

O L A

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Department of Commerce
Fiscal Year Ended June 30, 2006



March 15, 2007

07-03

Financial Audit Division

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

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

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

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

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

Through its Program Evaluation Division, OLA conducts several evaluations each year.

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

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

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

Department of Commerce

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Audit Participation

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

Cecile Ferkul, CPA, CISA	Deputy Legislative Auditor
Brad White, CPA, CISA	Audit Manager
Ken Vandermeer, CPA	Audit Coordinator
John Hakes, CPA	Senior Auditor
Xin Wang	Auditor

Exit Conference

We discussed the results of the audit with the following representatives of the Department of Commerce at an exit conference on February 27, 2007:

Glenn Wilson	Commissioner
Edward Garvey	Deputy Commissioner
Dennis Munkwitz	Chief Financial Officer
Janet Streff	Manager, State Energy Office
Tim Jahnke	Director, Financial Services
John Harvanko	Director, Energy Assistance

Report Summary

Key Findings:

- The Department of Commerce did not ensure that weatherization assistance funds were used in compliance with federal requirements. The department provided \$1,167,772 for improvements to dwellings that did not meet federal cost-effectiveness criteria. (Finding 1, page 3)
- The department did not identify federal program numbers for all of its federal accounts in the state's accounting system. (Finding 2, page 4)
- The department inappropriately included over \$13 million of federal low-income home energy assistance expenditures on its federal expenditure report that were already reported as expenditures by the Department of Human Services. (Finding 3, page 5)

The report contained three findings related to internal control and legal compliance. One of the findings was first reported last year and is not yet resolved.

Audit Scope:

Two major State of Minnesota federal programs for fiscal year 2006:

- Low-Income Home Energy Assistance Program (CFDA¹ #93.568)
- Weatherization Assistance for Low-Income Persons Program (CFDA #81.042)

Background:

In fiscal year 2006, the Department of Commerce managed federal expenditures totaling \$82.5 million for the Low-Income Home Energy Assistance Program and \$9.6 million for the Weatherization Assistance for Low-Income Persons Program.

¹ The Catalog of Federal Domestic Assistance (CFDA) is a unique number assigned by the federal government to identify its programs.



OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

Representative Rick Hansen, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Glenn Wilson, Commissioner
Department of Commerce

We have performed certain audit procedures at the Department of Commerce as part of our audit of the state’s compliance with the requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement*. We emphasize that this has not been a comprehensive audit of the Department of Commerce.

The Department of Finance prepares the *Minnesota Financial and Compliance Report of Federally Assisted Programs*. Table 1 identifies the major federal programs administered by the Minnesota Department of Commerce in fiscal year 2006. We performed certain audit procedures on these programs as part of our objective to obtain reasonable assurance that the State of Minnesota complied with the requirements applicable to each of its federal programs. Procedures involved reviewing the department’s compliance with federal requirements in areas such as cash management, recipient eligibility, financial reporting, and administrative costs.

Table 1
Major Federal Programs Administered by the
Department of Commerce
Fiscal Year 2006
(in thousands)

CFDA ^(Note 1) Number	Program Name	Expenditures
93.568	Low-Income Home Energy Assistance	\$82,514 ^(Note 3)
81.042	Weatherization Assistance for Low-Income Persons ^(Note 2)	9,576

Note 1: The Catalog of Federal Domestic Assistance (CFDA) is a unique number assigned by the federal government to identify its programs.

Note 2: The Office of the Legislative Auditor selected the federal Weatherization Assistance program as a major program for fiscal year 2006. This smaller high-risk federal program replaced a previously examined larger federal program we considered to be low-risk.

Note 3: The Department of Commerce’s Low-Income Home Energy Assistance Program received an additional \$13,399,244 that was funded through an interagency agreement with the Department of Human Services using the Temporary Assistance for Needy Families Program money.

Source: Minnesota Accounting and Procurement System for fiscal year 2006.

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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 *Government Auditing Standards*, issued by the Comptroller General of the United States.

Conclusions

Except for the findings discussed below, the Department of Commerce complied with and had controls to ensure compliance with certain provisions of laws, regulations, contracts, and grants applicable to its major federal programs for fiscal year 2006.

Findings and Recommendations

1. The Department of Commerce did not ensure that local service providers¹ delivered program funds in compliance with federal requirements for the Weatherization Assistance for Low-Income Persons Program (CFDA # 81.042).

The Department of Commerce did not sufficiently monitor local service providers to ensure they delivered federal program funds to dwellings with greater need for weatherization improvement. Local service providers distribute the program's financial assistance to eligible low income households to improve the energy efficiency of their homes. The department did not have an effective monitoring system, as required by federal regulation, to ensure local service providers complied with federal program requirements. Over 12 percent of the federal program's expenditures did not comply with federal requirements.

The program has three full-time staff in its monitoring unit, but they do not ensure that local service providers comply with the following federal program requirements:

- Selection of cost-effective dwellings – During fiscal year 2006, local service providers inappropriately provided weatherization assistance of \$1,167,772 to dwellings where the cost of the improvement exceeded the estimated long term energy savings. Federal regulations² require that funds used for weatherization improvements result in energy cost savings over the lifetime of the improvement at least equal to the cost of materials and installation. The state's plan with the federal government quantifies this analysis with a savings-to-investment ratio. If the ratio is below 1, meaning that the cost of the improvement exceeds the estimated energy savings, the improvement is not an effective use of weatherization assistance funds. The department inappropriately allowed local service providers to fund weatherization improvements even though the savings-to-investment ratio was 1 or less.
- Monitoring of local service providers – The department had no documentation to substantiate that it had monitored the minimum number of households and that contractor work complied with standards.

¹ A local service provider is a public or nonprofit entity or a community action agency authorized to determine eligibility for heating assistance and identify dwellings in need of financial assistance for weatherization improvements.

² 10 Code of Federal Regulations §440.21(c).

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- The state’s plan indicates that the department will examine at least five percent of the completed dwellings for each local service provider to ensure the completion of quality work and compliance with program requirements. Although there was evidence that the department conducted the reviews (the department had letters to the local service providers citing concerns and requesting corrective action plans), the department could not substantiate the number of reviews performed at each service provider.
- The department lacked a structured audit approach to guide quality and consistency of their monitoring work. Monitoring staff did not adequately document sample selection methods, recipients examined, and attributes tested. They had no testing documents showing that local service providers had evidence that contractors met program quality standards. Weatherization improvements done by private contractors must comply with standards concerning licensing, insurance, and workmanship. In addition, local service providers must inspect the contractor’s work to ensure it was satisfactory. The department’s site visits did not determine whether local service providers were verifying that contractors complied with those standards.

Because the department did not effectively monitor the local service providers, funds were inappropriately used for energy improvements that were not the most cost-effective and may not have complied with federal requirements or quality standards.

Recommendations

- *The Department of Commerce should work with the federal Department of Energy to resolve the \$1,167,772 in questioned costs for the Weatherization Assistance for Low-Income Persons Program.*
- *The Department of Commerce should improve its monitoring of local service providers to ensure compliance with federal requirements for the Weatherization Assistance for Low-Income Persons Program.*

2. PRIOR FINDING NOT RESOLVED: The Department of Commerce did not identify all of its federal program accounts on the state’s accounting system.

The department did not effectively use the state’s accounting system to accumulate federal program expenditures by their respective Catalog of Federal Domestic Assistance (CFDA) identification numbers. It did not identify the CFDA number in the accounting system for all federal accounts. As a result, department staff had to manually identify and assign federal program numbers to \$45.9 million of federal expenditure activity for fiscal year 2006. Without identifying federal program numbers in the accounting system, the department increased the risk of incorrectly reporting each program’s expenditures in *Minnesota’s Financial and Compliance Report on Federally Assisted Programs*.

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The Department of Finance's accounting system reports did not accumulate total federal expenditures by program, because the accounts did not contain the underlying program number. For example, to compile the total expenditures for the Low-Income Home Energy Assistance Program, the department had to identify activity from four different accounts and have the Department of Finance add the expenditures in those four accounts to determine the program total. If the department had entered the federal program number, accounting system reports would have automatically totaled expenditures for that program and eliminated the risk of omission or error.

Recommendation

- *The Department of Commerce should ensure that each federal account in the state's accounting system is identified with its corresponding federal program number.*

3. The Department of Commerce did not accurately measure federal expenditures for the Low-Income Home Energy Assistance Program (CFDA #93.568).

The department inappropriately included \$13,399,244 of the Low-Income Home Energy Assistance Program's expenditures on its federal expenditure report that were already included in expenditures measured by the Department of Human Services' Temporary Assistance to Needy Families Program. The error resulted in an audit adjustment to correct for double-counting of those federal expenditures by the two state departments.

The departments of Commerce and Human Services entered into an interagency agreement to make the funding available and ensure that recipients of heating assistance were eligible for benefits under the Temporary Assistance to Needy Families Program. The agreement, however, did not specify how to report these federal expenditures in the *State of Minnesota's Financial and Compliance Report on Federally Assisted Programs*.

Recommendation

- *The Department of Commerce should ensure that it properly coordinates reporting of federal expenditures when federal funds are transferred in from another state department.*

This report is intended for the information of the Legislative Audit Commission and the management of the Department of Commerce. This restriction is not intended to limit the distribution of this report, which was released as a public document on March 15, 2007.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

End of Fieldwork: January 26, 2007

Report Signed On: March 9, 2007

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

**Status of Prior Audit Issues
As of January 26, 2007**

Fiscal Year 2005 Statewide/Single Audit

Legislative Audit Report 06-06, issued in March 2006, examined the department's federal Low-Income Home Energy Assistance Program (CFDA #93.568) for the fiscal year ended June 30, 2005. The purpose of the audit was to examine the department's internal controls and compliance with federal government requirements. The audit identified two findings. The first issue identified concerns with the department's testing and verification of household eligibility for federal heating assistance. We determined that the department resolved this concern by improving the quality of eligibility testing and verification. The second finding cited errors caused by not recording federal program numbers for all federal accounts in the accounting system. This finding was not resolved and is repeated as Finding 2 in the current report.

Other Audit Reports

Legislative Audit Report 06-18, issued in June 2006, covered the three fiscal years ending June 30, 2005, for selected areas of the Department of Commerce. The scope of the audit included assessments to utility, telecommunications, and insurance companies; securities registration fee revenues; payroll and selected expenditure areas; and the unclaimed property program. The report contained seven findings related to internal control and legal compliance. We did not follow up on the results of this audit report.

State of Minnesota Audit Follow-Up Process

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



March 7, 2007

James Nobles, Legislative Auditor
Room 140 Centennial Building
658 Cedar Street
St. Paul, Minnesota 55155-1603

Dear Mr. Nobles:

Thank you for your audit of the department's single audit work on selected federal programs awarded to us for the year ended June 30, 2006. We realize the importance of regularly auditing this significant aspect of our business and we appreciate the effort you and your staff invested in the audit. As with all audits and reviews, we welcome your guidance and we will implement your recommendations.

The department's response is as follows:

Finding #1: The Department of Commerce did not ensure that local service providers delivered program funds in compliance with federal requirements for the Weatherization Assistance for Low-Income Persons Program (CFDA#81.042).

Recommendation: *The Department of Commerce should work with the federal Department of Energy to resolve the \$1,167,772 in questioned costs for the Weatherization Assistance for Low-Income Persons Program.*

Response: The department will comply with this recommendation.

The program year audited by your staff was the first full year the department and the service provider energy auditors used the new federal Department of Energy's computer-based energy audit software--the National Energy Audit Tool (NEAT). Moving toward the NEAT tool proved challenging for some of the service provider energy auditors. A couple of the major factors encountered included lack of database experience and discovering that the NEAT tool was somewhat complex and at times counter-intuitive. The department provided extensive training and technical assistance prior to and throughout the program year in an effort to ensure service provider energy auditors were gaining proficiency with NEAT. The department worked with the NEAT developers to provide suggestions for improving the tool's use. Recently a new version of the software was deployed incorporating these suggestions.

When department staff recognized that the Savings to Investment Ratios (SIRs) were not being calculated correctly, we made the decision to require that all jobs for this period must have an SIR of 1 or greater and directed all agencies to verify their records and make necessary changes. Because of the numbers of measures involved, having all data fixed by providers would have taken significant staff time, detracting from the work needed to be done on homes.

When your staff raised questions of inappropriately using funds for measures not reaching an SIR of 1 or better, department staff analyzed the data. Staff first took the measures that were \$1000 or more and analyzed 80 measures, which represented 10% of the questioned costs. Approximately 90% of those measures had qualifying SIRs when they were re-ran using the NEAT tools correctly. The remaining 10% of the measures did not have sufficient data to determine the SIR.

The department has taken or will take the following actions to ensure that all measures installed have appropriate SIRs:

- The department has informed agencies that all measures and jobs performed after June 30, 2006 must have an estimated SIR of 1 or greater. Measures not meeting that standard cannot be paid with DOE funds.
- Training and technical assistance continues to be provided on a one-to-one basis to ensure new auditors have the training needed and all existing auditors are made aware of any new requirements.

Recommendation: *The Department of Commerce should improve its monitoring of local service providers to ensure compliance with federal requirements for the Weatherization Assistance for Low-Income Persons Program.*

Response: The department will comply with this recommendation.

The department is drafting an interim monitoring protocol and tool to use for the remainder of the current program year and will have a permanent tool in place for the next program year. The department will consult with DOE and other state weatherization programs to identify and adopt monitoring best practices. The protocol and tool will be designed to:

- Identify and assess key technical and administrative compliance data for both desk monitoring and on-site monitoring.
- Test performance and cost indicators in a consistent manner across all service providers to identify underperforming agencies.
- Require random selection of federally-required minimum sample of households for on-site performance monitoring.
- Provide a template for clear communication to service providers of monitoring findings, and corrective action required.
- Provide comprehensive file reports of performance data, monitoring findings, and corrective actions taken.
- Meet all federal compliance requirements.

Responsible: Janet Streff

Estimated Date of Completion: Interim monitoring protocol and tool – March 15, 2007
Final protocol and tool – June 30, 2007

The department plans to contact the DOE to discuss the audit report and will provide detailed information to them upon public release of the document.

Finding #2: PRIOR FINDING NOT RESOLVED: The Department of Commerce did not identify all of its federal program accounts on the state's accounting system.

Recommendation:

The Department of Commerce should ensure that each federal account in the state's accounting system is identified with its corresponding federal program number.

Response: The department will comply with this recommendation.

The department will fully utilize the grants module of MAPS to ensure the proper federal program numbers are recorded in the state's accounting system. The department was negligent in not making all of the necessary entries for the fiscal year ending June 30, 2006 until November 2006. In order to ensure compliance in the future, the CFO will conduct periodic checks throughout the year to ensure the necessary federal program numbers are being recorded at the time of original document entry.

Responsible: Dennis Munkwitz

Estimated Date of Completion: Completed as of November 2006.

Finding #3: The Department of Commerce did not accurately measure federal expenditures for the Low-Income Home Energy Assistance Program (CFDA#93.568).

Recommendation:

The Department of Commerce should ensure that it properly coordinates reporting of federal expenditures when federal funds are transferred in from another state department.

Response: The department will comply with this recommendation.

An audit adjustment was made on February 14, 2007 to properly reflect the transfer of funds.

Responsible: Dennis Munkwitz

Estimated Date of Completion: Completed.

Thank you again for the time and effort you and your staff invested in conducting this review. As always, your staff conducted the audit with professionalism and respect. We enjoyed working with them and look forward to working with you again.

Sincerely,



GLENN WILSON
Commissioner