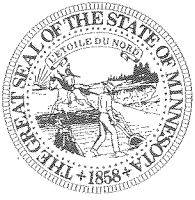


**STATEWIDE AUDIT
DEPARTMENT OF JOBS AND TRAINING
MANAGEMENT LETTER
YEAR ENDED JUNE 30, 1985**

MARCH 1986

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

VETERANS SERVICE BUILDING, ST. PAUL, MN 55155 • 612/296-4708

JAMES R. NOBLES, LEGISLATIVE AUDITOR

Mr. Joseph Samargia, Commissioner
Department of Jobs and Training
390 North Robert Street
St. Paul, Minnesota 55101

Dear Commissioner Samargia:

We have reviewed certain accounting procedures and controls for your department (which was named the Department of Economic Security until October 1, 1985) as part of our statewide audit of the State of Minnesota's fiscal year 1985 financial statements and federal programs. The scope of our work has been limited to:

- those aspects of your department which have material impact on any of the state's various funds and account groups shown on the financial statements;
- federal programs included in the Single Audit scope:
 - CFDA #10.550 Food Distribution
 - CFDA #13.646 Work Incentive
 - CFDA #13.665 Community Services Block Grant
 - CFDA #13.802 Social Security Disability Determination
 - CFDA #13.818 Low Income Home Energy Assistance Block Grant
 - CFDA #17.207 Employment Services
 - CFDA #17.225 Unemployment Insurance
 - CFDA #17.250 Job Training Partnership Act
 - CFDA #81.042 Weatherization Assistance for Low Income Persons
 - CFDA #84.126 Rehabilitation Services - Basic Support
- the status of prior audit recommendations.

We emphasize that this has not been a complete financial and compliance audit of all programs within your department. However, the Single Audit coverage satisfies the federal government's financial and compliance audit requirements for all federal programs administered by your department in fiscal year 1985. The federal government is ultimately responsible for determining resolution of Single Audit recommendations. The appropriate federal program agency staff will contact your agency to review your efforts toward corrective actions for 1985 and prior years. They will also notify you of their final resolution.

The first section of this management letter contains a reiteration of a fiscal issue identified in our previous letter. Our comments are meant to update our previous observations about certain aspects of the Unemployment Compensation Fund. They are not designed to reflect a finding or a criticism of your department. Obviously, this is an area of fiscal policy and financial management which must be pursued with the state Legislature.

The second section contains both our recommendations developed during this audit and a reiteration of our prior recommendations which have not been implemented. Attached to your management letter is a summary of the progress on all audit recommendations developed during our 1984 statewide audit.

The recommendations included in this letter are presented to assist you in improving accounting procedures and controls. Progress on implementing these recommendations will be reviewed during our audit next year.

SIGNIFICANT FISCAL ISSUE REQUIRING FUTURE CONSIDERATION

The Unemployment Compensation Fund Deficit

Minnesota's Unemployment Compensation Fund (UC Fund) has in the past experienced serious financial problems. Our previous management letters discussed UC Fund operations and cited three main problem areas:

- an increased dependence on borrowing from the Federal Unemployment Account to meet benefit payment obligations,
- an increasing deficit fund balance, which reached \$381 million at June 30, 1983; and
- interest costs to be paid on loans made after March 31, 1982.

Minnesota has relied heavily on the Federal Unemployment Account for financing its unemployment insurance program. The combination of increased dependence on borrowing, an unresponsive tax structure, unfavorable economic conditions, and changes in federal law have all resulted in the substantial fund deficit.

However, the deficit fund balance has significantly decreased over the past two fiscal years to \$115 million at June 30, 1985. The balance of the loans payable to the Federal Unemployment Account was \$139 million, the lowest balance since 1982.

The table below shows the fund balance and the amount of the interest and noninterest bearing loans to the Federal Unemployment Account at June 30, 1982 - 1985.

Fiscal Year Year Ending June 30	Fund Balance	Loan Balance		
		Interest	Noninterest	Total
(In Thousands)				
1982	\$(204,426)	\$ 16,942,117	\$191,900,000	\$208,842,117
1983	(380,879)	198,892,709	170,112,369	369,005,078
1984	(273,335)	162,511,117	119,481,985	281,993,102
1985	(115,523)	87,802,117	51,094,372	138,896,489

The decreases in the fund deficit and loans payable are a result of several factors, including:

- improved economic conditions which resulted in less benefits paid, and consequently reduced the dependence on borrowing from the Federal Unemployment Account,
- the provisions of Title XII of the Social Security Act which increased the employers' tax rates annually until all federal loans are repaid. The increase was first assessed on the 1982 Employers' Annual Federal Unemployment (FUTA) return. During fiscal years 1983, 1984, and 1985, respectively, \$21,787,631, \$50,630,383, and \$68,387,613 of taxes were collected under these provisions.

The following table summarizes the UC Fund's tax revenue (including additional FUTA tax, discussed above, but excluding surcharges, discussed below) and benefits paid for the fiscal years 1982 - 1985.

<u>Fiscal Year Ending June 30</u>	<u>Tax Revenue (*)</u>	<u>Benefits Paid</u>	<u>Excess(Deficit) Revenue Over Benefits Paid</u>
	(In Thousands)		
1982	\$246,425	\$387,538	\$(141,113)
1983	390,385	578,100	(187,715)
1984	430,899	326,232	104,667
1985	452,702	312,250	140,452

(*)Note: These amounts represent only part of the unemployment tax burden on the state's employers. In addition to the surcharge for paying interest discussed below, a federal unemployment (FUTA) tax is collected to finance the administration of Minnesota's unemployment insurance law. For fiscal year 1985, \$33,987,348 was sent to the state to administer the unemployment insurance and basic job service programs.

During 1981, amendments to Title XII Section 1202 eliminated the interest free status of loans made to the state on or after April 1, 1982, and also prohibited the payment of interest from the UC Fund. In response to these amendments, the 1983 Legislature established an emergency interest repayment fund for the sole purpose of paying interest accruing on these loans. A 10 percent surcharge on employer contributions paid or due and payable for calendar years 1982 and 1983 was assessed and payable by August 31, 1983 and 1984, respectively.

Surcharges totalling \$45,602,362 were collected as of December 31, 1985, and used to pay \$41,052,730 in interest. The remaining balance will be used to pay future interest costs if an outstanding loan balance continues. Accrued interest at December 31, 1985, was \$699,204.

The federal law changes, as well as improved economic conditions, have significantly reduced the UC Fund's deficit balance and the dependence on federal borrowing. If current economic conditions continue, taxes should

exceed benefits paid and eliminate the deficit. However, current economic forecasts indicate that a increase in unemployment is possible, which could result in more federal borrowing. In addition, another revenue source would be necessary to pay interest on the borrowing since the surcharge expired with the payments that were due in August 1984.

The Legislature must continue to review the structure of the fund and its responsiveness to changing economic conditions. The efforts toward fund solvency and the building of future fund reserves require the Legislature to identify sound and equitable short-term and long-range plans and goals. Without some type of legislative action, the fund could again experience severe financial difficulties.

CURRENT FINDINGS AND RECOMMENDATIONS

PRIOR RECOMMENDATION PARTIALLY IMPLEMENTED: The Department of Jobs and Training (DJT) needs to improve its federal grant cash management policies.

DJT received approximately \$216 million from several federal agencies to operate various programs and award grants to program recipients. The department has established a letter of credit with most of the federal grantor agencies and receives money by periodic drawdowns. In our last two management letters, we recommended that DJT improve its drawdown policies and procedures to comply with U.S. Treasury Circular 1075 (TC 1075), which provides the regulations governing cash management of federal grants.

T.C. 1075 states in part:

"Cash advances to a recipient organization shall be limited to the minimum amounts needed and shall be timed to be in accord only with the actual, immediate cash requirements of the recipient organization in carrying out the purpose of the approved program or project. The timing and amount of cash advances shall be as close as is administratively feasible to the actual disbursements by the recipient organization for direct program costs and the proportionate share of any allowable indirect costs."

T.C. 1075 also states:

"Cash advances made by primary recipient organizations to secondary recipient organizations shall conform substantially to the same standards of timing and amount as apply to cash advances by Federal program agencies to primary recipient organizations."

The department is in the process of modifying its cost accounting system, the State Employment Security Agency (SESA) system, to provide daily cash balances for each federal program. When these modifications are completed, the SESA system will provide the accounting information necessary to prevent negative cash balances. However, DJT needs to change its cash management policies and procedures to comply with T.C. 1075.

We noted three areas where DJT did not comply with T.C. 1075:

- federal program cash was temporarily used to pay the costs of other federal programs,
- drawdowns of federal cash were not based on actual costs, and
- federal cash was advanced to subrecipients.

Paying federal program costs with other program money.

The department's use of federal program cash to temporarily pay the cost of other programs was in part due to the U.S. Department of Labor's failure to promptly approve obligation authority for the Unemployment Insurance program (CFDA #17.225). Without an approved obligation authority, DJT could not draw federal cash to pay program expenditures. As a result, they paid expenditures of \$906,729 as of June 30, 1985, with monies from other federal programs. We were unable to determine which federal programs funded these expenditures, but federal monies for eight programs listed in the introduction (except #13.802 and #84.126) were commingled in one account.

T.C. 1075 limits cash advances to the actual needs of the approved program. If federal monies are temporarily unavailable, state money must be used to pay expenses. The Department of Finance has authorized the use of state funds for other agencies in similar situations by entering an appropriation, called a "specific budget", into the statewide accounting system. Agencies may use the specific budget to make expenditures until federal cash is available.

Basing cash drawdowns on estimated costs.

T.C. 1075 also requires that drawdowns of federal money be based on the actual and immediate cash needs of the recipient. DJT could not support the amount of its drawdowns with actual cost records. Drawdowns need to be based on such documents as payroll records and subrecipients' invoices for the following programs:

CFDA #13.646	Work Incentive
CFDA #13.665	Community Services Block Grant
CFDA #13.802	Social Security Disability Determination
CFDA #13.818	Low Income Home Energy Assistance Block Grant
CFDA #17.207	Employment Services
CFDA #17.225	Unemployment Insurance
CFDA #17.250	Job Training Partnership Act
CFDA #81.042	Weatherization Assistance for Low Income Persons
CFDA #84.126	Rehabilitation Services - Basic Support

Advancing federal cash to subrecipients.

Payments from DJT to subrecipients must be based on the actual, immediate cash needs of the subrecipients. However, DJT advanced funds to local units of government at the beginning of grant periods for the following programs:

CFDA #10.550	Food Distribution
CFDA #13.818	Low Income Home Energy Assistance Block Grant
CFDA #81.042	Weatherization Assistance for Low Income Persons

As of June 30, 1985, cash advances to subrecipients for the three federal programs totalled \$3,749,501.

In one example, a subrecipient under the Low Income Home Energy Assistance program submitted an invoice with expenditures of \$82,811, but received a payment of \$1,350,538 from DJT. The additional \$1,267,726 was an advance to pay future expenditures. However, in the next three months the subrecipient submitted invoices with expenditures of \$1,737,711, but was paid an additional \$1,860,474.

RECOMMENDATIONS:

- 1. DJT should request state money from the Department of Finance to pay expenses when federal money is temporarily unavailable.*
- 2. DJT should establish procedures to ensure that drawdowns of federal cash are based on actual, immediate cash needs.*
- 3. DJT should establish procedures to ensure that payments to subrecipients are based on the actual immediate cash needs of the subrecipients.*

A physical inventory of nonexpendable property was not taken every two years as required by federal regulations.

DJT receives federal funds to administer various federal programs. Fixed assets purchased with these funds are recorded in the State Employment Security Agency (SESA) accounting system. As of June 30, 1985, the SESA system showed \$9.3 million of fixed assets.

Our single audit scope included the federal programs stated in the introduction. We reviewed these programs for compliance with U.S. Office of Management and Budget (OMB) Circular A-102 which provides the standards for the administration of grants to the states. Attachment N within the circular sets the standards for property purchased with these funds. For nonexpendable property (property with an acquisition cost of \$1,000 or more and life expectancy exceeding one year), it requires the grantee to maintain accurate accounting records, submit an annual inventory listing of federally owned property to the federal grantor agency, take a physical inventory at least once every two years, and reconcile the accounting records to the physical inventory.

DJT's inventory policies and procedures do not require a physical inventory every two years; therefore, DJT is not in compliance with Circular A-102. Area offices are only required to take physical inventories when there is a change in the office manager. According to department staff, the last complete physical inventory was completed in 1982. Without a

Mr. Joseph Samargia, Commissioner

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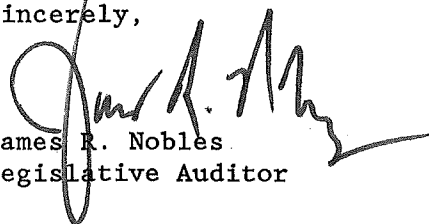
physical inventory every two years, DJT cannot substantiate to the federal grantor agency the existence, location, and condition of the fixed assets recorded on the SESA system.

RECOMMENDATION:

4. *DJT should revise its fixed asset inventory policies and procedures to require a physical inventory of nonexpendable property at least once every two years.*

Thank you for the cooperation extended our staff during this audit.

Sincerely,


James R. Nobles
Legislative Auditor


John Asmussen, CPA
Deputy Legislative Auditor

Attachment

February 28, 1986

DEPARTMENT OF JOBS AND TRAINING
(formerly DEPARTMENT OF ECONOMIC SECURITY)

STATUS OF PRIOR AUDIT RECOMMENDATIONS
AND

PROGRESS TOWARD IMPLEMENTATION

Attachment

The Department of Economic Security (DES) needs to improve its accounting and administrative controls over the management of federal program cash balances.

1. Using the requirements of U.S. treasury Circular 1075 as a guide, DES should continue efforts to improve its cash management procedures for federal programs to provide information on daily program cash balances and eliminate negative program cash balances.

Recommendation Partially Implemented. See current Recommendations #1-#3.

A Department of Economic Security employee may have violated the Hatch Act by being a candidate for public office.

2. The Department of Economic Security should work with the U.S. Merit System Protection Board:
 - to determine the applicability of the Hatch Act to state employees, considering the conflicting state statute and the U.S. District court opinion; and
 - to ensure that the possible violation by a DES employee is adequately resolved.

Recommendation Implemented. DES sent a letter dated February 20, 1985, to the U.S. Merit Systems Protection Board (Board) to inform them of the possible violation of the Hatch Act and request assistance in resolving the matter. At the request of the Board, on May 3, 1985, the Director of Labor Relations for DES gave a sworn affidavit of the facts surrounding the possible violation to representatives of the Board. Finally, in response to a telephone call from the Board, DES sent a letter dated May 10, 1985, providing the Board with additional information requested. To date, no final response has been received from the Board. The implementation has not yet received final acceptance by the federal government.

DEPARTMENT OF JOBS AND TRAINING
(formerly DEPARTMENT OF ECONOMIC SECURITY)

Attachment
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The financial statement amount shown as due from the Employment Services Administration Fund to the employment services contingent account lacks support.

3. A detailed ledger supporting the balance due from the Employment Services Administration Fund to the employment services contingent account should be developed and maintained. Adjustments should be made to the current balance as necessary after a valid amount is established.
4. Requests for reimbursements from the federal government and subsequent transfers to the contingent account should be completed in a timely manner.

Recommendations Implemented. DES could find no support for the account receivable balance. Consequently, the entire amount was written off. In the future, all receivable balances should be supported by a detailed ledger or similar documentation, and all reimbursements should be requested promptly.

A control account for combined wage claim payables is not maintained in the Unemployment Insurance Program (CFDA #17.225).

5. A control account for combined wage claim payables should be established and should periodically be reconciled to the subsidiary ledgers to ensure the correct recording of transactions.

Recommendation Implemented. A control account for combined wage claim payables was established in March 1985, and is reconciled monthly to the subsidiary ledgers. The implementation has not yet received final acceptance by the federal government.

Minnesota Department of Economic Security

390 North Robert Street, St. Paul, MN 55101

February 28, 1986

Mr. James R. Nobles
Legislative Auditor
Veterans Service Building
St. Paul, MN 55155

Dear Mr. Nobles:

The following information is prepared in response to your management letter resulting from your audit for the period ending June 30, 1985.

Recommendation #I:

DJT should request money from the Department of Finance to pay expenses when federal money is temporarily unavailable.

Department Response #I:

Federal agencies will be requested to meet their financial responsibilities of providing adequate funds in accordance with our approved budgets. Audit recommendations would result in the Department resolving cash flow needs, but would result in unacceptable costs to the State of Minnesota.

Recommendation #II:

DJT should establish procedures to ensure that drawdowns of federal cash are based on actual, immediate cash needs.

Department Response #II:

DJT is currently in the final testing of software that, when implemented, should resolve this cash management issue.

February 28, 1986
Mr. James R. Nobles
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Recommendation #III:

DJT should establish procedures to ensure that payments to subrecipients are based on actual immediate cash needs of subrecipients.

Department Response #III:

Department agrees.

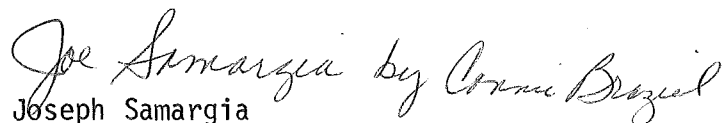
Recommendation #IV:

DJT should revise its fixed asset inventory policies and procedures to require a physical inventory of nonexpendable property at least once every two years.

Department Response #IV:

Department agrees and will revise policies and proceed with a physical inventory.

Sincerely,


Joseph Samargia
Commissioner

JS/JGB:pjk