



FINANCIAL AUDIT DIVISION REPORT

**Department of
Employment and
Economic Development**

Federal Compliance Audit

Year Ended June 30, 2014

March 24, 2015

Report 15-06

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Conclusion on Internal Controls

The Financial Audit Division bases its conclusion about an organization's internal controls on the number and nature of the control weaknesses we found in the audit. The three possible conclusions are as follows:

Conclusion	Characteristics
Adequate	The organization designed and implemented internal controls that effectively managed the risks related to its financial operations.
Generally Adequate	With some exceptions, the organization designed and implemented internal controls that effectively managed the risks related to its financial operations.
Not Adequate	The organization had significant weaknesses in the design and/or implementation of its internal controls and, as a result, the organization was unable to effectively manage the risks related to its financial operations.



OFFICE OF THE LEGISLATIVE AUDITOR

STATE OF MINNESOTA • James Nobles, Legislative Auditor

March 24, 2015

Representative Sondra Erickson, 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 2014. 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 on March 13, 2015. This audit was conducted by Brad White, CPA, CISA, CFE (Audit Director), Pat Ryan (Auditor-in-Charge), and assisted by auditor Heather Varez, CPA, CFE.

We received the full cooperation of the Department of Employment and Economic Development'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

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Report Summary

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 2014. However, the department had some internal control weaknesses and noncompliance with federal requirements, as noted in the findings presented in this report, including one unresolved finding from the prior audit.¹

Findings

- The Department of Employment and Economic Development did not assess financial penalties for applicants who filed fraudulent claims and inappropriately received federal extended unemployment benefits totaling \$2.1 million for fiscal year 2014. ([Finding 1, page 5](#))
- The Department of Employment and Economic Development did not have effective internal controls for equipment; it did not maintain inventory records sufficient to identify and locate its equipment and did not complete a physical inventory. This is a repeat finding. ([Finding 2, page 6](#))

Audit Scope

Our scope included two programs determined to be major federal programs for the State of Minnesota for fiscal year 2014:

- Unemployment Insurance Program (CFDA² 17.225) \$930 million
- Vocational Rehabilitation Program (CFDA 84.126) \$54 million

¹ Office of the Legislative Auditor's Financial Audit Division Report 14-10, *Department of Employment and Economic Development*, issued March 21, 2014.

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

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.³ Table 1 identifies these major federal programs.

Table 1
Department of Employment and Economic Development
Major Federal Programs
Fiscal Year 2014
(in thousands)

<u>Program Name</u>	<u>Federal Expenditures</u>
Unemployment Insurance ¹ (CFDA ² 17.225) ³	\$930,019
Vocational Rehabilitation (CFDA 84.126) ⁴	\$ 53,573

¹ Expenditures include unemployment insurance regular benefits totaling \$798 million, federal extended benefits totaling \$78 million, and about \$54 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 Federal Award Number UI-25212-14-55-A-27.

⁴ Federal Award Numbers H126A 140032 – 14C and H126A 140033 – 14C.

The federal Unemployment Insurance Program provided regular and extended unemployment benefits to eligible applicants and also funded the state's administration of the program. The federal Vocational Rehabilitation Program provided services to individuals with disabilities to prepare them for gainful employment.

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 2014. This audit is part of our broader federal single audit designed to obtain reasonable

³ 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 2014 exceeded \$30 million.

assurance about whether the State of Minnesota complied with the types of compliance requirements that are applicable to each of its federal programs.⁴ 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.⁵

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 2014. However, the department had some internal control weaknesses and noncompliance with federal requirements, as noted in the findings presented in this report, including one unresolved finding 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 internal control and compliance weaknesses.

⁴ 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 12, 2014, on the State of Minnesota's basic financial statements for the year ended June 30, 2014. In accordance with *Government Auditing Standards*, we also issued our report on our consideration of the State of Minnesota's internal controls 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 15-02, *Internal Controls Over Statewide Financial Reporting*, issued February 19, 2015.)

⁵ Office of the Legislative Auditor's Financial Audit Division Report 14-10, *Department of Employment and Economic Development*, issued March 21, 2014.

Findings and Recommendations

The Department of Employment and Economic Development did not assess financial penalties for applicants who filed fraudulent claims and inappropriately received federal extended unemployment benefits totaling \$2.1 million for fiscal year 2014.

Finding 1

The department did not comply with federal and state law requiring it to assess and pursue recovery of penalties on fraudulent claims for \$2.1 million of federal extended⁶ unemployment insurance benefits (CFDA 17.225).⁷ The department also had not assessed penalties on fraudulent extended benefit claims in prior fiscal years.

Table 2 shows our estimate of penalties that the department did not assess on fraudulent claims from extended benefits paid during fiscal year 2014 and the two preceding fiscal years.

	<u>FY 2014</u>	<u>FY 2013</u>	<u>FY 2012</u>
Fraudulent extended unemployment benefits detected by the department	\$ 2,105,998	\$ 4,679,212	\$ 7,117,482
Penalties not imposed	\$ 842,400	\$ 1,871,685	\$ 2,846,993

Source: Auditor calculation from Department of Employment and Economic Development Unemployment Insurance System data.

The Unemployment Insurance Program is a federal-state partnership based on federal law but implemented through state statutes. Federal law requires the state to impose a minimum 15 percent penalty on overpayments resulting from fraudulent claims and deposit the penalty into the state's account in the Unemployment Trust Fund.⁸ *Minnesota Statutes* 2014, 268.18, subd. 2 (a), sets the state penalty well above the federal minimum, stating:

⁶ Applicants were eligible for extended benefit programs after their regular 26-week unemployment benefits were exhausted. The last federal extended benefit program ended on December 28, 2013.

⁷ For regular unemployment claims, the department appropriately issued penalties on nearly \$12 million of fraudulent benefits paid in fiscal year 2014.

⁸ Public Law 112-40, Sec. 251, required mandatory penalties of not less than 15 percent of the erroneous payment due to fraud committed by individuals.

Any applicant who receives unemployment benefits by knowingly misrepresenting, misstating, or failing to disclose any material fact ...has committed fraud. ...the commissioner must assess a penalty of 40 percent of the amount fraudulently obtained.

Department staff indicated that the unemployment insurance computer system was not programmed to assess penalties for extended benefit programs, but it did notify applicants of their overpayment and that a determination of ineligibility was made due to fraud. *Minnesota Statutes* 2014, 268.101, subd. 2 (f), indicates a “determination of ineligibility is final unless an appeal is filed by the applicant or notified employer within 20 calendar days after sending.” As a result, since the department notified applicants of a final determination and the appeal period has passed, department staff indicated they are legally unable to submit a new determination letter that retroactively includes the penalty amount.

The purpose of the penalty is to discourage fraud and create a significant consequence should it occur. In addition, noncompliance with the state and federal penalty requirements resulted in lost revenues that could have been available for the purposes of the Unemployment Trust Fund and the General Fund.⁹

Recommendation

- *The Department of Employment and Economic Development should ensure the unemployment insurance system is programmed to assess penalties, as required by state and federal law, from applicants who filed fraudulent claims for federal extended benefits.*

Finding 2

The Department of Employment and Economic Development did not have effective internal controls for equipment; it did not maintain inventory records sufficient to identify and locate its equipment and did not complete a physical inventory. This is a repeat finding.

The department did not maintain sufficient detail in its inventory of equipment, purchased with federal money, in the asset management module in the state’s accounting system. During fiscal year 2014, the department purchased equipment totaling \$3.2 million for the Unemployment Insurance Program (CFDA 17.225) and \$345,000 for the Vocational Rehabilitation Program (CFDA 84.126). Since our prior audit, the department appropriately removed nonequipment items and

⁹ *Minnesota Statutes* 2014, 268.199, establishes a contingent account for the Minnesota Unemployment Insurance Program. *Laws of Minnesota* 2013, chapter 85, art. 1, sec. 15, requires that deposits into the contingent account “estimated to be \$7.5 million each year, shall be transferred before the closing of each fiscal year to the general fund.” For fiscal year 2014, the department made a transfer of \$7,153,550 to the General Fund.

nonstate equipment purchased for vocational rehabilitation clients, from equipment inventory records.¹⁰ However, it had not updated important information (individual asset tag numbers, custodian, or specific locations) assigned to individual pieces of equipment purchased in the current and prior fiscal years. 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 updates specific identification and location information in the inventory records, it will be unable to complete an effective physical inventory.

Recommendation

- *The Department of Employment and Economic Development should improve controls over its equipment inventory by:*
 - *including specific equipment identification, custodian, and locations in the equipment inventory records; and*
 - *conducting a physical inventory at least every two years.*

¹⁰ Office of the Legislative Auditor’s Financial Audit Division Report 14-10, *Department of Employment and Economic Development*, issued March 21, 2014, Finding 1.

March 20, 2015

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, 2014. We are pleased that the audit determined that DEED generally complied with and had controls in place to ensure compliance with certain legal requirements applicable to its major federal programs for fiscal year 2014 and that we have resolved the prior year finding pertaining to subrecipients monitoring.

Audit Finding 1: The Department of Employment and Economic Development did not assess financial penalties for applicants who filed fraudulent claims and inappropriately received federal extended unemployment benefits totaling \$2.1 million for fiscal year 2014.

Recommendation

- *The Department of Employment and Economic Development should ensure the unemployment insurance system is programmed to assess penalties, as required by state and federal law, from applicants who filed fraudulent claims for federal extended benefits.*

Response:

DEED agrees with the finding that the department should ensure that the Unemployment Insurance (UI) system is programmed to assess additional financial penalties against applicants who were found to be overpaid Federal extended benefits due to fraud.

Minnesota has special laws that bar an applicant who has committed UI fraud from obtaining any additional UI benefits until the fraud debt is repaid in full or for ten years if the debt is not repaid. This integrity law, which has been implemented in a couple of states, is the strongest deterrent to UI fraud. In fiscal year 2014, DEED issued fraud determinations totaling \$2.1 million for Federal extended unemployment benefits. Those individuals cannot collect benefits until the funds have been repaid in full or for ten years.

The UI computer system was not programmed to assess and perform all functions related to accounting and assigning the additional fraud penalties applicable to the Federal emergency UI program. The Federal extended unemployment benefit program ended on December 31, 2013.

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The UI programming effort has faced numerous challenges. Emergency benefits were stopped and started on thirteen separate occasions. Programming time was also consumed by special Federal sequestration laws that had to be implemented.

DEED will make the programming changes to the UI system which will enable the assessment of additional financial penalties on applicants who are assessed fraud determinations related to Federal extended benefits. Fraud determinations and additional penalties do not necessarily ensure collections. DEED utilizes all available collection tools including revenue recapture of state and Federal tax refunds. Those efforts still do not enable collection of the face amount of any determinations which are issued. The key integrity sanction and deterrent is barring future UI benefits. That deterrent and sanction was in effect for all Federal extended benefits.

Rick Caligiuri, Unemployment Insurance Director, will oversee resolution of this finding by October 1, 2015.

Audit Finding 2: The Department of Employment and Economic Development did not have effective internal controls for equipment; it did not maintain inventory records sufficient to identify and locate its equipment and did not complete a physical inventory. This is a repeat finding.

Recommendation

- *The Department of Employment Economic Development should improve controls over its equipment inventory by:*
 - *Including specific equipment identification, custodian, and locations in the equipment inventory records; and*
 - *Conducting a physical inventory at least every two years.*

Response:

DEED concurs with the finding and has implemented a number of procedures to ensure the integrity of its assets and prepare for an agency wide physical inventory:

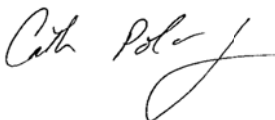
- In September 2014, DEED added three experienced employees within the Administrative Financial Services (AFS) to fill some key vacancies. These employees focus on procurement and asset management activities.
- DEED established a centralized email location for procurement and asset management. This enables employees to submit purchase requests and asset questions to the AFS procurement team for technical assistance and support.
- DEED has removed the purchase order buyer role from users who have initiated very limited procurement activity. Furthermore, DEED will refrain from expanding the purchase order buyer role to any employees for administrative type orders.
- For FY2016 purchases, DEED is implementing an on-line, automated purchase request system for administrative purchases and will be using the centralized procurement and asset management staff for the buys. This approach will provide for more consistency and internal control and compliance, which should greatly improve the accuracy of the asset records.
- DEED's Internal Auditor randomly audits procurement transactions initiated by DEED buyers each month and offers assistance as needed when procurement or asset management errors are found.

- An interface table in the asset management module is now being reviewed by an AFS procurement/asset management specialist. This is performed at least once each week. This review helps identify items which have been incorrectly coded as 'tracked assets' before being placed into the asset management module. This process should significantly reduce the number of items which are incorrectly recorded as assets. This activity is being paired with proactive technical assistance and support provided to the buyers and receivers to avoid the errors from occurring.
- In addition, DEED has performed the following functions to improve the asset management system and records in preparation for the upcoming physical inventory:
 - Updated assets listed in the asset management module as received, but not in service
 - Recorded cost data for some assets which lacked such information
 - Updated locations for 30 assets
 - Split assets showing a quantity of 1 when they reflected multiple assets such as 25 laptops showing as 1 asset in the asset management system
 - Reviewed and updated assets which had an initial quantity received which was not equal to 1 due to multiple funding streams/cost allocations used by DEED
 - Researched and removed items with a unit cost below \$250 that are not considered assets or sensitive items
 - Reviewed and reclassified 57 assets which were initially determined to be sensitive items. In addition, we reclassified some non-capital equipment assets as sensitive items
 - Removed any client asset which was inaccurately reflected in the asset records as a state-owned asset since the asset is client-owned
 - Removed incidentals such as bottled water and car repairs that were not assets but had automatically migrated to the asset management system based on an incorrect category code selected at the time of the purchase by the local buyers.
 - Added or updated asset descriptions, as needed
 - Created a physical inventory and asset management project team to address the upcoming physical inventory and streamline, automate and improve the processes for the future statutorily required audits which will be conducted in calendar year 2017 and every two years thereafter.

DEED will complete an agency-wide physical inventory by August 31, 2015 and we expect full compliance and resolution of this finding by that date. Julie Freeman, chief financial officer, oversees resolution of this finding.

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

Sincerely,



Cathy Polasky
Chief Deputy Commissioner