

Department of Economic Security

Financial Audit

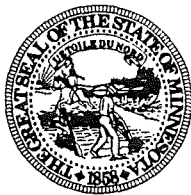
For the Fiscal Year Ended June 30, 1995

May 1996

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Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

96-20



STATE OF MINNESOTA

OFFICE OF THE LEGISLATIVE AUDITOR

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JAMES R. NOBLES, LEGISLATIVE AUDITOR

Representative Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Ms. R. Jane Brown, Commissioner
Department of Economic Security

We have audited selected programs of the Department of Economic Security for the fiscal year ended June 30, 1995, as further explained in Chapter 1. The work conducted in the department is part of our Statewide Audit of the State of Minnesota's fiscal year 1995 financial statements and Single Audit. The Comprehensive Annual Financial Report for the year ended June 30, 1995, includes our report, issued thereon dated December 1, 1995. The Minnesota Financial and Compliance Report on Federally Assisted Programs for the year ended June 30, 1995, will include our reports on the supplementary information schedule, internal control structure, and compliance with laws and regulations. We anticipate issuing this report in June 1996. Therefore, we emphasize that this has not been a complete audit of all financial activities of the Department of Economic Security. The following Summary highlights the audit objectives and conclusions. We discuss our concerns more fully in the individual chapters of this report.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we obtain an understanding of management controls relevant to the audit. The standards require that we design the audit to provide reasonable assurance that the Department of Economic Security complied with provisions of laws, regulations, contracts, and grants that are significant to the audit. Management of the Department of Economic Security is responsible for establishing and maintaining the internal control structure and complying with applicable laws, regulations, contracts, and grants.

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 May 3, 1996.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: March 10, 1996

Report Signed On: April 24, 1996

SUMMARY

State of Minnesota

Office of the Legislative Auditor

Centennial Office Building • St. Paul, MN 55155
612/296-4708

Department of Economic Security

Financial Audit For the Fiscal Year Ended June 30, 1995

Public Release Date: May 3, 1996

No. 96-20

Agency Background

The Department of Economic Security is responsible for providing an employment, rehabilitation, and income support system to increase the economic independence of Minnesotans. A few of the major programs administered by the department include: Reemployment Insurance, Rehabilitation Services, Job Service, Low Income Energy Assistance, and Job Training Partnership Act. Ms. R. Jane Brown serves as the commissioner of the department.

Audit Areas and Conclusions

Our audit scope was limited to those activities material to the State of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1995, and to requirements of the Single Audit Act of 1984, relating to federal financial assistance. In addition, we reviewed certain aspects of the State Extended Employment Program.

We reviewed Reemployment Insurance revenues and benefit payments. The Department of Economic Security complied with statutory requirements for disbursing reemployment insurance benefits. In addition, the department appropriately accounted for and deposited reemployment insurance revenues. However, we found that the department needs to improve controls over employer tax rates.

In addition, we reviewed specific compliance requirements related to federal programs reviewed under the Single Audit Act. We found that the department is complying with most of these requirements. However, we found that the department did not have records to support a portion of the state match it reported to the federal government for federal fiscal years 1993, 1994, and 1995 for the Basic Support federal grant (CFDA 84.126).

Finally, we looked at different aspects of the State Extended Employment Program. We feel the department did not meet required audit and reconciliation requirements.

Contact the Financial Audit Division for additional information.

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Department of Economic Security

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Audit Participation

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

John Asmussen, CPA	Deputy Legislative Auditor
Claudia Gudvangen, CPA	Senior Audit Manager
Warren Bartz, CPA	Audit Manager
Beth Hammer, CPA, CISA	Auditor-in-Charge
Geniene Herrlich, CPA	Auditor
Marina Mirman	Auditor
Margie Caneff	Auditor
Chad Leiker	Intern

Exit Conference

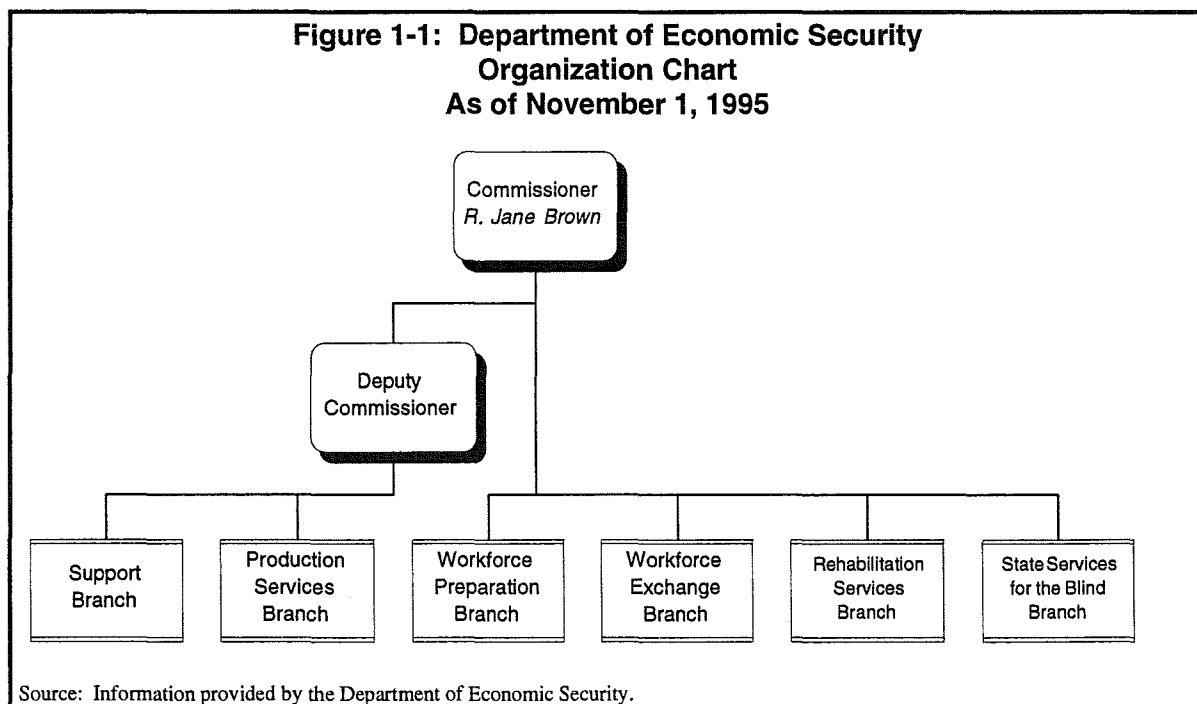
The findings and recommendations in this report were discussed with the following staff of the Department of Economic Security on April 12, 1996:

R. Jane Brown	Commissioner
Earl Wilson	Deputy Commissioner
Al St. Martin	Assistant Commissioner, Production Services
Norena Hale	Assistant Commissioner, Rehabilitation Services
John Stavros	Director, Fiscal Management
Dale Wing	Director, Management Planning
Mark Kaszynski	Director, Energy Programs
Frank Schneider	Director, Workforce Preparation Program Support
Larry Simmons	Director, Rehabilitation Services
Jack Andrews	Supervisor, Rehabilitation Services
Jim Wandell	Supervisor, Reemployment Programs
Leland Schuster	Supervisor, Tax Liability
Bev Amos	Director, Financial Services
Tim Langlie	Manager, General Accounting
Sandy Kopecky	Senior Accounting Officer
Marge Heininger	Intermediate Accounting Officer

Chapter 1. Introduction

The mission of the Department of Economic Security is to help Minnesotans help themselves achieve economic security. The department accomplishes this mission by providing an accessible, integrated employment and training system for all Minnesotans.

In November 1995, the department restructured into branches based on business functions. Figure 1-1 depicts the current structure of the department. Except for the support branch, which reports directly to the deputy commissioner, each branch reports to an assistant commissioner. The commissioner has overall responsibility for the department. The Governor appointed Ms. R. Jane Brown as commissioner effective February 8, 1991.



Each branch provides specific services to meet the department's mission. The following summarizes each branch's responsibilities:

- **Support Services** - provides department-wide services to the other branches such as fiscal services, human resources, and planning and technology.
- **Production Services** - performs high volume processes and other compliance oriented activities. One example is the collection and deposit of reemployment revenues.
- **Workforce Preparation** - oversees training and other support services needed prior to work search.

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- **Workforce Exchange** - administers the operation of reemployment and employer services.
- **Rehabilitation Services** - serves individuals with disabilities.
- **State Services for the Blind** - serves visually impaired individuals.

Prior to November 1995, the department was structured in five divisions. The divisions included four programmatic and a support services. The four divisions centered around programs included: Job Service and Reemployment Insurance, Community Based Services, Rehabilitation Services, and State Services for the Blind.

The department is financed primarily from federal grants, General Fund appropriations, and the collection of reemployment taxes from employers. Our audit scope focused on 1995 expenditures for the programs included in Table 1-1. In addition, we included reemployment insurance revenues totaling \$491,134,000 in our audit scope. These financial activities were material to the state's financial statements and to the Single Audit objectives.

**Table 1-1: Department of Economic Security
Selected Expenditures by Program for Fiscal Year 1995**

Reemployment Insurance Fund: (1)	
Reemployment Insurance Benefits	\$368,453,000
Federal Fund: (2)	
Low Income Energy Assistance (CFDA #93.568)	65,251,118
Unemployment Insurance Administration (CFDA #17.225)	43,433,437
Rehabilitation Services Basic Support (CFDA #84.126)	30,401,216
State Services for the Blind Basic Support (CFDA #84.126)	7,006,320
Job Training Partnership Act (CFDA #17.250)	27,512,134
Dislocated Worker (CFDA #17.246)	14,810,754
Employment Services Administration (CFDA #17.207)	14,789,371
Social Security - Disability Insurance (CFDA #93.802)	13,186,747
Low Income Persons Weatherization Assistance (CFDA #81.042)	11,838,867
Food Distribution (CFDA #10.550)	1,325,568

Sources:

- (1) State of Minnesota's Comprehensive Annual Financial Report for fiscal year 1995.
 - (2) Minnesota's Financial and Compliance Report on Federally Assisted Programs.
-

Our work in the Department of Economic Security is completed as part of our annual Statewide Audit. The primary objective of the Statewide Audit is to render an opinion on the state of Minnesota's financial statements. This includes determining whether the state's financial statements present fairly its financial position, results of operations, and changes in cash flows in conformity with generally accepted accounting principles. As part of our work, we are required to gain an understanding of the internal control structure and ascertain whether the state complied with laws and regulations that may have a material effect on its financial statements.

The Statewide Audit is also designed to meet the requirements of the Single Audit Act of 1984, relating to federal financial assistance. The Single Audit Act established two additional audit objectives and requires us to determine whether:

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- the state complied with rules and regulations that may have a material effect on each major federal program; and
- the state has internal accounting and other control systems to provide reasonable assurance that it is managing federal financial assistance programs in compliance with applicable laws and regulations.

To address our Statewide Audit objectives, we interviewed key department employees, reviewed applicable policies and procedures, performed analytical procedures, and tested representative samples of financial transactions.

The State of Minnesota's Comprehensive Annual Financial Report for the year ended June 30, 1995, includes our unqualified audit opinion, issued thereon dated December 1, 1995. The Minnesota Financial and Compliance Report on Federally Assisted Programs for the year ended June 30, 1995, will include our reports on the supplementary information schedule, internal control structure, and compliance with laws and regulations. We anticipate issuing this report in June 1996.

In addition to preparing those standard reports, we have also developed some audit findings and recommendations. In Chapter 2 we discuss our findings regarding reemployment insurance. In Chapter 3 we discuss our findings regarding Rehabilitation Service Branch programs.

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Chapter 2. Reemployment Insurance

Chapter Conclusions

The Department of Economic Security complied with statutory requirements for disbursing reemployment insurance benefits. In addition, the department appropriately accounted for and deposited reemployment insurance revenues. However, we found that the department needs to improve controls over employer tax rates.

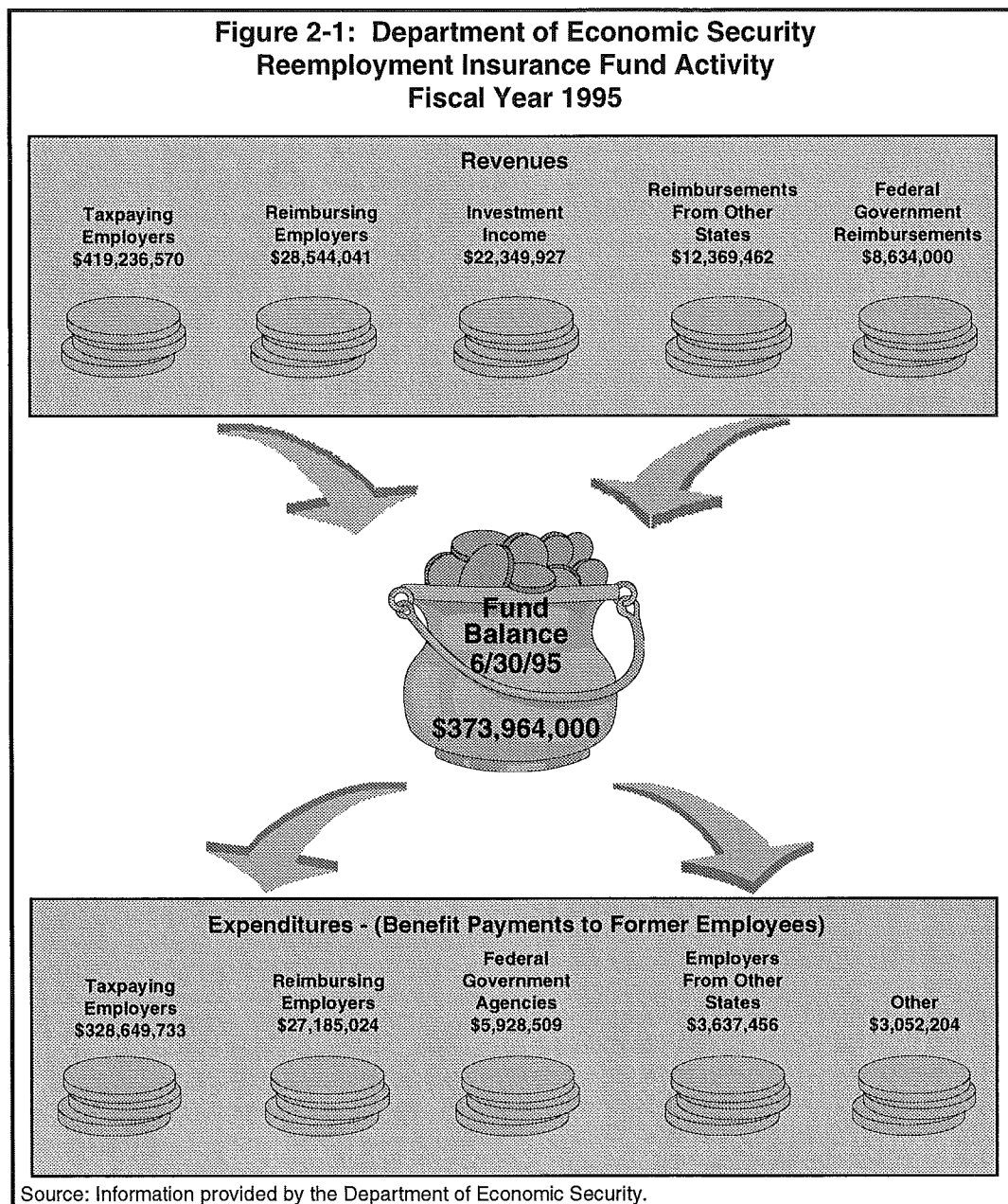
Reemployment insurance provides economic relief to unemployed persons. The program serves workers seeking reemployment, who are unemployed through no fault of their own. Minnesota law established a Reemployment Insurance Fund to be administered by the Department of Economic Security. The department is to use the fund to accumulate money from employers during periods of employment to provide benefits for periods of unemployment. Figure 2-1 depicts the major sources and uses of money to the fund during fiscal year 1995.

The Department of Economic Security disburses benefit payments to unemployed workers who meet specific criteria established in Minnesota law. As part of our audit of Minnesota's Reemployment Insurance Program, we reviewed material compliance requirements relating to disbursing benefit payments to claimants. Our testing showed that the department complied with those requirements.

Each taxpaying employer makes a quarterly tax payment to the department based on a tax rate and the employer's taxable payroll. Certain non-profit organizations and government units do not have a tax rate. Rather, those organizations directly reimburse the fund for payments made to their unemployed workers.

The Department of Economic Security's Production Services Branch is responsible for determining employer liability, assigning tax rates, processing quarterly tax and wage reports, and collecting and accounting for reemployment taxes. Annually, the branch calculates a tax rate for taxpaying employers based on a complex formula established in Minnesota law. The formula measures an employer's experience with unemployment. The less unemployment experienced by an employer, the lower the employer's tax rate becomes.

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Our audit also included a review of reemployment revenues. Our testing verified that the department was appropriately collecting and depositing these revenues in the Reemployment Insurance Fund. In addition, we verified the accuracy of employer tax rate calculations. We noted weaknesses in the control structure that could result in the department assigning inaccurate tax rates to employers. We discuss these weaknesses in Finding 1.

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1. The Department of Economic Security has inadequate controls over assigning tax rates to employers.

Controls over reemployment insurance tax rates are weak for several reasons. First, a large number of employees have the ability to change tax rates. Many of these employees do not need this ability to fulfill their job responsibilities. In addition, the department does not review the accuracy or reasonableness of tax rate changes.

The Department of Economic Security's reemployment tax system contains an employer master record screen. Most employees use this screen to make adjustments to non-sensitive data such as updating federal tax identification numbers. However, some employees use this screen to change tax rates. The dual functionality of this screen causes a weakness in the department's control structure. The department's security software can only control access at the screen level. The department should limit access to employer tax rates based on an employee's job responsibilities. Since tax rates can be changed on the same screen as non-sensitive data, the department is not able to limit access to employer tax rates. We think the department should remove the ability to make tax rate changes from the employer master record screen and add this function to a separate screen.

The concern about the number of employees with access to change tax rates is compounded by the department not having adequate controls to ensure that it assigns correct tax rates to employers. As discussed previously, the department calculates tax rates annually. If any of the components within the calculation change, employees must manually recalculate the tax rate and adjust the rate on the employer master record screen. Due to the complexity of the calculation, errors and irregularities could occur and go undetected. For example, our review found an employer for whom the department assigned an incorrect tax rate for three years. The incorrect tax rate was the result of an employee error. Due to this error, the employer underpaid the Reemployment Insurance Fund \$34,600 over the three years. The department has since corrected the employer's tax rate and billed the employer for the additional taxes owed.

Recommendations

- *The Department of Economic Security should remove the ability to change employer tax rates from the employer master record screen.*
- *The Department of Economic Security should ensure that adequate controls are in place over employer tax rates.*

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Chapter 3. Rehabilitation Services

Chapter Conclusions

The Department of Economic Security complied with most legal requirements in the OMB Compliance Supplement for the Basic Support federal grant (CFDA 84.126). However, we found that the department did not have records to support a portion of the state match it reported to the federal government for federal fiscal years 1993, 1994, and 1995.

In addition, we looked at different aspects of the State Extended Employment Program. We feel the department did not meet required audit and reconciliation requirements.

The Rehabilitation Services Branch serves individuals who have disabilities. Some of the services provided by the branch include vocational planning, employment information and referrals, and guidance to maintain employment. The branch provides services through four major programs:

- Vocational Rehabilitation Services
- Extended Employment Program
- Independent Living
- Projects with Industry

We concentrated our work on the Vocational Rehabilitation Services Program. In addition, we conducted interviews with agency staff concerning the Extended Employment Program. This chapter discusses our work completed on these two programs.

Vocational Rehabilitation Services

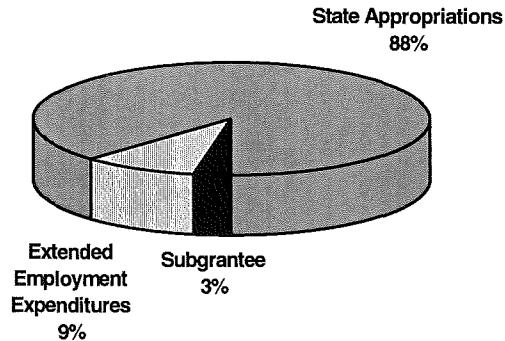
Basic vocational rehabilitation services to consumers include vocational counseling, planning, guidance, and placement, as well as certain special services based on individual circumstances. These may include academic or skill training, artificial appliances or prostheses, rehabilitation technology, and tools or equipment. The U.S. Department of Education's Basic Support federal grant (CFDA 84.126) funds the program. The state of Minnesota provides required matching funds.

The required state match is equal to 21.3 percent of total Basic Support expenditures. Federal regulations require the department to make the match for each federal fiscal year ending September 30. The department's state match for federal fiscal year ending September 30, 1994, was \$7,561,666. As seen in Figure 3-1, the department met the majority of the match with state appropriations. Beginning in federal fiscal year 1993, the department began to use a portion of

Department of Economic Security

expenditures from the state funded Extended Employment Program to match Basic Support federal funds. We discuss the Extended Employment Program in more detail in the next section. The department meets the remaining match requirement with subgrantee funds.

**Figure 3-1: Department of Economic Security
Basic Support (CFDA 84.126) - State Match Funding Sources
Federal Fiscal Year 1994**



Source: Data provided by Department of Economic Security employees.

The U.S. OMB Compliance Supplement discusses the Basic Support Program objective. In addition, it contains specific compliance requirements that the state must meet in order to receive federal funds. The supplement categorizes these requirements into: types of services allowed or unallowed, eligibility, matching, level of effort, special reporting and special tests and provisions. We tested the department's adherence to the specific requirements outlined in the compliance supplement. Our testing showed that the department complied with most of these requirements. However, the department did not have adequate documentation to support the Extended Employment expenditures used to meet the Basic Support grant's state match requirement. We discuss this concern in Finding 2.

Extended Employment Program

The Extended Employment (EE) Program funds non-profit rehabilitation facilities to provide ongoing employment support to Minnesotans with severe disabilities. What is now EE began as the Sheltered Workshop Program which was first authorized by the state Legislature in 1965. In 1986, the state Legislature implemented a performance based funding system in response to constituent demands for incentives and equity in the funding system.

The performance-based funding system rewards non-profit rehabilitation facilities for their performance based on a number of criteria. The Legislature identified specific criteria for the department to use in completing annual evaluations of facilities. Table 3-1 outlines the specific evaluation criteria that were in effect through June 30, 1995. Beginning in fiscal year 1996, the Legislature simplified the EE statute by eliminating the specific evaluation criteria.

**Table 3-1: Department of Economic Security
Extended Employment Program Evaluation Criteria
Effective through June 30, 1995**

1. Wages and benefits paid to workers and number of hours worked;
2. Rate of placement in competitive employment;
3. Opportunities for workers to participate in decisions affecting their employment;
4. Rehabilitation facility responsiveness to workers' grievances;
5. Increases in individual workers' productivity;
6. Efficiency of the rehabilitation facilities; and
7. Types and levels of disability of the workers and willingness of the rehabilitation facility to accept and assist persons with serious behavioral, mental, sensory, or physical disabilities.

Source: Minnesota Statutes 268A.09, Subd. 3.

Administering the EE Program is complex due to statutory and program rule requirements. Funding for the program is competitive and based on each facility's performance compared to the performance of every other facility. Initially, the department advances EE Program funds to facilities. Program rules require an annual audit of each facility to evaluate their performance compared to the other facilities, using the criteria in Table 3-1.

After finishing all facility audits, the department completes a reconciliation. This reconciliation determines the difference between the cash initially advanced to facilities and the amount actually earned by each facility. This reconciliation does not change the total dollar amounts allocated to the facilities. Rather, it reallocates the dollars among the facilities based on performance. In effect, some facilities will receive more funds and others will owe funds. For fiscal year 1993, the department advanced \$9,717,003 to the facilities. After completion of facility audits and reconciliations, the department determined it should reallocate \$710,328 among the facilities.

The department has encountered a number of problems with the performance based process. First, the department has not completed audits of facilities and the reconciliation process in accordance with program rules. We discuss this concern in Finding 3. In addition, the department entered into a proposed settlement to resolve a number of facility appeals. The 1996 Legislature enacted legislation to implement the settlement. The legislation includes a provision to expedite the completion of audits. In addition, a provision appropriates \$725,000 to the Department of Economic Security to resolve disputed audits for fiscal years 1991, 1992, and 1993.

2. The Department of Economic Security does not have adequate documentation to support a portion of the required state match for the Rehabilitation Services Basic Support federal grant (CFDA 84.126) for federal fiscal year 1993, 1994, and 1995.

The Department of Economic Security does not have adequate documentation to support its state match for the Vocational Rehabilitation Services Program funded with the Basic Support Grant for federal fiscal years 1993, 1994, and 1995. The department used a portion of expenditures

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from the state Extended Employment (EE) Program to meet match requirements. However, the department did not base the match on actual EE Program expenditures. Rather, it used estimated expenditures. Table 3-2 shows the estimated EE expenditures used to match Basic Support federal funds for three federal fiscal years.

**Table 3-2: Department of Economic Security
Extended Employment Expenditures
Used to Match the Basic Support Federal Grant (CFDA 84.126)**

<u>Federal Fiscal Year</u>	<u>Extended Employment Estimated Expenditures Used for Match</u>	<u>Basic Support Federal Funds Received (1)</u>
1993	\$663,037	\$2,449,813
1994	709,283	2,620,684
1995	<u>716,376</u>	<u>2,646,892</u>
Total	<u>\$2,088,696</u>	<u>\$7,717,389</u>

(1) Auditor calculated amount, see Figure 3-1 for other components of match.

Source: Data provided by Department of Economic Security employees.

Federal regulations require the department to submit a state plan to the Department of Education every three years. This plan outlines the department's compliance with federal regulations. The department, in an attachment to their state plan for the Vocational Rehabilitation (VR) Services Program, states:

Supported employment funds expended on an active VR case under an individual written rehabilitation plan (IWRP) with the goal of supported employment are utilized to match federal vocational rehabilitation funding. Only cases that meet this criteria are utilized for the federal match. These cases are identified by using the Rehabilitation Services information database to identify active VR Program consumers with a supported employment goal who are also served by the Extended Employment Program. Rehabilitation Services then applies to the federal match only the expenditures for employment and employment related services from the time the IWRP is initiated to the time a case is closed.

Federal regulations did not require the department to seek approval from the U.S. Department of Education to use the EE Program expenditures as state match. However, representatives from the U.S. Department of Education reviewed and approved the attachment with the above provision. These representatives were not aware that the department based the match on estimated expenditures.

The department could not produce support for the cases that met the criteria stated above. Eventually, the department was able to produce reports with specific cases. However, the department based the reported expenditures on estimated expenditures rather than actual. We could not determine the basis for the estimates used for the match. The department does not know what actual expenditures are since it is behind in completing EE Program audits. As discussed previously, the audits determine actual expenditures.

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When the department determines actual expenditures, it intends to adjust the estimated figures and amend reports submitted to the U.S. Department of Education. However, we disagree with the department's approach in notifying the Department of Education that they were meeting the match based on actual expenditures when, in fact, the department did not know what the actual expenditures were. The reports submitted to the Department of Education do not make it clear that the expenditures were estimates rather than actual expenditures.

Recommendation

- *The Department of Economic Security should work with the U.S. Department of Education to support the Basic Support federal funding received using the Extended Employment Program expenditures.*

3. The Department of Economic Security did not complete Extended Employment Program audits of non-profit rehabilitation facilities timely.

The Department of Economic Security did not conduct audits and reconciliations of rehabilitation facilities in accordance with the department's rules. Extended Employment (EE) Program rules require an annual audit of rehabilitation facilities to evaluate their performance based on the criteria in Table 3-1. The reconciliation process uses the results of the audits to reallocate funds to facilities. Currently, the department has only conducted audits through fiscal year 1993.

As further evidence of the department's failure to conduct timely EE audits, rehabilitation facilities brought concerns about delays to the attention of the 1995 Legislature. The Legislature enacted specific dates by which the department was to complete audits and reconciliations for fiscal years 1991 through 1994. The legislation required the department to complete audits and reconciliations for the EE Program according to the following schedule:

- fiscal year 1991 by April 14, 1995
- fiscal year 1992 by July 28, 1995
- fiscal year 1993 by July 28, 1995
- fiscal year 1994 by June 1, 1996

The department has met the specific deadlines for audits and reconciliations for fiscal year 1991, 1992, and 1993. The 1996 Legislature enacted legislation to expedite fiscal year 1994 and 1995 audits. The legislation requires extended employment service providers to secure independent outside audits. It requires the providers to submit the audit reports to the department by May 1, 1996. After receipt of all audit reports, the department has 90 days to complete the reconciliation process.

Recommendation

- *The Department of Economic Security should conduct Extended Employment Program audits and reconciliations in accordance with Minnesota law.*

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Office of the Commissioner

Minnesota Department of Economic Security

Formerly the Department of Jobs and Training

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April 22, 1996

Mr. 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 audit report dated April 8, 1996. Please include this information in your final report.

Recommendation 1

The Department of Economic Security should remove the ability to change employer tax rates from the employer master record screen.

The department should ensure that adequate controls are in place over employer tax rates.

We agree. We will create a new on-line screen which will be used for tax rate changes, and will remove the capability from the existing screen. We will set up restricted access to the new screen; the number of people with access will be as small as possible and still meet our legitimate business needs.

Also, the Tax Branch has reinstituted the Quality Review Process in the Liability Unit and tax rate changes is one of the items selected for review. This will be a random sample rather than a complete review.

Responsible Individual: Al St. Martin



James Nobles
Page Two
April 22, 1996

Recommendation 2

The Department of Economic Security should work with the U.S. Department of Education to support the basic support federal funding received using the Extended Employment Program expenditures.

We concur that the documentation process is not adequate and we will increase our communication with the Department of Education to clarify this issue. Completion of the Extended Employment Program audit and reconciliation requirements as stated in Finding 3 below will allow the agency to develop a more exacting method on which to base estimates. Estimates will continue to be used until the Extended Employment Program Unit can begin a program monitoring operation to ensure that program information is more accurate on an on-going basis rather than waiting until audited results are available.

Responsible Individual: Norena Hale

Recommendation 3

The department should conduct Extended Employment Program audits and reconciliations in accordance with Minnesota law.

We concur with the recommendation. The Extended Employment Program Unit has initiated steps 1) to ensure that independent outside audits are concluded, submitted, and accepted by the department, and that 2) reconciliations to be performed by the program unit are completed by the dates specified in legislation.

Responsible Individual: Norena Hale

Sincerely,

A handwritten signature in cursive script that reads "R. Jane Brown". The signature is written in black ink and is positioned above the printed name and title.

R. Jane Brown
Commissioner

RJB:mes