OLA **OFFICE OF THE LEGISLATIVE AUDITOR**
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

Department of Employment and Economic Development

Federal Compliance Audit

Year Ended June 30, 2013

March 21, 2014 **Report 14-10**

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

March 21, 2014

Senator Roger J. Reinert, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Katie Clark Sieben, 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 2013. 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 the department's staff at an exit conference on March 14, 2014. This audit was conducted by Brad White, CPA, CISA, CFE (Audit Manager), Joan Haskin, CPA, CISA (Auditor-in-Charge), and auditors Sandy Ludwig, Melissa Strunc, Heather Varez, CPA, CFE, and Emily Wiant.

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

James R. Nobles
Legislative Auditor

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

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Report Summary

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The Department of Employment and Economic Development generally complied with and had controls to ensure compliance with certain legal requirements applicable to its major federal programs for fiscal year 2013. However, the department had some internal control weaknesses and noncompliance with federal requirements, as noted in the findings presented in this report, including two unresolved findings from the prior audit.[1]

Key Findings

- The Department of Employment and Economic Development did not effectively control equipment and maintain accurate equipment inventory records in the state's accounting system. This is a repeat finding. (Finding 1, page 5)

- The Department of Employment and Economic Development did not adequately monitor subrecipients of grants from the federal Vocational Rehabilitation program. This finding includes a prior issue that was not fully resolved. (Finding 2, page 6)

Audit Scope

Our scope included programs determined to be major federal programs for the State of Minnesota for fiscal year 2013, including Unemployment Insurance (CFDA[2] 17.225), Workforce Investment Act Cluster[3] (CFDAs 17.258, 17.259, and 17.278), and Vocational Rehabilitation program (CFDA 84.126).

[1] Office of the Legislative Auditor's Financial Audit Division Report 13-08, *Department of Employment and Economic Development*, issued May 23, 2013.
[2] The Catalog of Federal Domestic Assistance is a unique number assigned by the federal government to identify its federal programs
[3] A cluster of programs is a group of closely related programs that have similar compliance requirements and are treated as a single program.

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.[4] Table 1 identifies these major federal programs.

Table 1
Department of Employment and Economic Development
Major Federal Programs
Fiscal Year 2013
(in thousands)

Program Name	Federal Expenditures
Unemployment Insurance[1] (CFDA[2] 17.225)	$1,104,532
Vocational Rehabilitation (CFDA 84.126)	$ 53,003
Workforce Investment Act Cluster[3] (CFDAs 17.258, 17.259, and 17.278)	$ 33,197

[1]Expenditures include unemployment insurance benefits and about $55 million of federal administrative reimbursements.

[2]The Catalog of Federal Domestic Assistance (CFDA) is a unique number assigned by the federal government to identify its programs.

[3]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.

The unemployment insurance program provided regular and extended unemployment benefits to eligible applicants and also funded the state's administration of the program. The Vocational Rehabilitation program provided services to individuals with disabilities to prepare them for gainful employment. The Workforce Investment Act cluster provided grants to fund employment, educational, and training services to adults, youth, and dislocated workers.

[4] 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 2013 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 2013. This audit is part of our broader federal single audit designed 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.[5] 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.[6]

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 legal requirements applicable to its major federal programs for fiscal year 2013. However, the department had some internal control weaknesses and noncompliance with federal requirements, as noted in the findings presented in this report, including two unresolved findings from the prior audit.

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.

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[5] 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 18, 2013, on the State of Minnesota's basic financial statements for the year ended June 30, 2013. 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 14-04, *Report on Internal Control Over Financial Reporting*, issued February 14, 2014.)

[6] Office of the Legislative Auditor's Financial Audit Division Report 13-08, *Department of Employment and Economic Development*, issued May 23, 2013.

Findings and Recommendations

Finding 1

The Department of Employment and Economic Development did not effectively control equipment and maintain accurate equipment inventory records in the state's accounting system. This is a repeat finding.

The department did not maintain an accurate inventory of equipment, purchased with federal money, in the asset management module in the state's accounting system.[7] Inventory records for over 1,000 equipment items, valued at about $2 million as of December 2013, had no individual asset tag numbers, custodian, or specific locations assigned to individual pieces of equipment. In addition, the department had not conducted a physical inventory since December 2011.

Title 2 Code of Federal Regulations 200.313 requires that the "state must use, manage and dispose of equipment acquired under a Federal award by the state in accordance with state laws and procedures." The federal regulation's equipment management requirements include the following:

(1) Property records must be maintained that include a description of the property, a serial number or other identification number, the source of funding for the property (including FAIN) [Federal Award Identification Number], who holds title, the acquisition date, and cost of the property, percentage of Federal participation in the project costs for the Federal award under which the property was acquired, the location, use and condition of the property, and any ultimate disposition data including the date of disposal and sale price of the property.

(2) A physical inventory of the property must be taken and the results reconciled with the property records at least once every two years.

Until the department includes specific identification and location information in the inventory records, it will be unable to complete an effective physical inventory.

In addition, the department incorrectly coded in the state's accounting system some nonequipment purchases as equipment, such as bottled water, printer toner, and bus passes. The department also included some items it purchased for clients served through the Vocational Rehabilitation program as equipment instead of as grants. The client equipment and other items were inappropriately included in the department's equipment inventory list.

[7] Unemployment Insurance (CFDA 17.225), Workforce Investment Act Cluster (CFDAs 17.258, 17.259, and 17.278), and Vocational Rehabilitation program (CFDA 84.126).

Recommendation

- *The Department of Employment and Economic Development should improve controls over its equipment inventory by:*
  - *including equipment identification, custodian, and locations in the equipment inventory records, and conducting a physical inventory at least every two years;*
  - *ensuring staff accurately code expenditures in the accounting system so that only equipment purchases are recorded in equipment inventory records; and*
  - *removing all nonequipment items, and purchases for Vocational Rehabilitation clients, from equipment inventory records.*

Finding 2

The Department of Employment and Economic Development did not adequately monitor subrecipients of grants from the federal Vocational Rehabilitation program. This finding includes a prior issue that was not fully resolved.

The department did not adequately monitor how subrecipients used grants from the Vocational Rehabilitation program (CFDA 84.126).[8] The department did not comply with state grants management policies that require a financial reconciliation at least once during the grant's period for grants exceeding $50,000.[9] A financial reconciliation involves a comparison of the subrecipient's request for payment for a given period with supporting documentation for that request, such as invoices and payroll records.

The department had not conducted a financial reconciliation for any of the three subrecipients we selected for testing. For each of those subrecipients, fiscal year 2013 expenditures of federal Vocational Rehabilitation grants exceeded $50,000; expenditures for the largest grant totaled $224,252.

Title 2 Code of Federal Regulations Part 200.331 requires the state to monitor "the activities of the subrecipient as necessary to ensure that the subaward is used for authorized purposes, in compliance with Federal statutes, regulations, and the terms and conditions of the subaward; and that subaward performance goals are achieved." The regulation further requires the state to review "financial and programmatic reports" required by the state. Through a financial reconciliation, state policy requires the department to review the documentation supporting a

[8] Federal Award H126A130032-13C and H126A130033-13C.
[9] Department of Administration, Office of Grants Management, Policy 08-10, requires a financial reconciliation, at least once during the grant period, for grants exceeding $50,000.

subrecipient's request for payment. By not performing the financial reconciliations the department diminishes its ability to ensure that subrecipients used federal grant funds in accordance with the program's requirements.

Recommendation

- *The Department of Employment and Economic Development should improve controls over Vocational Rehabilitation grants by performing the required financial reconciliations during the grant period.*

March 17, 2014

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 Single Audit on selected federal programs awarded to the Department of Employment Economic Development (DEED) for the year ending June 30, 2013. We are pleased that you have determined that DEED generally complied with and had controls in place to ensure compliance with requirements applicable to major federal programs.

Audit Finding 1: The Department of Employment and Economic Development did not effectively control equipment and maintain accurate equipment inventory records in the state's accounting system. This is a repeat finding.

Recommendation

- *The Department of Employment Economic Development should improve controls over its equipment inventory by:*

  - *including equipment identification, custodian, and locations in the equipment inventory records, and conducting a physical inventory at least every two years.*

  - *ensuring staff accurately code expenditures in the accounting system so that only equipment purchases are recorded in equipment inventory records; and*

  - *removing all non-equipment items, and purchases for Vocational Rehabilitation clients, from equipment inventory records.*

Response:
DEED concurs with the finding that improvement is needed in the administration of its asset property records to address missing or misclassified asset information.

DEED has undertaken numerous actions to correct this finding:

- DEED updated its asset management policy in August 2012 to clarify processes, roles and responsibilities.
- In August 2013, MN.IT @ DEED hired two new service desk employees with responsibility for receiving information technology assets.
- To comply with asset tracking requirements, MN.IT@DEED conducted a mandatory laptop verification survey in October / November 2013 to account for all DEED-owned laptops in use by employees, resource centers, and pooled within a work unit. The information collected included: name of owner (custodian), physical location, specific information about the laptop, and general usage. The Disability Determination Services Unit (DDS) was excluded from the survey because their devices are owned and managed by the Social Security Administration (SSA). The response rate to the survey was 100%. MN.IT@ DEED staff has verified the data collected with current property records and reconciled any reported discrepancies. The updated laptop asset information is in the process of being loaded into the SWIFT Asset Management module and is expected to be completed by the end of April 2014.
- In December 2013, Administrative and Financial Services (AFS), procurement staff, and MN.IT @ DEED met with Minnesota Management and Budget (MMB) asset management and accounting / general ledger staff to ascertain root causes underlying asset management errors including failure to designate a location or custodian (missing information), incorrect category coding resulting in asset misclassifications, and failure to appropriately itemize assets, i.e. multiple assets recorded as one asset in the asset management module. Capital asset certification process was also discussed. This meeting provided clarity and understanding regarding how the system works, roles and expectations, and the proper sequencing of transactions.
- Within the December 2013 timeframe, MMB released new asset management step by step procedural guidance in response to asset management problems experienced by all state agencies. The initial guidance released by MMB When the SWIFT system was originally implemented was not accurate and did not address proper sequencing of entry that has to occur to be successful with the asset management transaction. Since there are no hard edits in the system, state agency employees had thought the transactions were successful and did not realize errors / problems were being generated. The new step by step guidance was shared with DEED employees who had the procurement and receipting roles and responsibilities.
- DEED's centralized procurement / asset coordinator has followed up individually with field employees who have experienced asset management problems. The centralized asset coordinator provided corrective advice to fix the problem and to ensure that the same errors are not repeated. As a result of this intervention, the site asset coordinators are fixing these items themselves if the purchase order is still open and the goods have not been received. If they have, these problems are being referred back to DEED's centralized procurement / asset coordinator for fixing the error in the asset management module. Also, errors related to classification of assets purchased for client

use are being fixed and employees have been instructed to code client equipment as grants so that these items are not incorrectly defaulted as state-owned assets in the asset management module. The centralized asset coordinator has been working to dispose /abandon assets which were improperly coded and populate the correct location and custodian fields. DEED is pleased to communicate that 100% of the location fields have been populated as of the date of this response. The centralized asset coordination team is in the process of merging the other asset records and inputting this information into SWIFT. It is expected that DEED will achieve 100% compliance no later than April 2014. It is also anticipated that all misclassified assets will be addressed no later than April 2014 as well.

DEED had several mitigating factors that delayed substantial progress on addressing this asset management finding:

- The SWIFT system was designed so that the location field was supposed to be automatically populated with the same information as the ship to location. There is a defect in the system so that this has not consistently occurred and is only occurring intermittently. MMB is researching why there is this defect and how it can be fixed. Also, DEED was recently notified by MMB subject matter experts during the last month that even when a custodian is properly entered, a statewide accounting system defect does not always retain this information. There is some concern that our efforts to address this finding and populate the custodian field will not be retained despite our agency's efforts.
- At the end of June 2013, DEED's centralized procurement and asset coordinator retired. Due to difficulties recruiting and hiring a qualified candidate, this position was not filled until the end of November 2013.
- In October 2013, the procurement manager responsible for oversight of asset management activities transferred to another agency. This individual had been spearheading DEED's corrective action activities.
- In January 2014, DEED temporarily lost the services of the agency centralized procurement coordinator due to an unexpected four month leave of absence due to family emergency. This left only the centralized procurement / asset coordinator position that began at the end of November 2013 to perform these critical, high volume agency-wide centralized purchases.
- At the same time, there was a retirement in MN.IT @ DEED which left them with no one with authority for local (ALP) certification to purchase IT goods and services and no offer of ALP certification training by Admin's Material Management Division (MMD) in the near future. This volume overflowed to the centralized procurement / asset coordinator for procurement and dispatch to the vendor.
- During March 2014, DEED obtained the temporary services of an experienced procurement employee via an interagency agreement with another agency to assist in meeting the procurement and asset management needs and addresses the findings during the leave of absence of the other employee.

All of these mitigating factors played a role in DEED's ability to address and overcome the findings.

DEED's next steps in addressing the finding follow:

- When we have corrected the existing custodian, location, and misclassified asset errors, we will conduct a complete physical inventory. The most recent physical inventory was initiated on December 19, 2011 and completed in mid-January 2012. Since we are required to conduct a physical inventory every two years, we are two months past due in meeting this requirement. Given that the centralized asset coordinator is in place, DEED is in the process of planning the asset physical inventory approach and will kick-off the physical inventory by the end of April 2014.
- DEED will soon be moving to a centralized procurement process for its administrative purchases which will utilize CPRS (Centralized Purchase Request System). We expect that moving to a more centralized model will improve the procurement, receipting and asset management processes and reduce financial risk for the agency.
- We will continue to provide individualized assistance and reinforce formal communications with buyers and receivers, as appropriate.

In closing, DEED will continue its corrective action procedures and expect to resolve the findings by September 30, 2014. Julie Freeman, Chief Financial Officer, oversees corrective action activities.

Audit Finding 2: The Department of Employment and Economic Development did not adequately monitor sub-recipients of grants from the federal Vocational Rehabilitation program. This finding includes a prior issue that was not fully resolved.

Recommendation

- *The Department of Employment and Economic Development should improve controls over Vocational Rehabilitation grants by performing the required financial reconciliations during the grant period.*

Response: The DEED has taken corrective action procedures during the past year to rectify the finding.

During May 2013, the director of the Office of Grants Management (OGM) conducted a training seminar with selected VRS and financial services staff. This included the chief financial officer and director of Vocational Rehabilitation Services. The training outlined OGM policies and procedures including OGM 08-10 which addresses monitoring and financial reconciliations.

In October 2013, appropriate DEED grants staff and internal control participated in financial reconciliation training which was sponsored by OGM. Additional DEED staff attended training in February 2014.

VRS staff conducted a comprehensive gap analysis to determine causes of grant management issues, including the lack of financial reconciliations. This analysis resulted in ten recommendations designed to improve the entire grants management process within VRS.

In January 2014, VRS grantees subject to required financial reconciliations received webinar training. The training was designed to outline the purpose of reconciliations, time frames, and expectations for supporting documentation. The chief financial officer provided the opening remarks and stressed the importance of financial reconciliation and grant monitoring and safeguarding of public funds.

Given the significant budgetary challenges that have necessitated the creation of waiting lists for customer access to VR services, VRS management has had to carefully consider limited options. The division decided to utilize the services of the agency's internal control unit and one VRS employee for financial reconciliations. Other staff, including each grant's assigned manager, is involved in the process.

VRS utilizes SharePoint as a central scheduling tool and repository for grantee supporting documentation and financial reconciliation reporting. All grants and grantees required to undergo financial reconciliations have been identified. As of March 14, 2014, six VRS grant reconciliations have been completed and summary reports have been issued.

DEED would like to point out the significant progress regarding financial reconciliations. Due to lack of resources, we have been unable to secure additional manpower to perform the required work and have had to add these responsibilities to existing staff. We are pleased that WIA grants subject to OGM 08-10 requirements are now in compliance.

VRS has now implemented a complete process which will ensure that required monitoring and reconciliations are performed in a timely manner. Kim Peck, director of Vocational Rehabilitation Services, oversees resolution of this finding. We expect that this finding will be resolved by June 30, 2014.

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

My Best Regards,

Katie Clark Sieben

Katie Clark Sieben
Commissioner