



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Management Letter

Department of Economic Security
Fiscal Year Ended June 30, 2000



MARCH 8, 2001

01-07

Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota State government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately fifty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year and one best practices review.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of Representatives and Senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

This document can be made available in alternative formats, such as large print, Braille, or audio tape, by calling 651-296-1727 (voice), or the Minnesota Relay Service at 651-297-5353 or 1-800-627-3529.

All OLA reports are available at our Web Site: <http://www.auditor.leg.state.mn.us>

If you have comments about our work, or you want to suggest an audit, investigation, evaluation, or best practices review, please contact us at 651-296-4708 or by e-mail at auditor@state.mn.us

Department of Economic Security

Table of Contents

	Page
Report Summary	1
Management Letter	2
Status of Prior Audit Issues	6
Department of Economic Security Response	7

Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Brad White, CPA, CISA	Audit Manager
Susan Rumpca, CPA	Auditor-in-Charge
Ellen Sibley	Auditor
Irene Hass	Auditor

Exit Conference

The findings and recommendations in this report were discussed with the following officials of the Department of Economic Security at an exit conference held on February 20, 2001:

Earl Wilson	Commissioner
Al St. Martin	Deputy Commissioner
Jim Korkki	Assistant Commissioner, Workforce Services
Bonnie Elsey	Assistant Commissioner, State Services for the Blind
Howard Glad	Assistant Commissioner, Rehabilitation Services
John Stavros	Chief Financial Officer
Mark Butala	Internal Security Director
Tim Langlie	Accounting Director
Janelle Stoesz	Unemployment Insurance Director

Report Summary

Key Findings and Recommendations:

- **PRIOR FINDING PARTIALLY RESOLVED.** The department did not provide adequate oversight of American Learning Exchange Grant (CFDA 17.207) vendors to ensure that they complied with grant provisions. The department did not receive timely progress reports and adequate documentation to support reimbursements to certain vendors. We also noted that certain overhead rates and fees submitted by the vendors were not specified in the grant agreement. We recommended the department improve its oversight of this grant by clarifying these financial concerns. (Finding 1, page 4)
- The department did not effectively monitor certain manual checks generated from the Unemployment Insurance Benefit Account. We found that one employee was responsible for the preparation and mailing of the checks, in addition to recording the transactions in the accounting system. We recommended improved controls by having an independent person ensure that all checks issued were authorized. (Finding 2, page 5)

Management letters address internal control weaknesses and noncompliance issues found during our annual audit of the state's financial statements and federally-funded programs. The scope of work in individual agencies is limited. During the fiscal year 2000 audit, our work at the Department of Economic Security focused on financial activities of the Unemployment Insurance Trust Fund and eight federal programs administered by the department. The department's response to our recommendations is included in the report.



OFFICE OF THE LEGISLATIVE AUDITOR
State of Minnesota • James Nobles, Legislative Auditor

Representative Dan McElroy, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Earl Wilson, Commissioner
Department of Economic Security

We have performed certain audit procedures at the Department of Economic Security as part of our audit of the financial statements of the State of Minnesota for the year ended June 30, 2000. We also have audited certain federal financial assistance programs administered by the Department of Economic Security as part of our audit of the state's compliance with the requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement*. We emphasize that this has not been a comprehensive audit of the Department of Economic Security.

Table 1 identifies the financial activities within the Department of Economic Security that were material to the state's financial statements. We performed certain audit procedures on these programs as part of our objective to obtain reasonable assurance about whether the State of Minnesota's financial statements for the year ended June 30, 2000, were free of material misstatement.

Table 1
Programs Material to the State's Financial Statements
Fiscal Year 2000

	<u>Amount</u>
Unemployment Insurance Cash	\$666,847,000
<u>Revenue Areas</u>	
Unemployment Insurance Taxes	\$378,184,000
Unemployment Insurance Investment Income	\$43,046,000
<u>Expenditure Areas</u>	
Unemployment Insurance Grants	\$384,840,000

Source: State of Minnesota Comprehensive Annual Financial Report for fiscal year 2000.

Table 2 identifies the State of Minnesota's major federal programs administered by the Department of Economic Security. We performed certain audit procedures on these programs as part of our objective to obtain reasonable assurance about whether the State of Minnesota complied with the types of requirements that are applicable to each of its major federal programs.

Department of Economic Security

Table 2
Major Federal Programs Administered by the Department of Economic Security
Fiscal Year 2000

<u>CFDA #</u>	<u>Program Name</u>	<u>Expenditures</u>
17.225	Unemployment Insurance ⁽¹⁾	\$421,288,000
	<u><i>Employment Services Cluster:</i></u>	
17.207	Employment Services	\$17,836,000
17.801	Disabled Veterans' Outreach Program	1,370,000
17.804	Local Veterans' Employment	<u>1,681,000</u>
	Total Employment Services Cluster	<u>\$20,887,000</u>
	<u><i>Job Training Partnership Act Cluster:</i></u>	
17.250	Job Training Partnership Act (JTPA Title II)	\$15,778,000
17.246	Employment and Training Assistance – Dislocated Workers (JTPA Title III)	<u>8,632,000</u>
	Total Job Training Partnership Act Cluster	<u>\$24,410,000</u>
17.253	Welfare to Work	\$8,576,000
96.001	Social Security Disability Insurance/ Supplemental Security Insurance	\$16,991,000

Note: **(1)** Expenditures include \$380,570,000 of state unemployment insurance grants, \$2,851,000 in federal unemployment insurance grants, and \$37,867,000 of federal administrative reimbursements.

Source: State Employment Security Agency Cost Accounting System for fiscal year 2000.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Conclusions

Our December 1, 2000, report included an unqualified opinion on the general purpose financial statements included in the State of Minnesota's Comprehensive Annual Financial Report for fiscal year 2000. In accordance with *Government Auditing Standards*, we also issued our report, dated December 1, 2000, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. At a later date, we will issue our report on compliance with requirements applicable to each major federal program and internal control over compliance in accordance with OMB Circular A-133.

As a result of our procedures, we identified the following weaknesses in internal control at the Department of Economic Security.

Department of Economic Security

1. PRIOR FINDING PARTIALLY IMPLEMENTED: The Department of Economic Security did not provide adequate oversight of American Learning Exchange Grant vendors.

The department did not adequately control payments to American Learning Exchange Grant vendors to ensure that they complied with grant provisions. The U.S. Department of Labor funded American Learning Exchange Grants as part of the Employment Services Program (CFDA 17.207). During Fiscal Year 2000, the department spent \$5.7 million on this grant, which included subgrant expenditures. We continue to find that the department did not receive timely and adequate documentation to support the vendor reimbursement requests. According to the grant agreements, the department would reimburse the vendors after submission of monthly invoices that provide a financial status report and a report of project progress. The vendors did not submit invoices or financial status reports each month. In addition, the invoices that were submitted did not provide sufficient detail of the project costs. Some invoices did not provide the timeframe for services billed, details of services provided, or other supporting information. Also, one of the vendors applied a fringe and overhead rate of 92 percent of labor costs, and a general and administrative rate of 6.9 to 7 percent, to all invoices. Some of the invoices from this vendor contained a questionable 4.5 percent additional fee. The grant agreement did not specify any of these rates or fees.

During the current audit, the department did request and receive more detailed documentation of services provided by one vendor questioned in our prior audit. However, we noted that another vendor changed invoice formats and provided less detail. This vendor previously applied a fringe and overhead rate of 92 percent of labor costs plus other fees that were not specified in the grant agreement. The revised vendor invoice showed total charges by expense category but lacked details itemizing labor costs, travel expenses, consultant activity, and equipment purchases. Also, we found additional vendors that did not provide timely and adequate documentation to support their reimbursement requests. For example, a vendor submitted one invoice claiming reimbursement of \$171,534 for services provided over twelve months. The department paid this invoice and did not question why the vendor did not report more frequently. The contract specified monthly invoices supported by financial status and progress reports. Finally, we found that the department overpaid one vendor \$18,379 by paying the cumulative amount billed on a subsequent invoice when, in fact, they had already paid the original invoice. The department has recovered the overpayment by offsetting subsequent payments.

Recommendation

- *The Department of Economic Security should actively oversee the American Learning Exchange Grant by obtaining timely progress reports and other detailed support for reimbursement. The department should also clarify use of overhead rates and fees that are not specified in the grant agreement.*

Department of Economic Security

2. The Department of Economic Security did not adequately monitor manual checks.

The department did not adequately monitor certain manual checks generated from the Unemployment Insurance Benefit Account. The checks are primarily used to return funds when applicants have overpaid the department. During fiscal year 2000, we noted that the department produced 157 checks totaling \$488,000. The department also issued manual checks to transfer funds to other state agencies and to other accounts within the department; however, they now make these transfers electronically. We noted a key weakness with the department's internal controls for processing manual checks. One employee was responsible for preparing and mailing the checks, as well as recording the transactions in the accounting system. These functions are typically incompatible. The department has not developed any mitigating controls to monitor these sensitive checks. To reduce the risk of unauthorized transactions, someone independent of this process should ensure that all checks issued were properly authorized.

Recommendation

- *The Department of Economic Security should improve internal control by having an independent person review manual checks issued from the Unemployment Insurance Benefit Account to ensure that all checks issued were authorized.*

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Economic Security. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 8, 2001.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Claudia J. Gudvangen

Claudia J. Gudvangen, CPA
Deputy Legislative Auditor

End of Fieldwork: January 25, 2001

Report Signed On: March 5, 2001

Status of Prior Audit Issues As of January 25, 2001

March 2000, Legislative Audit Report 00-12 examined the department's activities and programs material to the State of Minnesota's Comprehensive Annual Financial Report and the Single Audit for the year ended June 30, 1999. The scope included material selected activities for the Reemployment Insurance Fund and the following federal programs: Unemployment Insurance Administration, Rehabilitation Services Basic Support, Social Security Disability Insurance/Supplemental Security Income, Employment Services Cluster (Employment Services, Disabled Veterans' Outreach Program, Local Veterans' Employment Program), and Job Training Partnership Cluster (Job Training Partnership Act Title II, Dislocated Workers Title III).

The report contained three findings. The department resolved Findings 2 and 3. Finding 2 addressed a question on funding certain personnel costs. Finding 3 identified disbursements to subgrantees after the grant period ended. Finding 1 recommended the need for the department to improve oversight of grants to two vendors to ensure they complied with grant provisions. The department took some steps to resolve this issue by requesting and receiving more detailed documentation of services provided by one vendor. However, we found that the department did not adequately monitor the other vendor cited in the prior report. In addition, we noted that similar problems were encountered with other vendors that were not identified in our prior audit. See Finding 1 in this report.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota, any quasi-state organizations, such as the metropolitan agencies, or the State Agricultural Society, the state constitutional officers, or the judicial branch.



State of Minnesota

Department of Economic Security

390 North Robert Street
Saint Paul, Minnesota 55101

Office of the Commissioner

February 27, 2001

James R. Nobles
Legislative Auditor
First Floor, Centennial Office Building
658 Cedar Street
St. Paul, Minnesota 55155

Dear Mr. Nobles:

The following information is offered in response to your draft report for the fiscal year ended June 30, 2000.

Finding 1

- **PRIOR FINDING PARTIALLY IMPLEMENTED: The Department of Economic Security did not provide adequate oversight of American Learning Exchange Grant vendors.**

We agree. Although, we did improve oversight on the largest vendor, more needs to be done. We will review all current and future grants to ensure that the grants include language showing sufficient reporting and billing requirements and that the invoices presented for payment include adequate documentation for services rendered.

Finding 2

- **The Department of Economic Security did not adequately monitor manual checks.**

We agree. We plan to implement additional controls and procedures to reduce the risk of unauthorized transactions in the Unemployment Insurance Benefit Account.

Sincerely,

/s/ Earl Wilson

Earl Wilson
Commissioner

ERW/tl