OLA | OFFICE OF THE LEGISLATIVE AUDITOR

Judy Randall, Legislative Auditor
State of Minnesota

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Members of the Minnesota State Legislature

The Honorable Tim Walz, Governor

Erin Campbell, Commissioner, Minnesota Management and Budget

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Minnesota as of and for the year ended June 30, 2023, and the related notes to the financial statements, which collectively comprise the State of Minnesota's basic financial statements, and have issued our report thereon dated December 15, 2023. Our report includes a reference to other auditors who audited the financial statements of the Minnesota State Colleges and Universities, Minnesota State Lottery, Minnesota Housing Finance Agency, Metropolitan Council, University of Minnesota, Minnesota Sports Facilities Authority, Office of Higher Education, Public Facilities Authority, and Workers' Compensation Assigned Risk Plan, as described in our report on the State of Minnesota's financial statements. The financial statements of the Minnesota Housing Finance Agency and Workers' Compensation Assigned Risk Plan were not audited in accordance with *Government Auditing Standards*. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State of Minnesota's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of Minnesota's internal control. Accordingly, we do not express an opinion on the effectiveness of the State of Minnesota's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify a certain deficiency in internal control, described in the accompanying *Finding and Recommendation* section as Finding 1, that we consider to be a material weakness.

Report on Compliance and Other Matters

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

State of Minnesota's Response to Findings

Government Auditing Standards requires the auditor to perform limited procedures on the State of Minnesota's response to the findings identified in our audit and described in the accompanying *Finding and Recommendation* section. The State of Minnesota's response was not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

Purpose of this Report

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

Lori Leysen, CPA
Deputy Legislative Auditor

Zach Yzermans, CPA
Audit Director

December 15, 2023

Finding and Recommendation

FINDING 1

The Department of Employment and Economic Development did not have adequate internal controls to ensure it accurately reported the cash and unearned revenue balances in the Unemployment Insurance Fund financial statements.

The Department of Employment and Economic Development (DEED) overstated the cash and unearned revenue balances in the Unemployment Insurance Fund financial statements by $69.68 million. During Fiscal Year 2023, the federal government reduced the amount of cash in a federal account that DEED could spend on anticipated unemployment obligations under the Federal Pandemic Unemployment Compensation program by $69.68 million. DEED did not record this reduction in its accounting records. DEED staff stated that the federal government typically sends a notification letter when it plans to reduce available funds. DEED could not confirm whether it received a notification letter for this reduction, but regardless, it did not record the reduction. In addition, DEED did not reconcile the cash in the account to its accounting records and thus did not identify and record the reduction. The unrecorded cash reduction caused the misstatement in the Unemployment Insurance Fund financial statements.

Minnesota Management and Budget posted the proposed audit adjustment to reduce cash and unearned revenue by $69.68 million.

RECOMMENDATION

The Department of Employment and Economic Development should reconcile cash in its accounts to cash recorded in the accounting records.

EMPLOYMENT AND ECONOMIC DEVELOPMENT

February 9, 2024

Judy Randall, Legislative Auditor
Office of the Legislative Auditor (OLA)
Room 140 Centennial Building
658 Cedar Street
Saint Paul, MN 55155-1603

Dear Legislative Auditor Randall:

Thank you for the opportunity to submit a written response to the findings and recommendations of your financial statement audit of the Unemployment Insurance Fund for the period from July 1, 2022, through June 30, 2023.

The audit reported inadequate internal controls to ensure it accurately reported the cash and unearned revenue balances in the Unemployment Insurance Fund financial statements. The audit report summary contains the specific audit finding and recommendation listed in the following page.

This letter responds to the written findings and recommendations identified in the audit report.

If you have any questions or need additional information, please contact me or Julie Freeman, CFO, at Julie.freeman@state.mn.us or 651-259-7085.

Regards,

Matt Varilek
Commissioner
Department of Employment and Economic Development

Finding Number 1

The Department of Employment and Economic Development did not have adequate internal controls to ensure it accurately reported the cash and unearned revenue balances in the Unemployment Insurance Fund financial statements.

The Department of Employment and Economic Development (DEED) overstated the cash and unearned revenue balances in the Unemployment Insurance Fund financial statements by $69.68 million. During Fiscal Year 2023, the federal government reduced the amount of cash in a federal account that DEED could spend on anticipated unemployment obligations under the Federal Pandemic Unemployment Compensation program by $69.68 million. DEED did not record this reduction in its accounting records. DEED staff stated that the federal government typically sends a notification letter when it plans to reduce available funds. DEED could not confirm whether it received a notification letter for this reduction, but regardless, it did not record the reduction. In addition, DEED did not reconcile the cash in the account to its accounting records and thus did not identify and record the reduction. The unrecorded cash reduction caused the misstatement in the Unemployment Insurance Fund financial statements.

Minnesota Management and Budget posted the proposed audit adjustment to reduce cash and unearned revenue by $69.68 million.

Recommendations

The Department of Employment and Economic Development should reconcile cash in its accounts to cash recorded in the accounting records.

Minnesota Department of Employment and Economic Development
Administrative and Financial Services
180 E 5th Street, Suite 1200, St. Paul, Minnesota 55101
Phone 651/259-7161 or 1-800-657-3858
mn.gov/deed

EMPLOYMENT AND ECONOMIC DEVELOPMENT

DEED's Response

The Department of Employment and Economic Development (DEED) agrees that a federal de-obligation of available funds for the *Federal Pandemic Unemployment Compensation* (FPUC) program as they appear in the federal *Automated Standard Application for Payments* (ASAP) was not detected and immediately entered into its accounting records. This meant that DEED's accounting records were incorrect insofar as Cash and offsetting Unearned Revenue amounts did not reflect the amount shown in ASAP.

This financial statement error had no net impact on cash available to the State of Minnesota or its Unemployment Insurance program, and assets and liabilities were in balance before the adjustment.

DEED notes that FPUC monies depicted in ASAP were present to allow states to administer the FPUC program on behalf of the federal government. The funds are expenditure-based, and states are only permitted to draw FPUC funds from ASAP in amounts equivalent to actual expenditures. DEED did not draw FPUC amounts in excess of expenditures. Any amount of federal FPUC funds as reflected in ASAP that are depicte d as cash must always also be depicted as unearned revenue since these funds will either be expended as benefits paid to eligible applicants or will revert to the federal government. DEED notes that while the FPUC program activity must be fully and accurately reflected in its Unemployment Insurance Program accounting records, FPUC funds themselves never form part of the Unemployment Insurance Trust Fund.

DEED was always timely in making FPUC payments to eligible applicants. The amount of FPUC funds the federal government assigned to Minnesota in ASAP was always significantly greater than current or potential future expenditures. DEED was aware that when the FPUC program ended in September 2021, most of the amount shown in ASAP would eventually be de-obligated by the federal government. For this program, DEED had relied upon federal government notifications from the ASAP system to adjust both the cash and unearned revenue accounts in its accounting records. During Fiscal Year 2023, the federal government re duced the amount of cash in the ASAP account that DEED could spend on anticipated unemployment obligations in the FPUC account in the ASAP system by $69.68 million without notice to the agency. Until these FPUC funds were de-obligated without notice in Fiscal Year 2023, the federal government had notified the department regarding each such de-obligation.

When we found the underlying de-obligation transaction that caused the cash variance issue, we prepared the adjusting ACFR entries to correct the cash and unearned revenue issue for the ACFR statement presentation to Minnesota Management and Budget (MMB).[1]

[1] Initial OLA guidance was that DEED adjust federal grants revenue on the financial statement. DEED did not agree with the recommendation as this would have been an incorrect adjustment since the cash returned to the Federal Government had already been classified in the financial statement as unearned revenue as part of our normal reporting process. After discussion between DEED, MMB, and OLA, OLA ultimately agreed that it should be an adjustment to unearned revenue, not federal grants revenue.

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