



FINANCIAL AUDIT DIVISION REPORT

**Department of Employment
and Economic Development**

Federal Compliance Audit

Fiscal Year 2010

April 8, 2011

Report 11-06

FINANCIAL AUDIT DIVISION

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

April 8, 2011

Representative Michael Beard, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Mark Phillips, Commissioner
Department of Employment and Economic Development

This report presents the results of our audit of certain federal financial assistance programs administered by the Department of Employment and Economic Development during fiscal year 2010. We conducted this audit as part of our audit of the state's compliance with federal program requirements. We emphasize that this has not been a comprehensive audit of the Department of Employment and Economic Development.

We discussed the results of the audit with department staff at an exit conference on March 28, 2011. The audit was conducted by Brad White, CPA, CISA, CFE, (Audit Manager) and Joan Haskin, CPA, CISA, (Auditor-in-Charge), assisted by auditors Carissa Moritz, Pat Ryan, Blake Schwagel, and Paul Thompson.

This report is intended for the information and use of the Legislative Audit Commission and the management of the Department of Employment and Economic Development. This restriction is not intended to limit the distribution of this report, which was released as a public document on April 8, 2011.

We received the full cooperation of the department's staff while performing this audit.

Handwritten signature of James R. Nobles in black ink.

James R. Nobles
Legislative Auditor

Handwritten signature of Cecile M. Ferkul in black ink.

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

Table of Contents

| | <u>Page</u> |
|--|-------------|
| Report Summary | 1 |
| Findings and Recommendations | 5 |
| 1. The Department of Employment and Economic Development did not identify and recover up to \$3.2 million of estimated overpaid unemployment insurance benefits for the Federal Additional Compensation Program and \$19,660 of other benefit extensions | 5 |
| 2. Prior Finding Partially Resolved: The Department of Employment and Economic Development did not fully identify and monitor its internal controls to ensure compliance with federal requirements | 6 |
| Agency Response | 9 |

Report Summary

Conclusion

The Department of Employment and Economic Development generally complied with and had controls to ensure compliance with provisions of laws, regulations, contracts, and grants applicable to the major federal programs we audited for fiscal year 2010. However, the department had weaknesses, as noted in the two findings presented in this report, including one repeat finding from last year's audit that the department did not fully resolve.

Findings

- The Department of Employment and Economic Development did not identify and recover up to \$3.2 million of estimated overpaid unemployment insurance benefits for the Federal Additional Compensation Program and \$19,660 of other benefit extensions. ([Finding 1, page 5](#))
- Prior Finding Partially Resolved: The Department of Employment and Economic Development did not fully identify and monitor its internal controls to ensure compliance with federal requirements. ([Finding 2, page 6](#))

Audit Scope

Our scope included programs determined to be major federal programs for the state of Minnesota for fiscal year 2010, including Unemployment Insurance, Workforce Investment Act Cluster, and Vocational Rehabilitation.

Department of Employment and Economic Development

Federal Program Overview

The Department of Employment and Economic Development administered federal programs that we considered major federal programs for the State of Minnesota, subject to audit under the federal Single Audit Act.¹ Table 1 identifies these major federal programs.

Table 1
Department of Employment and Economic Development
Major Federal Programs
Fiscal Year 2010
(in thousands)

| <u>CFDA</u> ¹ | <u>Program Name</u> | <u>Federal Expenditures</u> | <u>Federal ARRA</u> ² <u>Expenditures</u> | <u>Total</u> |
|--------------------------|---|-----------------------------|---|------------------|
| 17.225 | Unemployment Insurance ³ | \$2,193,426 | \$897,217 | \$3,090,643 |
| | <u>Vocational Rehabilitation Cluster:</u> ¹ | | | |
| 84.126 | Vocational Rehabilitation Grants to States | 52,967 | 0 | 52,967 |
| 84.390 | Vocational Rehabilitation Grants to States, Recovery Act | 0 | 3,113 | 3,113 |
| | Total Vocational Rehabilitation Cluster | <u>\$ 52,967</u> | <u>\$ 3,113</u> | <u>\$ 56,080</u> |
| | <u>Workforce Investment Act Cluster:</u> ¹ | | | |
| 17.258 | Workforce Investment Act-Adult | 9,636 | 5,368 | 15,004 |
| 17.259 | Workforce Investment Act-Youth | 12,781 | 13,514 | 26,295 |
| 17.260 | Workforce Investment Act-Dislocated Worker | 21,395 | 20,617 | 42,012 |
| | Total Workforce Investment Act Cluster | <u>\$ 43,812</u> | <u>\$ 39,499</u> | <u>\$ 83,311</u> |

¹The Catalog of Federal Domestic Assistance (CFDA) is a unique number assigned by the federal government to identify its programs. Some federal programs are clustered if they have similar compliance requirements. Although the programs within a cluster are administered as separate programs, they are treated as a single program for the purpose of meeting the audit requirements of the U.S. Office of Management and Budget's Circular A-133.

²American Recovery and Reinvestment Act.

³Expenditures include unemployment insurance benefits and about \$54 million of federal administrative reimbursements.

Source: Department of Employment and Economic Development's accounting system for fiscal year 2010.

¹ We defined a major federal program for the State of Minnesota in accordance with a formula prescribed by the federal Office of Management and Budget as a program or cluster of programs whose expenditures for fiscal year 2010 exceeded \$30 million.

Objective, Scope, and Methodology

The objective of our audit was to determine whether the Department of Employment and Economic Development complied with federal program requirements in its administration of these federal programs for fiscal year 2010. This audit is part of our broader federal single audit objective to obtain reasonable assurance about whether the State of Minnesota complied with the types of compliance requirements that are applicable to each of its federal programs.² In addition to specific program requirements, we examined the department's general compliance requirements related to federal assistance, including its cash management practices. We also followed up on findings and recommendations reported to the department's management in our previous audit.³

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States of America and with the U.S. Office of Management and Budget's *Circular A-133 Compliance Supplement*.

Conclusion

The Department of Employment and Economic Development generally complied with and had controls to ensure compliance with certain provisions of laws, regulations, contracts, and grants applicable to its major federal programs for fiscal year 2010. However, the department had some weaknesses, as noted in the following *Findings and Recommendations* section, including one repeat finding from last year's audit that it did not fully resolve.

We will report these weaknesses to the federal government in the *Minnesota Financial and Compliance Report of Federally Assisted Programs*, prepared by the Department of Management and Budget. This report provides the federal government with information about the state's use of federal funds and its compliance with federal program requirements. The report includes the results of our audit work, conclusions on the state's internal controls over and compliance with federal programs, and findings about control and compliance weaknesses.

² The State of Minnesota's single audit is an entity audit of the state that includes both the financial statements and the expenditures of federal awards by all state agencies. We issued an unqualified audit opinion, dated December 20, 2010, on the State of Minnesota's basic financial statements for the year ended June 30, 2010. In accordance with *Government Auditing Standards*, we also issued our report on our consideration of the State of Minnesota's internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grants. (Office of the Legislative Auditor's Financial Audit Division Report 01-02, *Report on Internal Control Over Financial Reporting*, issued February 18, 2011.) This report included control deficiencies related to the Department of Employment and Economic Development.

³ Office of the Legislative Auditor's Financial Audit Division Report 10-10, *Department of Employment and Economic Development*, issued March 18, 2010.

Findings and Recommendations

Finding 1

The Department of Employment and Economic Development did not identify and recover up to \$3.2 million of estimated overpaid unemployment insurance benefits for the Federal Additional Compensation Program and \$19,660 of other benefit extensions.

During fiscal year 2010, the department did not identify and recover up to \$3.2 million⁴ of Unemployment Insurance Program (CFDA 17.225⁵) estimated overpayments for the Federal Additional Compensation Program.⁶ Through the Additional Compensation Program, which was authorized by the American Recovery and Reinvestment Act (Recovery Act), the department supplemented regular unemployment benefits with \$25 weekly payments, which totaled about \$211 million in fiscal year 2010. The department's unemployment insurance computer system has edits to detect overpayments for regular and extended unemployment benefits. However, those edits did not identify and track overpayments of the weekly \$25 supplement payments to recipients for weeks they were not eligible for unemployment benefits.

The federal government first alerted department management to this problem in September 2009 when the Office of Inspector General reported on how well states had implemented the \$25 supplemental payment.⁷ According to the report, the department stated it would begin recovery of these overpayments once it had completed its reprogramming of the computer system in October 2009. However, as of March 2011, the department had not developed a process to identify or pursue recovery of these overpayments. The federal government requires states to identify, recover, and report any overpayments of Federal Additional Compensation.⁸

In addition, the department overpaid five applicants a total of \$19,660 of extended unemployment benefits funded through the Recovery Act. The overpayments resulted from applicants receiving more weeks of eligibility than allowed by the

⁴ The \$3.2 million estimate of overpaid Federal Additional Compensation was determined using the ratio of benefit overpayments to the total benefits paid for fiscal year 2010 multiplied by the annual level of Federal Additional Compensation received by the State of Minnesota.

⁵ The federal government does not assign grant numbers for Unemployment Insurance benefits.

⁶ The American Recovery and Reinvestment Act authorized a temporary Federal Additional Compensation Program that provided a \$25 supplement to the weekly benefit allowance for eligible recipients.

⁷ U.S. Department of Labor, Office of Inspector General Report number 18-09-004-03-315, dated September 30, 2009 - *RECOVERY ACT: States have aggressively implemented the \$25 weekly supplemental unemployment benefit, but some challenges remain.*

⁸ U.S. Department of Labor's Unemployment Insurance Program Letter 11-09, dated February 23, 2009.

extended benefit programs. Although the department's unemployment system produced a report to identify these overpaid benefits, employees did not follow-up on these exceptions to establish and track the overpayment recovery. Extended benefits are available to workers who have exhausted regular unemployment insurance benefits during periods of high unemployment.

Recommendations

- *The Department of Employment and Economic Development should identify, recover, and report overpayments of the Federal Additional Compensation and work with the federal government to resolve the overpayments it made.*
- *The department should review unemployment system reports designed to ensure that it only provides benefits to applicants for the number of weeks allowed by each extended benefit program and recover the overpayments it made to the five applicants.*

Finding 2

Prior Finding Partially Resolved: The Department of Employment and Economic Development did not fully identify and monitor its internal controls to ensure compliance with federal requirements.

The department developed a risk assessment and began to identify compliance controls that mitigate the risk of federal program noncompliance. However, the department's risk assessment did not adequately identify needed controls or how management would monitor those controls to ensure they are operating as intended. The department's risk assessment had the following weaknesses:

- Certain internal controls the department described in its assessment were federal compliance requirements rather than actual control procedures to ensure those requirements are met. Financial and program management should work to specify the control procedures and to prescribe expectations that provide the necessary assurances for Unemployment Insurance administration (CFDA 17.225⁹), Workforce Investment Act Cluster (CFDA 17.258, 17.259, and 17.260)¹⁰ and Vocational Rehabilitation Cluster (CFDA 84.126 and 84.390).¹¹

⁹ Federal Grant UI-18028-09-55-A-27 and UI-19590-10-55-A-27 (Unemployment Insurance Administration, Emergency Compensation, and Trade Benefits); however, federal grant numbers are not used for Unemployment Insurance benefits.

¹⁰ Federal Grant AA-18648-09-55-A-27 and ARRA AA-17129-08-55-A-27.

¹¹ Federal Grant H126A090032, H126A090033, H126A100032C, H126A100033C, H390A090032, and H390A090033.

- Department controls did not address the risk of inaccurate federal financial and program reports. The department submits a wide variety of financial and program reports to the federal government for its Unemployment Insurance (CFDA 17.225¹²), Workforce Investment Act Cluster (CFDA 17.258, 17.259, and 17.260) and Vocational Rehabilitation Cluster (CFDA 84.126 and 84.390) programs. However, the reports are prepared and submitted by several employees without any independent review by a supervisor or other employee prior to submission. By not adequately reviewing federal financial reports, the department increased the likelihood of errors and the risk of noncompliance.
- The department also did not have an independent review of its draft federal Schedule of Federal Awards submitted to the Department of Management and Budget. If the department had conducted an independent review, it may have detected that it had overstated expenditures by approximately \$493,000 for the Workforce Investment Act Cluster (CFDA 17.258, 17.259, and 17.260). Management has the responsibility to complete a supervisory review of reports performed to assure accuracy and completeness of data and information included in the reports.¹³
- The department did not monitor the internal controls identified in its risk assessment to ensure compliance with requirements for the federal Workforce Investment Act Cluster (CFDA 17.258, 17.259, and 17.260) and Vocational Rehabilitation Cluster (CFDA 84.126 and 84.390). Without monitoring, department management may not know whether its staff performed the internal control procedures as intended and whether those controls were effective in reducing the risk of noncompliance.

State policy states that each agency head has the responsibility to identify, analyze, and manage business risks that impact an entity's ability to maintain its financial strength and the overall quality of its products and government services.¹⁴ The federal government expects management to take responsibility for effective internal controls over its financial operations and compliance with federal program requirements.

¹² Federal Grant UI-18028-09-55-A-27 and UI-19590-10-55-A-27 (Unemployment Insurance Administration, Emergency Compensation, and Trade Benefits); however, federal grant numbers are not used for Unemployment Insurance benefits.

¹³ OMB Circular A-133 Compliance Supplement 2010, Part 6 – Internal Control.

¹⁴ Department of Management and Budget Policy 0102-01.

Recommendation

- *The department should improve its internal control structure ensuring compliance with federal requirements by:*
 - *identifying specific controls that mitigate risk of noncompliance;*
 - *assessing the criticality and need for independent review of federal reports and determining the cost-benefit of a second review prior to submission to the federal government;*
 - *reviewing the accuracy of federal schedules sent to the Department of Management and Budget; and*
 - *monitoring the designed controls to provide management with the assurance that they are operating as intended.*
-

April 4, 2011

Mr. James Nobles
Legislative Auditor
First Floor, Centennial Building
658 Cedar Street
St Paul, MN 55155

Dear Mr. Nobles:

Thank you for the opportunity to respond to the findings and recommendations related to the audit on selected federal programs awarded to the Department of Employment and Economic Development (DEED) for the year ending June 30, 2010.

Audit Finding 1: The Department of Employment and Economic Development did not identify and recover up to \$3.2 million of estimated overpaid unemployment insurance benefits for the Federal Additional Compensation Program and \$19,660 of other benefit extensions.

Recommendations:

- *The department should identify, recover, and report overpayments of the Federal Additional Compensation and work with the federal government to resolve the overpayments it made.*
- *The department should review unemployment system reports designed to ensure that it only provides benefits to applicants for the number of weeks allowed by each extended benefit program and recover the overpayments it made to the five applicants.*

Response: The department agrees with the finding and the recommendations. The American Recovery and Reinvestment Act was enacted on February 17, 2009 and authorized the FAC payments effective February 22, 2009. As we were required to implement this program very quickly, our first focus was on getting the additional benefit payments issued to UI applicants.

In 2009, DEED contracted with a vendor to enhance and improve UI computer applications and address various law changes and the FAC overpayment issues. The technical complexity of writing and accounting for FAC overpayments was much more challenging than originally anticipated. Furthermore, there have been five separate occasions of Extended Unemployment Compensation (EUC) phase out and retroactive phase in from late 2009 through 2010 by the federal government. These actions have consumed a tremendous amount of DEED staff time and technical resources, leaving little time available for working on the FAC overpayment issues. Only recently have we been able to begin working with the vendor again to address FAC overpayments.

DEED has an internal control report that identifies applicants who have received more than the maximum allowable amount of benefits. Due to the tremendous volume and benefit program complexity experienced during fiscal year 2010, staff sometimes fell behind in working the report. DEED has followed up on the five applicants

identified in the audit report and the necessary corrections have been made. Keith Goodwin, Unemployment Insurance Division Director, will oversee resolution of this finding by September 30, 2011.

Audit Finding 2: Prior Finding Partially Resolved: The Department of Employment and Economic Development did not fully identify and monitor its internal controls to ensure compliance with federal requirements.

Recommendation:

- *The department should improve its internal control structure ensuring compliance with federal requirements by:
 - identifying specific controls that mitigate risk of noncompliance;
 - assessing the criticality and need for independent review of federal reports and determining the cost-benefit of a second review prior to submission to the federal government;
 - reviewing the accuracy of federal schedules sent to the Department of Management and Budget; and
 - monitoring the designed controls to provide management with the assurance that they are operating as intended.*

Response: The department agrees with the finding and the recommendation. The department has made substantial progress in assessing risks, identifying related controls, and in performing selected monitoring activities although recognizes that there is always room for improvement and this will be an ongoing process. DEED will consider the cost/benefit relationship of implementing additional controls and monitoring activities and will implement additional procedures to address the most critical risks. Cindy Farrell, Chief Financial Officer, will oversee resolution of this finding by September 30, 2011.

If you have any questions or need additional information please contact Cindy Farrell at 651-259-7085 or Cindy.Farrell@state.mn.us.

Sincerely,



Mark Phillips
Commissioner