practices. What I would like to document is specifically did Angie ever alert you to any concerns and if so when and what were they. Please answer to this e-mail ASAP, as your response will be included in our response to the Division of Risk Management.

No significant or illegal items were presented as a result of this email.

In February of 2006, before formally responding to Director Zschomler about the BM&A review, Blunt spoke with Jason Wahl of NDOSA about his thoughts and concerns regarding the BM&A review. Blunt's main concern was the lack of consideration and mention of the historically standing purchasing practices of WSI in BM&A's review. In this same discussion, Blunt also expressed that if there were any findings of non-compliance in the performance audit, they would not be based on a willful intent and that it was his expectation that everyone follow all applicable laws, rules, and policies.

On March 6, 2006, Blunt formally responded to Director Zschomler's February 1, 2006, letter. Blunt stated, in part:

To a prudent person, proactively requesting legal authority and guidance from regulatory bodies as well as promoting and centralizing the oversight of procurement would not appear to be the actions of an organization trying to operate unethically and illegally.

Lastly, many of the items referenced as inappropriate in this investigation were acceptable purchasing practices at WSI prior to the current leadership team being instituted. In support of this statement, attached documents show Ms. Scherbenske not only supported but approved identical items. ... Since many of the cited actions were practiced for years by Ms. Scherbenske and/or existed in WSI's Employee Policy Handbook, it was logical to conclude the practices were proper and legal.

There is no evidence that BM&A performed any due diligence in the investigation of the reported claims beyond simply accepting Ms. Scherbenske's assertions as true.

WSI takes any accusations of inappropriate action(s) quite seriously. Please know that it is WSI's intention to follow every law and conduct itself appropriately. We obeyed Director Sharp's guidance to the letter and I am more than able to stand before the public and factually and quantitatively defend every expenditure made. While oversight and minor, unintentional errors can and did appear to occur, it does not make them willful or fraudulent. Nonetheless, we have been and continue to be committed to the development of procedural mechanisms that will eliminate these types of unintended errors.

Also presented with Blunt's March response was an 11 page request to clarify or correct 17 issues related to the BM&A review and Director Zschomler's recommendations as well as a detailed, point-by-point attachment with concrete examples and data to refute the review. Under the very first response in the 11 page request, **it is noted that Blunt had directed that the procurement practices in question be stopped immediately until WSI received a response to the justification for the expenses outlined in this document.** Below are some key highlights from the 11 page request:

If WSI is provided with authority that supports it is in violation of any procurement practices, the purchases will be stopped. However, it is the opinion of WSI staff that purchasing gift certificates and awards as well as promotional materials are allowable purchases as more fully explained below. In accordance with 65-02-01.2 of the NDCC, WSI has its own system of personnel administration. WSI personnel policies have been developed pursuant to this statutory authority. Additionally, WSI does operate in accordance with Office of Management and

Budget (OMB) Guidelines and had inquired on interpretation of these guidelines in the past. At the Request of the CEO, purchases that still remain in question based on the findings of this report have been immediately stopped and will remain so until WSI receives a response to the justification for the expenses outlined in this document.

The relatively few and minor examples cited in this report served as mechanisms to promote and articulate WSI's vision to its employees who would then turn the vision into actions that supported North Dakota and its workforce. Therefore, it was (and still is) WSI's understanding that each item was a legitimate promotional expense. Additionally, if Ms. Scherbenske felt these promotional expenses were not legitimate, she had a professional obligation to inform her direct supervisor or a member of senior management of such.

WSI requests that BM&A either provide verifiable evidence regarding how these expenses are a violation of the organization's purchasing authority, endorse WSI's ability to purchase these items, or entirely strike the reference of these purchases from all related documents. Casually referring to these purchases throughout the document creates an element of suspicion without validation.

Again, key individuals involved in the procurement process are and were not aware of fraudulent or unethical procurement practices. WSI is unable to locate any significant documentation where compliance was questioned.

Additionally, once the questions raised in the report have been resolved and WSI is in a position to determine if procedural modifications are necessary, WSI is requesting that RMD and BM&A present their final report to WSI's Board Audit Committee and/or Board of Directors.

**Angie Scherbenske Wife of NDOSA Auditor
Involved in Performance Audit of WSI**

Yet, even after leaving WSI in the Fall of 2005, Angie was still working with the NDOSA on the Performance Audit of WSI. Her continued involvement was evidenced by the fact that on February 01, 2006 at 5:07 PM (on the day that the WSI Performance Audit began), Scherbenske was sending Ron Tolstad (NDOSA) information from OMB on WSI contracts.

From: Tolstad, Ron I.
Sent: Thursday, February 02, 2006 7:53 AM
To: Wahl, Jason M.
Subject: FW: Report of Services for 2004

This gives us a few more contracts.

Ron Jr.

From: Scherbenske, Angie K.
Sent: Wednesday, February 01, 2006 5:07 PM
To: Tolstad, Ron I.
Subject: Report of Services for 2004

Ron,

Good afternoon. Here is the report of services for 2004. With a large disclaimer attached.

Because it was the first year collecting the information, the SPO received a wide variety of data; which made it very difficult to compile information. What we also found was that many agencies reported services that were exempt from being reported, so SPO will be trying to get the message out more on what to report and what not to report. I also added more fixed fields to the new 2006 form.

Which brings us back to this form... To best compile the information we took what we were given and tried to sort out what we knew was exempt. If we even questioned it, it remained on the report. The summary shows this type of sort.

The tabs after that show what each agency submitted without any data removed.
If you need any explanation on the spreadsheet please let me know.

Thanks.

Angie Scherbenske
Procurement Officer
State Procurement Office
Phone: 701.328.2779
Fax: 701.328.1615

The WSI Performance Audit Did Not Follow Government Standards Pertaining to Familial Relationships and Audit Objectivity

From the "Performance Audits" section of NDOSA website – "As defined by Government Auditing Standards, issued by the Comptroller General of the United States, performance audits are "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 relationships between NDOSA executive Ed Nagel and his WSI employee sister Joanne Maher as well as NDSOA auditor Kevin Scherbenske and his WSI employee wife Angie seem clearly in violation of the following very specific criteria.

The 2003 GAGAS, best known as the Yellow Book Standards, state (in part)...

3.03 The general standard related to independence is: In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, should be free both in fact and appearance from personal, external, and organizational impairments to independence.

3.04 Auditors and audit organizations have a responsibility to maintain independence so that opinions, conclusions, judgments, and recommendations will be impartial and will be viewed as impartial by knowledgeable third parties. Auditors should avoid situations that could lead reasonable third parties with knowledge of the relevant facts and circumstances to conclude that the auditors are not able to maintain independence and, thus, are not capable of exercising objective and impartial judgment on all issues associated with conducting and reporting on the work.

3.05 Auditors need to consider three general classes of impairments to independence—personal, external, and organizational. If one or more of these impairments affects an individual auditor's capability to perform the work and report results impartially, that auditor should either decline to perform the work, or in those situations in which the government auditor, because of a legislative requirement or for other reasons, cannot decline to perform the work, the impairment or impairments should be reported in the scope section of the audit report.

3.07 The audit organization should have an internal quality control system to help determine whether auditors have any personal impairments to independence that could affect their impartiality or the appearance of impartiality. The audit organization needs to be alert for personal impairments to independence of its staff members. Personal impairments of staff members result from relationships and beliefs that might cause auditors to limit the extent of the inquiry, limit disclosure, or weaken or slant audit findings in any way. Auditors are responsible for notifying the appropriate officials within their audit organizations if they have any personal impairments to independence. Examples of personal impairments of individual auditors include, but are not limited to, the following:

- a. immediate family or close family member¹⁸ who is a director or officer of the audited entity, or as an employee of the audited entity, is in a position to exert direct and significant influence over the entity or the program under audit;

e. preconceived ideas toward individuals, groups, organizations, or objectives of a particular program that could bias the audit;

f. biases, including those induced by political, ideological, or social convictions, that result from employment in, or loyalty to, a particular type of policy, group, organization, or level of government;

¹⁸ *Immediate family member is a spouse, spouse equivalent, or dependent (whether or not related). A close family member is a parent, sibling, or nondependent child.*

Scope of the WSI Audit Was Limited To The Blunt Administration Period

The time period that was being audited almost exclusively covered the Blunt administration. Activities that were common immediately prior to the Blunt administration under CEO Brent Edison were not scrutinized in any manner. There was apparently no interest on the part of NDOSA to consider historical continuity related to WSI procedure. The NDOSA did, though, have significant interest when interviewing WSI Board Members about the dismissal of Brent Edison as there were several related question on that matter.

Without justification or precedent, NDOSA seized over 37,000 emails from thirteen managers and WSI leaders. NDOSA advised those thirteen that if the emails did not match exactly with emails that NDOSA already had that WSI employees could be charged with a Class C Felony.

NDOSA Investigates Ohio Blunt Connection By Contacting Newspapers

Before coming to ND, Sandy Blunt was the Chief Operating Officer for the Ohio Bureau of Workers' Compensation (BWC). After a massive and lengthy investigation, Terrence Gasper of BWC eventually pled guilty to corruption charges in June of 2006 related to losses in a Bermuda-based hedge fund and cooperated with law enforcement as part of his plea arrangement. Through the course of the Gasper investigation, Blunt was meticulously scrutinized by a number of county, state and federal law enforcement agencies to assure he had no involvement in a crime. Not only was Blunt cleared of having any involvement whatsoever in the commission of any crime, but he was also designated a "friend of the court" as a result of the investigation.

The Audit began on February 1, 2006 and on Thursday, February 16, 2006 at 10:43 AM Ron Tolstad (under the subject "BWC ND Connection") was writing a reporter at the Toledo Blade investigating the Ohio scandal involving Gasper:

My office recently started a performance audit of the North Dakota Workforce Safety and Insurance. We have read some of your stories relating to the Ohio Bureau of Workers' Compensation. Our top executive came from BWC and he has brought in several people from the same organization. We think it is prudent to ask you if their names have come up in your investigative reporting in a manner we should know about. We refer to:

- Blunt, Charles "Sandy" A.
- Long, James D.
- Hutchings, Tim B.
- Nallie, Sonja Z.
- Spencer, Dave W.

As part of a continuing audit I am not able to share any information. Our state's largest paper will have a story Sunday relating to WSI <http://www.in-forum.com/>. The reporter (Pat Springer pspringer@forumcomm.com) thought we were working on similar topics.

So is the inference by Tolstad in his statement "the reporter thought we were working on similar topics" that Tolstad and the Toledo Blade reporter were both working on exposing criminal acts by Blunt? Seems so to me. Is this not a fairly bold and impaired assertion by what is supposed to be an "independent auditor?"

Is it not also odd that rather than contacting law enforcement officials, the Ohio State Auditor's Office, or any other official channel they instead contact a newspaper reporter who at best can supply NDSOA with third-party hearsay information and not absolute facts? Not contacting law enforcement authorities and instead serving as intermediary between media personnel seems to be a method not to get to the official facts concerning Blunt's Ohio record but rather to try to stimulate press coverage. This, after Patrick Springer had written a series of articles that contained a large number of factual errors and highly critical of WSI for the Fargo Forum.

NDOSA Only Asks For AG Opinions Only In Case of WSI/Blunt Jeopardy

There is no record that the NDOSA ever asked the NDAG to clarify or render an opinion on any legal claims made by WSI management that would have substantiated the position of WSI. NDOSA went to the NDAG on numerous occasions when they questioned issues that would prove damaging to WSI, WSI management, or Blunt.

NO WSI Performance Audit Findings of Wrongdoing

In conducting the WSI Performance Audit, the Auditor's Office followed the Yellow Book Standards. Within the Yellow Book Standards are two chapters that are very applicable to further demonstrating that there is no criminal intent presented in the WSI Performance Audit. Chapters 7 (Field Work Standards for Performance Audits) and 8 (Reporting Standards for Performance Audits) of the GAGAS are designed to guide the audit team and its findings. The most relevant portions of Chapter 7 and Chapter 8 are presented below for purposes of context.

GAGAS 7.27 states: "An audit made in accordance with these standards provides reasonable assurance of detecting illegal acts, violations of provisions of contracts or grant agreements, or fraud that could significantly affect the audit results." Found within SAO working papers are the Field Work and Reporting Standards Checklist based on GAGAS. Relevant portions of the "Planning" checklist ask:

- c. Were questions concerning the applications or interpretation of laws and regulations referred to the Attorney General's Office or otherwise resolved (7.19) ANSWER – YES
- d. Did the audit team discuss potential fraud risks, considering elements of the fraud triangle, that could significantly affect the audit objectives and results of the audit? (7.21) ANSWER -- YES
- e. Was there information indicating fraud or abuse may have occurred? If so, was a determination made whether the possible fraud or abuse affects the audit results significantly? If determined to significantly affect the audit results, were audit steps and procedures extended? (7.23, 7.25) ANSWER – YES
- f. Was due professional care exercised in pursuing indications of possible fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse to avoid interfering with potential investigations and/or legal proceedings? (7.26) ANSWER – YES

Relevant portions of the "Report Contents" checklist ask:

- 7. If it is determined that fraud, illegal acts, significant violations of provisions of contracts or grant agreements, or significant abuse either occurred or is likely to have occurred, does the report include relevant information and place the finding in proper perspective? (8.18-8.20) ANSWER – YES
- 8. Was fraud, illegal acts, violations or provision of contracts or grant agreements, and abuse reported directly to outside parties if legally required or if officials of the audited entity did not take appropriate action to notify outside parties? (8.22-8.25) ANSWER – YES

As noted in the planning checklist, on March 27, 2006, the audit team conducted a three hour meeting:

...to discuss fraud and aspects of fraud as they related to the goals and objectives that had been identified for field work. The discussion included a definition of fraud, the types of fraud, information related to the fraud triangle (individual's incentive or pressures to commit fraud, opportunity for fraud to occur, and rationalization for it), and fraud risk assessment. ... As a result, it is determined there is a high fraud risk for this audit.

Even after this very extensive review and elevated audit level and unsubstantiated concern of illegal activity, at no time were any fraudulent or illegal acts presented to the WSI Board of Directors, WSI Leadership Team, or the North Dakota Legislature in audit. Additionally, as required, the Auditor's Office worked and consulted routinely with the North Dakota Attorney General's Office during the audit. And at any time of question or concern, the Auditor's Office immediately contacted the Attorney General's Office (multiple NDAG Opinions relating to WSI and NDAG billing records to the Auditor's Office are tangible evidence of this close consulting relationship). In fact, NDAG billing records show that between March 6, 2006, and November 22, 2006, the Auditor's Office was officially provided 108.9 hours of counsel over a nine month period for an average of 12.1 hours per month.

Along with the Field Work and Reporting Standards Checklist, the GAGAS sections below are very succinct in the Auditors responsibilities had they discovered any fraudulent or illegal acts:

8.13 Auditors should report findings by providing credible evidence that relates to the audit objectives. These findings should be supported by sufficient, competent, and relevant evidence.

8.16 The audit report should also include any significant deficiencies in internal control, all instances of fraud and illegal acts unless they are clearly inconsequential, significant violations of provisions of contracts or grant agreements, and significant abuse.

8.19 When auditors conclude, based on evidence obtained, that fraud, illegal acts, significant violations of provisions of contracts or grant agreements, or significant abuse either has occurred or is likely to have occurred, they should include in their audit report relevant information. Abuse occurs when the conduct of a government program or entity falls far short of behavior that is expected to be reasonable and necessary business practices by a prudent person.

8.21 If the auditors have communicated instances of fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse in a separate letter to officials of the audited entity, auditors should refer to that letter in the audit report.

8.22 GAGAS require auditors to report fraud, illegal acts, violations of provisions of contracts or grant agreements, and abuse directly to parties outside the audited entity in certain circumstances...

8.26 Laws, regulations, or other authority may require auditors to report promptly indications of certain types of fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse to law enforcement or investigatory authorities. In such circumstances, when auditors conclude that these types of fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse either have occurred or are likely to have occurred, they should ask those authorities or legal counsel if publicly reporting certain information about the potential fraud, illegal acts, violations of provisions of contracts or grant agreements, or abuse would compromise investigative or legal proceedings.

It should again be noted, that at no time did the State Auditor's Office declare or publish in the audit any findings of fraud or illegal activity. In fact, in a November 2006 meeting between WSI Leadership and Jason Wahl and Gordy Smith of the Auditor's Office, Jason states that there was no fraud committed or documented in the WSI Performance Audit. Additionally, in his November 29, 2006, testimony before the Interim Legislative Audit and Fiscal Review Committee, Audit Manager Gordy Smith stated in response to a question from Committee Chairman Frank Wald that, "There was no fraud committed by the Board or anyone at WSI that we are aware of." Finally, in response to Blunt's July 16, 2007, public records request for any "documented and founded cases of fraud and illegal activity found during the WSI Performance Audit," Mr. Wahl writes that he has "no such records."

These are quite supportive comments considering the Auditor's Office spent nearly ten months at WSI conducting an extremely extensive performance audit that --as of November 20, 2006-- ran almost 40% (or 998 hours) longer than estimated. Had there been any such activity, the Auditors would have found it and, by GAGAS directives, would have had to have noted it. Additionally, notes in the Audit Management Leadership and Accountability section of the working papers dated 10-25-06 show that: **"Overall it appears the Executive Director is attempting to or has fulfilled most of his responsibilities."**

It is a critical point to understand that in the audit there no mention or declaration of "abuse, fraud or illegal activity" in relationship to WSI's procurement activities. So, if the activities were neither abusive, fraudulent, nor illegal then what exactly were they?

As directed under GAGAS 8.15, the Auditor is to provide the Criteria, Condition, Cause, and Effect of their findings in order to assist the audited entity:

8.15 To the extent possible, in presenting findings, auditors should develop the elements of criteria, condition, cause, and effect to assist officials of the audited entity or oversight officials of the audited entity in understanding the need for taking corrective action. In addition, if auditors are able to sufficiently develop the findings, auditors should provide recommendations for corrective action.

The most relevant of these four elements to the charges in this case would be the element of cause. GAGAS 8.15(c) states the following about the presentation of an evidence based “cause:”

- c Cause provides persuasive evidence on the factor or factors responsible for the difference between condition and criteria. In reporting the cause, auditors may consider whether the evidence provides a reasonable and convincing argument for why the stated cause is the key factor or factors contributing to the difference as opposed to other possible causes, such as poorly designed criteria or factors uncontrollable by program management. The auditors also may consider whether the identified cause could serve as a basis for the recommendations.

Under the element of “cause” did the auditor state that Blunt specifically knew these purchase were illegal and intentionally pursued them anyway? No. Instead, Auditor Ron Tolstad documented the evidence based causes for the procurement and legislative expense errors as:

Cause:

WSI has been flush with cash (special funds / nongeneral fund appropriation) and used to operating as they please.

Cause:

WSI has been used to operating as it pleases.

Based on the definition above, neither of these assertions rise to the level of “cause.”

Author’s Interpretive Summary

It is my view, having exerted much effort of data collection, study, analysis, and writing descriptive and interpretive commentary, that two people have been charge with felonies as a result of an audit that began with the goal of punishment. The conflicts of interest that have never been in any manner openly discussed likely had significant bearing on the events that have unfolded. It seems to me that when Sandy Blunt took over a very troubled agency and that he had to make very difficult personnel decisions. He had to run the troubled agency with a strong hand. Some people disliked his new management very much. That is the way it happens when ever there is a change of management almost anywhere in the corporate or government world. A significant number of people unhappy with the new administration had long and deep connections with the state agency that has administrative oversight authority, the North Dakota State Auditor’s Office. The objectivity of the audit is suspect as the logical twists, the omission of fact, the process of inference that turned to analysis, which was then summed to become fact, and then was mutated into indictment was truly amazing.

It turns out that if you are running a state government agency and you do not know every rule and law that you cannot depend on the advice of your subordinates to give you proper advice. If you do not know everything and understand the complex subtle interrelationship of law and government regulation, and make every proper judgment you too could be charged with a felony. After all, a man with a stellar record of accomplishment over more than a decade of public service without one iota of malfeasance in his past will likely spend tens of thousand of dollars to defend himself though his stolen honor will be impossible to recover. On what factual basis? On what real evidence has this man been punished? If this travesty is allowed to continue, none --and I do mean none of us-- are safe from the duplicity and vagary of our own government.

After Audit Problems: NDOSA Involvement in Blunt Prosecution

There was an open discussion among the attendees at one of Blunt's court hearings that Jason Wahl had been plainly seen entering and exiting the Burleigh County State's Attorney (BCSA) office prior to the hearing. As discussed previously, it has been established that Blunt had done not anything fraudulent, let alone illegal. Auditing criteria demanded the recording and reporting of fraudulent or illegal activity found by an audit. To what degree then, if any, was the Auditor's office involved in the criminal prosecution of Blunt? Did they present to the BCSA that they had found no evidence of crimes by Blunt or did they assist the BCSA in making the case against Blunt? Did Wahl advise the BCSA that on Friday, July 20, 2007, at 11:25 AM (under the subject "RE: Public Records Request") he told Blunt "I have no such records in my possession" when asked:

"Unless you have any records given to you from a law enforcement and/or investigatory authority during the course of the audit that demonstrate any founded illegal or fraudulent activity, then you are correct the request is withdrawn. If you can provide any such records, then request is not withdrawn."

If the NDSAO was involved with the BCSA, is this not yet another sign of impairment by the office that should preclude them returning to audit WSI any further? If this potential involvement alone is not a significant impairment then what about it in combination with:

- documented personal and family relationships between the Auditor's Office and WSI;
- premeditated admissions about the intent to conduct a Performance Audit between Smith and Peterson;
- 43 pages of email communication within the Auditor's Office released by the Auditor's Office;
- public comments by Smith such as "There were nearly 200 recommendations," Smith said about the performance evaluation and the audit. "Then they hired someone for a morale survey. They have all these suggestions on how to make things better and how to tackle it and such, and you wonder when they're going to do it. Why do you need another study?*" when he had personally heard testimony by WSI before the Interim Budget Committee on October 29, 2007, that 73% of the agency's 351 recommendations had been implemented and another 15% were partially implemented for a total of 88%. (*Crystal Reid, "WSI board holding closed session today," Bismarck Tribune, Nov 13, 2007)
- and, an unprofessional relationships between Kay Grinsteinner and members of the Auditor's Office.

Kay Grinsteinner and the Secret Audit

Concerns were raised by WSI Internal Audit Manager Kay Grinsteinner concerning several subjects in an email just prior to her November 5, 2007 request for Whistleblower protection and after Sandy Blunt's October 22, 2007 reinstatement by the board as CEO of WSI:

From: Kay Grinsteinner [mailto:grinnyka@bis.midco.net]
Sent: Wednesday, October 31, 2007 6:35 AM
To: 'gsmith@nd.gov'; 'Wahl, Jason M.'; 'rtolstad@nd.gov'
Subject: WSI Financial Statements

Good morning,

I believe WSI may have significant unaccrued liabilities, possibly material to the financial statements. I just thought of this last week. Here's why I'm wondering:

1. The notes from the April 11 meeting (Jason has read them) seem to indicate we are denying claims with little or no basis on the hopes the claimants will not appeal.
2. The acceptance rates (if you can believe our stats...big ? there) seem to indicate about a 7% drop in claims accepted. I'm sure Brady Martz looked at this?
3. Cade Jorgenson told me has seen Attorney Work Product notes from Nilles Law Firm stating WSI would have only a 10% chance of prevailing on some of their legal positions. I don't know how widespread this is, but I have to believe it could be significant.

Management would not have brought this to B&M's attention. This is our dirty little secret on how we're really treating injured workers. Someone should take a closer look, in my opinion.

Then on **October 31, 2007 7:37** at AM, an hour and two minutes after the first email, Grinsteinner goes on to add to Jason Wahl, Ron Tolstad, and Gordy Smith (under RE: WSI Financial Statements) that:

Oh, and I would normally feel compelled to take this forward to management/or AC Chair/Board Chari, but they're too busy trying to fire me.

It is absolutely clear that each of the parties involved in this issue were distinctly aware of the proper procedure and protocol to be used, yet, they chose to not only willfully ignore the proper procedure and protocol but mock it as well. In fact, it was not until the following Monday, November 05, 2007, that Kay Grinsteinner finally advises her supervisor (the Board) under the subject "Letter to Board 11.05.07.doc" that:

The attached meeting notes caused concern when I read them. I have been urged by my attorney to bring this to the Board's attention. Given feedback on recent Policy Governance training sessions, I believe the Board is concerned about injured worker issues. These documents are what they are. Information to be reviewed, contemplated, and perhaps investigated further. I also wonder if we have inappropriately denied claims which could lead to tort liability, and if that liability could be material to the financial statements? I inquired via SAO/Brady Martz as to the implications, and BM&A felt there is adequate claims reserves. However, they did not have details regarding these notes and I presume, are relying on legal letters from our outside attorneys concerning threatened or pending litigation. I see this as possibly similar to the Social Security offset issue that resulted in a \$16 ? million liability accrual due to Supreme Court ruling. Other questions arise as well.

I feel the Board at least needs an opportunity to review this information and discuss as necessary. Perhaps everyone is on the same page, I don't know. I think an in-depth review should be conducted, but that's just my opinion. This is not a typical audit report.

In Ms. Grinsteinner's November 5, 2007, email she clearly states: **"I have been urged by my attorney to bring this to the Board's attention."** I does not say at the urging of the State Auditor's Office (Smith, Wahl and/or Tolstad) or Brady Martz, but rather by her attorney. Did not each CPA in this case have a professional obligation to notify the governing authority –the WSI Board– immediately upon being made aware of the stated concerns? Yes. Did any of them do so? From what little evidence I have seen, no. In fact, the only evidence I can find in relation to anyone notifying the Board is an attachment to Ms. Grinsteinner's November 5, email above where she states:

"Dear Board: In writing this letter, I am taking an unconventional approach to fulfill my responsibility as Internal Audit Manager to inform you of matters of significance concerning WSI. ... Please take this information in the spirit intended. My responsibility is to ensure the Board is fully informed and to call attention to issues and concerns."

If Ms. Grinsteinner's "responsibility is to ensure the Board is fully informed and to call attention to issues and concerns" then why did she not fulfill it when the responsibility was first apparent to her? And if it is her responsibility as a CPA, then was it not also Ronald Tolstad, Gordon Smith, Jason Wahl, John Mongeon, and Richard Awalt's responsibility as well? Yet none of them took any responsible action until after Ms. Grinsteinner's attorney advised her to do so –an attorney that was retained in relation to her whistleblower claims. My most significant concern is that this group of CPAs was each well aware of Ms. Grinsteinner's lack of notice or responsibility to the Board about her concerns and well aware of Mr. Tolstad's directive that "Well, you knew this was a high risk audit. ... I've got a feeling more crap is about to hit the fan. Do what you have to do to, but be as discrete as you can be."

What "high risk audit" was there? The Board neither directed nor was made aware or a secretive "high risk" audit being conducted. So how can it be an official, legitimate, and ethical audit? Was it not more of a collusion to conduct an unfounded, undercover investigation based on zero use of protocol or standards? What CPA standard implores a licensee to "be as discrete as you can be" regarding fundamental operational and financial concerns? What CPA standard sets out that CPAs are to ignore Audit Charter guidelines and intentionally leave the Board of Directors (the employer) unadvised of concerns? What CPA standard sets out that concerns may be frivolously raised with no supporting documentation or review to base such conclusions? This apparent disregard for auditing standards by these CPAs (most notably those from the State Auditor's Office) is quite troubling and demands further review.

Planning and Administrative File
Client Acceptance Questionnaire

Prospective Client – Workforce Safety and Insurance
Date January 17, 2006

	YES	NO
1. Is there any reason to doubt the integrity of the entity's management or officers?	<u>X</u>	<u> </u>
2. Are we aware of any independence problems or conflicts of interest because of relationships with other clients, management, or staff?	<u> </u>	<u>X</u>
3. Is the expertise necessary to perform the engagement beyond our capabilities?	<u> </u>	<u>X</u>
4. Is the staffing commitment required by the job beyond our capabilities?	<u> </u>	<u>X</u>
5. Is there anything about the engagement that causes us to be uncomfortable about being associated with the engagement?	<u> </u>	<u>X</u>
6. Does the engagement go beyond the statutory powers and duties of North Dakota's Office of the State Auditor?	<u> </u>	<u>X</u>

COMMENTS

A "YES" response does not necessarily indicate that the prospective client should be rejected. However, for any "YES" response, explain the steps that we plan to take to mitigate the situation, e.g., closer supervision, assistance from another firm, etc.

evaluation
Based on working with WSI management through a performance review process, concerns were identified regarding WSI management. As a result, an audit team was compiled that will include an Audit Manager as a staff member + closer supervision of staff is expected to occur. In addition, interviews with WSI employees will occur with two SAO team members present.

CONCLUSION

We should accept X or not accept the engagement

Audit manager

OR

Audit Director

Date

Date

* The perf. evaluation process resulted in WSI management initially indicating they wanted no part in setting the scope of the evaluation. Subsequently we developed the scope, and provided WSI management a draft copy of the scope. WSI management then strongly objected to 3 segments we proposed (IT consultants and Human Resource Management). During their argument, they cited cost, expertise and the fact it wasn't appropriate since there weren't "corporate" WSI. We believe their objections seemed without merit and believe specifying add'l professional steps would be called for. 1/18/06

Gordy,

Thanks for the return call yesterday and thanks for agreeing to meet with us to discuss the proposed elements for the Performance Evaluation Tuesday, November 8, 11:00am at our office. Additionally, WSI's Board Audit Committee meets Wednesday, November 9, 2005 at 3:00pm. I know you indicated you may not be available, but if possible can a representative of the Office of the State Auditor attend this meeting to outline for the Board Audit Committee the element selection and performance evaluation process. If this date does not work, WSI's Board of Directors meets at 8:30am Thursday November 10 in the Board Room at WSI. A briefing of the full Board would be acceptable as well.

Please accept this document as WSI's formal request to remove and replace a portion of the elements proposed in the State Auditor's draft WSI Performance Evaluation RFP. As I indicated in our discussion and as Sandy referenced in his previous correspondence with Auditor Peterson, outlined in this request are some of the questions and concerns we have with the proposed elements.

As you are aware, the performance evaluation statute was passed by the 1997 legislature at the request of our organization to ensure ongoing accountability and continual improvement. The key emphasis within the legislation was securing the "*workers' compensation industry expertise*" to identify potential improvement opportunities for our core operating areas. This is a critical element given our monopolistic environment, as outside this agency, workers' compensation expertise within this state is very limited. Based upon the elements suggested by the State Auditor's draft RFP, we are concerned that we are migrating away from the original intent of utilizing the *workers' compensation industry expertise* to evaluate and recommend changes to our core programs. In the draft RFP the scope tends to be shifting from core workers' compensation operational functions to more administrative and support functions.

As indicated previously, our understanding for this biennium is that the statute requires the following areas at a minimum:

- **65-02-30**--the effectiveness of safety and loss prevention programs under section 65-03-04
- **65-02-30**--evaluate the Board to determine whether the Board is operating within section 65-02-03.3 and within the board's bylaws
- **65-02-30**--performance measurements maintained by the organization
- **65-02-23**--effectiveness of fraud expenditures

It is also our understanding that a review of the status of prior recommendations is a common element with these evaluations and should continue to be so.

At your request, we provided you a list of alternative elements that we would like evaluated. These areas were:

- Medical bill audit procedures/processes and overall effectiveness
- Utilization Review procedures/processes and overall effectiveness
- PHS—Experience Modification calculations, premium billing process (billing after policy renewal versus before), premium audits, and collections

In identifying these areas, we took into account the following:

- In what areas will workers' compensation industry expertise provide the most value for the dollar?
- What major operating areas were not reviewed last biennium and consistent with statute should be reviewed at least every other biennium?
- How can we avoid duplication of management reviews/audits by the WSI and its Board Audit Committee as well WSI's internal audit function?

As a result of asking these questions we took the following set of key facts into mind. WSI pays out nearly \$50 million per year in medical benefits. Medical Bill Audit and Utilization Review are key components to controlling medical dollars. To the extent there are industry medical cost-containment strategies out there that we are not utilizing, we would welcome a systematic set of professional recommendations to implement them. Policyholder Services is tasked with billing and collecting over \$100 million in premium per year. To the extent there exists industry practices to improve our current practices, we would again welcome the professional recommendations. The potential value for the dollar in each of these areas is significant. Yet, none of these suggestions were proposed as elements. Below, are the proposed elements provided by the State Auditor's Office. **WSI's comments or proposed alterations are highlighted in red.**

Element One - Evaluation of WSI Performance Measurements

The review must evaluate the performance measurements developed by WSI in accordance with NDCC § 65-02-30, and include any recommendations for enhancement of the existing system and identification of any additional areas of measurement to be utilized. **(Agree, Statutorily required)**

Element Two – Evaluation of Safety and Loss Prevention Programs

The review must evaluate the administration and effectiveness of WSI's work safety and loss prevention programs, as compared to industry standards and practices. (NDCC § 65-03-04) Recommendations for improvement should be made if necessary. **(Agree, Statutorily required)**

Element Three – Evaluation of Information Technology Section

- Determine whether the Information Technology (IT) section of WSI is being managed in an effective, efficient and proactive manner.
- Are on-going maintenance costs being monitored and compared against the cost of replacing ineffective or inefficient systems?
- Are the policies and procedures used for IT project management effective and being followed?

Recommendations for improvement should be made if necessary.

WSI IS ASKING THAT THIS ELEMENT BE REMOVED FROM THIS PERFORMANCE AUDIT: This element is currently being addressed by WSI and is not a function of a workers' compensation expert. WSI is working with Information Technology Department (ITD) and the Interim Information Technology Committee on system issues. Additionally, WSI's Information Systems were recently reviewed by The Gartner Group, controls are reviewed annually as part of the agency's financial audit, and two pending RFPs exist for IT Change Management Services and IT Transformation Project Services.

Element Four – Evaluation of Consulting Contracts

Evaluate WSI's contracting process with "outside" consultants. This evaluation should include:

- determining the total amount of money WSI spent on outside consultants during the evaluation period (1/1/04 – 12/31/05);
- ascertaining whether WSI used an appropriate process to select specific consultants (including issuing requests for proposals, evaluating the proposals using objective criteria and documenting the process sufficiently);
- determining whether the work done by the consultants could have been done by WSI with increased staff at a reduced cost; and
- concluding as to whether or not WSI has implemented the recommendations or suggestions provided by the consultants.

If consulting contracts were awarded without an RFP process, was there adequate documented rationale for this course of action? Recommendations for improvement should be made if necessary.

WSI IS ASKING THAT THIS ELEMENT BE REMOVED FROM THIS PERFORMANCE AUDIT: There is a review currently in progress and this is not a function of a workers' compensation expert..

Element Five - Evaluation of WSI Audit Committee and Internal Audit Division

Evaluate whether the Internal Audit Division is functioning appropriately and conducting effective audits of WSI. Determine if recommendations set forth by the Internal Audit Division have been implemented by WSI. Conclude as to whether the Audit Committee is functioning properly. Recommendations for improvement should be made if needed.

WSI IS ASKING THAT THIS ELEMENT BE COMBINED WITH ELEMENT SEVEN: The Board Audit Committee is a sub-function of the Board of Directors and should therefore be covered under a thorough Board Audit.

Element Six - Evaluation of Human Resource Management

Evaluate the human resources management process to ensure it is functioning properly. At a minimum, this evaluation should include:

- determining compliance with its human resource policies and procedures manuals;
- concluding whether all employees received performance reviews in a timely manner and if pay raises were appropriately based upon these performance reviews;
- ascertaining whether all positions were filled after an appropriate hiring process was followed (including advertising for positions, documented evaluations of applicants, adherence to appropriate NDCC or ND Administrative Code sections dealing with hiring, etc.);
- conducting staff surveys to determine job satisfaction and soliciting suggestions from staff on improvements that would increase their job satisfaction. Staff surveys should be kept confidential. Surveys should not be anonymous in order to allow consultants to determine if problems cited, if any, are relevant only to certain divisions.

Making recommendations for improvements, if needed.

WSI IS ASKING THAT THIS ELEMENT BE REMOVED FROM THIS PERFORMANCE AUDIT: This element is currently being addressed by WSI and is not a function of a workers' compensation expert. HR functions were reviewed a little over a year ago by HR expert Van Black of Developmental Dimensions International (DDI). The compensation plan and performance appraisal system were reviewed by international workers' compensation HR experts at the HayGroup within the last six months. And, WSI is currently structuring a pricing proposal for organizational culture assessment and measurement tools.

Element Seven - Review of North Dakota Workforce Safety and Insurance Board

The review shall also determine whether the ND Workers' Compensation Board is operating in accordance with NDCC § 65-02-03.3, and within the Board's bylaws. **(Agree, Statutorily required)**

Element Eight - Fraud Unit

Evaluate and report on, the effectiveness of expenditures incurred by WSI's fraud unit, in accordance with NDCC § 65-02-23. **(Agree, Statutorily required)**

Element Nine – Status of Prior Recommendations

Determine the status of the recommendations included in the prior performance evaluation. The recommendations should be classified as either; implemented, partially implemented, not implemented or no longer applicable. The status of each recommendation should be accompanied by a brief explanation of the conditions causing the recommendation and why the recommendation has been classified in the category where it appears. (Agree, Common Element)

The following are elements that we would like to again propose be those that replace the removed elements:

Add a Medical Services review including Bill Review and Audit and Utilization Review procedures, processes, and overall effectiveness.

Add a Policyholder Services (PHS) review including experience modification calculations, premium billing process (billing after policy renewal versus before), premium audit, collections, and rate classification manuals.

The elements as proposed by the State Auditors Office will require at a minimum a firm with extensive expertise in workers' compensation practices and standards, a Human Resources firm, an Information Technology firm, and a safety expert. We anticipate that this along with services that were previously provided will significantly drive up the cost of the evaluation. I think you will agree that duplicative services combined with the ineffective use of workers' compensation expertise are not a good use of funds and would not be viewed favorably by our premium paying customers.

Thank you for your consideration and we look forward to discussing these items on Tuesday.

John