



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

FINANCIAL AUDIT DIVISION REPORT

**Department of
Employment and
Economic Development**

Federal Compliance Audit

Year Ended June 30, 2012

May 23, 2013

Report 13-08

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

May 23, 2013

Senator Roger Reinert, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Kathryn 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 2012. We conducted this audit as part of our audit of the state's compliance with federal program requirements. We emphasize that this has not been a comprehensive audit of the Department of Employment and Economic Development.

We discussed the results of the audit with the department's staff at an exit conference on May 13, 2013. This audit was conducted by Brad White, CPA, CISA, CFE, (Audit Manager) and Joan Haskin, CPA, CISA (Auditor-in-Charge), assisted by auditors Natalie Mehlhorn, Daly Miskowicz, CPA, and Pat Ryan.

This report is intended for the information and use of the Legislative Audit Commission and the management of the Department of Employment and Economic Development. This restriction is not intended to limit the distribution of this report, which was released as a public document on May 23, 2013.

We received the full cooperation of the department'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 provisions of laws, regulations, contracts, and grants applicable to the major federal programs we audited for fiscal year 2012. However, the department had weaknesses, as noted in the six findings presented in this report, including two repeat findings from last year's audit that the department did not resolve.

Key Findings

- **Prior Finding Not Resolved:** The Department of Employment and Economic Development did not monitor grant recipients for the Workforce Investment Act Cluster and a scanned copy for one grant agreement was incomplete. ([Finding 1, page 5](#))
- The Department of Employment and Economic Development paid expenses totaling \$213,660 after the federal period of availability for two unemployment insurance grant awards. ([Finding 2, page 6](#))
- The Department of Employment and Economic Development overcharged the federal unemployment insurance program for \$77,088 of indirect costs. ([Finding 3, page 6](#))
- **Prior Finding Not Resolved:** The Department of Employment and Economic Development did not identify and recover \$24,500 of overpaid unemployment insurance benefits to four applicants. ([Finding 4, page 7](#))

Audit Scope

Our scope included programs determined to be major federal programs for the State of Minnesota for fiscal year 2012, including Unemployment Insurance, Workforce Investment Act Cluster, and Vocational Rehabilitation Cluster.

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.¹ Table 1 identifies these major federal programs.

Table 1
Department of Employment and Economic Development
Major Federal Programs
Fiscal Year 2012
(in thousands)

<u>Program Name</u>	<u>Federal Expenditures</u>
Unemployment Insurance ¹ (CFDA ¹ 17.225)	\$1,531,000
Vocational Rehabilitation Cluster: ² (CFDAs 84.126 and 84.390)	\$ 46,000
Workforce Investment Act Cluster: ¹ (CFDAs 17.258, 17.259, 17.260, 17.277, and 17.278)	\$ 38,000

¹Expenditures include unemployment insurance benefits and about \$54 million of federal administrative reimbursements.

²The Catalog of Federal Domestic Assistance (CFDA) is a unique number assigned by the federal government to identify its programs. Some federal programs are clustered if they have similar compliance requirements. Although the programs within a cluster are administered as separate programs, they are treated as a single program for the purpose of meeting the audit requirements of the U.S. Office of Management and Budget's Circular A-133.

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 2012. This audit is part of our broader federal single audit designed to obtain reasonable assurance about whether the State of Minnesota complied with the types of

¹ 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 2012 exceeded \$30 million.

compliance requirements that are applicable to each of its federal programs.² 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.³

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 provisions of laws, regulations, contracts, and grants applicable to its major federal programs for fiscal year 2012. However, the department had some weaknesses, as noted in the following *Findings and Recommendations* section, including two repeat findings from last year's audit that it did not resolve.

We will report these weaknesses to the federal government in the *Minnesota Financial and Compliance Report of Federally Assisted Programs*, prepared by the Department of Management and Budget. This report provides the federal government with information about the state's use of federal funds and its compliance with federal program requirements. The report includes the results of our audit work, conclusions on the state's internal controls over and compliance with federal programs, and findings about control and compliance weaknesses.

² 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 March 20, 2013, on the State of Minnesota's basic financial statements for the year ended June 30, 2012. In accordance with *Government Auditing Standards*, we also issued our report on our consideration of the State of Minnesota's internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts, and grants. (Office of the Legislative Auditor's Financial Audit Division Report 13-06, *Report on Internal Control Over Financial Reporting*, issued May 17, 2013.) This report included control deficiencies related to the Department of Employment and Economic Development.

³ Office of the Legislative Auditor's Financial Audit Division Report 12-05, *Department of Employment and Economic Development*, issued March 23, 2012.

Findings and Recommendations

Prior Finding Not Resolved: The Department of Employment and Economic Development did not monitor grant recipients for the Workforce Investment Act Cluster (CFDA 17.258, 17.259, and 17.278)⁴ and a scanned copy for one grant agreement was incomplete.

Finding 1

During fiscal year 2012, the department did not perform a fiscal review to monitor 4 of 20 grant recipients tested that received federal Workforce Investment Act funding. Federal program regulations require an annual fiscal review that includes a comparison of expenditures reported in the financial status reports to supporting source documentation.⁵ In fiscal year 2012, the four recipients received grant payments ranging from \$469,000 to \$2.4 million. In our 2011 audit, we reported that the department did not have the necessary evidence for monitoring two other grant recipients. Without financial monitoring, ineligible costs and noncompliance with federal regulations could occur without detection.

In addition, a scanned electronic image of a master grant agreement was incomplete and did not include the back-side of the document's pages. Once scanned, the department destroyed the original paper copy of the grant agreement. The grant involved \$750,000 of Workforce Investment Act-Adult (CFDA 17.258) and \$675,000 of Workforce Investment Act-Dislocated Worker (CFDA 17.278) funds. Without a full and complete copy, the department did not have evidence that management authorized the agreement and no assurance that the agreement contained all the required elements.

Recommendations

- *The Department of Employment and Economic Development should annually monitor all grant recipients to provide management with assurance of compliance with federal requirements.*
- *The Department of Employment and Economic Development should develop quality control procedures to ensure that electronically scanned grant documents are a replica of the original paper grant agreement.*

⁴ Federal Grant Award AA-21403-11-55-A-27

⁵ Federal Workforce Investment Act, Title 1.b, Section 6.2.

Finding 2

The Department of Employment and Economic Development paid expenses totaling \$213,660 after the federal period of availability for two unemployment insurance (CFDA 17.225) grant awards.

For two grant awards,⁶ the department used federal funds to pay for \$213,660 of program expenses occurring after the expiration of the period of availability. The federal government makes federally-funded grant awards available to the department for a specified period of time. The department did not request a federal extension for permission to use the funds for an additional period of time.

Recommendation

- *The Department of Employment and Economic Development should work with the federal government to resolve the costs charged after the period of the grant award.*

Finding 3

The Department of Employment and Economic Development overcharged the federal unemployment insurance (CFDA 17.225) program for \$77,088 of indirect costs.

The department did not have effective internal controls ensuring that indirect cost charges to the federal unemployment insurance program were correct. As a result, the department overcharged the program by \$68,088 for agency indirect costs and \$9,000 for statewide indirect costs. In July 2011, the state implemented a new accounting system that automated indirect cost allocations and periodically charged agency and statewide indirect costs to each program. However, the department did not verify that the accounting system allocations were accurate or required adjustment.

Agency and statewide indirect costs are authorized charges to federal programs. Agency indirect costs reimburse the state's General Fund for central support services, such as accounting, purchasing, and computer services provided by the department for its federal programs. Statewide indirect cost recoveries reimburse the state's General Fund for state-funded central services, such as use of the state's accounting and payroll system, used to deliver federal programs.

Recommendation

- *The Department of Employment and Economic Development should resolve the overpaid amount in fiscal year 2012 and develop controls that ensure indirect costs are accurately charged to federal programs.*

⁶ Federal Grant Awards: UI-18028-09-55-A-27 and UI-19590-10-55-A-27.

Prior Finding Not Resolved: The Department of Employment and Economic Development did not identify and recover \$24,500 of overpaid unemployment insurance (CFDA 17.225) benefits to four applicants.

Finding 4

The department overpaid two unemployed applicants a total of \$14,716 in federal emergency unemployment benefits⁷ and also overpaid \$9,784 in state unemployment to two other applicants during fiscal year 2012. The overpayments occurred when department staff made errors when manually establishing applicant accounts and posting federal emergency and state benefits in the system. While the department generated reports to ensure the applicant accounts were set up on the correct benefit program for effective dates, the reports were not designed to identify the types of errors that staff made when entering the data. Because of the errors, the department paid the unemployed workers for more weeks of eligibility than allowed by program requirements. In our fiscal year 2011 audit we reported a similar concern with manual updates made by staff. Improved monitoring or an independent review would provide management with assurance that the department staff accurately updated the applicant accounts for the proper period and benefit amount.

Recommendations

- *The Department of Employment and Economic Development should recover the \$24,500 of unemployment benefit overpayments to the four applicants identified.*
- *The Department of Employment and Economic Development should develop controls providing for an independent review of benefits manually posted by staff, or improve queries or exception reports that allow the department to detect benefits paid to unemployed workers that exceed the number of weeks allowed by each benefit program.*

The Department of Employment and Economic Development's grants funded from the federal Vocational Rehabilitation Cluster (CFDA 84.126 and 84.390) had financial control weaknesses.

Finding 5

The department had some weaknesses in financial controls over grants paid from the Vocational Rehabilitation Cluster. Beyond specific federal program requirements, the federal government requires the department to follow state-level control and compliance requirements. We tested the two largest grants, with awards totaling \$162,000 and \$159,449, and the department had the following weaknesses in its oversight of these two grants:

⁷ Federal Emergency Unemployment Compensation Program (Tier 3) benefits were available to workers who had exhausted regular unemployment insurance benefits during periods of high unemployment.

- **Expenditures incurred prior to encumbrance of grant funds** – The department reimbursed the grantees for costs incurred before the department had encumbered the funds in the accounting system. For one grant, the department created the encumbrance on November 2, 2011, for an amount which included \$27,794 of reimbursed costs incurred from October 1, 2011, to December 31, 2011. For the other grant, the department encumbered funds on October 14, 2011, for an amount that included reimbursement of \$16,301 for expenditures incurred between October 1, 2011, and December 31, 2011. State statutes require an encumbrance in the accounting system before obligations are incurred to ensure sufficient monies are set aside.⁸
- **Lack of financial reconciliations** – For both grants tested, the department did not perform a financial reconciliation, as required by state policy.⁹ A financial reconciliation involves a comparison of a grantee's request for payment for a given period with supporting documentation for that request, such as invoices and payroll records. Not performing the financial reconciliations diminishes accountability and greatly increased the risk that grantees could be reimbursed for unallowable expenditures without detection.
- **Lack of quarterly progress reports** – In one grant, the department reimbursed \$49,000 to the grantee without receiving their quarterly progress report. State policy requires that departments review the grantee's request for reimbursement against progress reports.¹⁰ The policy also states that departments should not make grant payments on grants with past due progress reports.
- **Grant spending budgets** – The department reimbursed a grantee for expenditures that exceeded the approved budget categories. While the grantee did not receive more than the \$162,000 budgeted, travel expenditures exceeded the budget by \$2,843 (22%) and professional development expenditures exceeded the \$250 budget by \$2,752 (1100%). Department staff told us they require a revised budget from the grantee when expenditures exceed the approved budgeted line item amounts by 10 percent or more. The grant contract allowed the department, upon written request from the grantee, to approve budget modifications without amending the grant as long as the modifications do not cause the total grant amount to be exceeded. However, the grantee did not submit a budget revision request to the department.

⁸ *Minnesota Statutes* 2012, 16A.15, subd. 3(a).

⁹ Department of Administration, Office of Grants Management, Policy 08-10 requires a financial reconciliation, at least once during the grant period, for grants exceeding \$50,000.

¹⁰ Department of Administration, Office of Grants Management, Policy 08-08.

Recommendation

- *The Department of Employment and Economic Development should improve controls over Vocational Rehabilitation grants by:*
 - *reimbursing grantees costs for expenditures incurred after grant funds are encumbered;*
 - *performing the required financial reconciliations during the grant period;*
 - *ensuring that grantees submit progress reports prior to reimbursing them; and*
 - *requiring grantees to submit budget modifications when individual line item expenditures exceed the approved budget.*

The department did not properly identify most federally-funded equipment purchases in the state's new asset management module.¹¹ For 321 of 352 asset purchases, totaling \$2.6 million for fiscal year 2012, there were no individual asset tag numbers, custodian, or specific locations assigned to each piece of equipment. Furthermore, the department recorded a purchase of 28 computer laptops as one asset in the module. The federal government requires the department to follow state-level procedures, including maintaining equipment records and safeguarding equipment with a physical inventory at least once every two years.¹² Without specific identification and detailed locations, the department will be unable to complete an effective physical asset inventory.

Finding 6*Recommendation*

- *The Department of Employment and Economic Development should update equipment identification, custodian, and locations in the asset management module.*

¹¹ Unemployment Insurance (CFDA 17.225), Workforce Investment Act Cluster (CFDA 17.258, 17.259, and 17.278), and Vocational Rehabilitation Cluster (CFDA 84.126 and 84.390).

¹² Office of Management and Budget A-133 (June 2012), Compliance Requirement E - Equipment and Real Property Management.

May 21, 2013

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 and Economic Development (DEED) for the year ending June 30, 2012. We are pleased that you have found that the Department of Employment and Economic Development generally complied with and had controls in place to ensure compliance with provisions of laws, regulations, contracts and grants applicable to the major federal programs audited.

Audit Finding 1: Prior Finding Not Resolved: The DEED did not monitor grant recipients for the Workforce Investment Act cluster (CFDA 17.258, 17.259, and 17.278) and scanned copies for one grant agreement was incomplete.

Recommendations

- *The department should annually monitor all grant recipients to provide management with assurance of compliance with federal requirements.*
- *The department should develop quality control procedures to ensure that electronically scanned grant documents are a replica of the original paper grant agreement.*

Response: Since the conclusion of the auditor's field work, the Department has completed the fiscal review of 3 of the 4 grant recipients noted in the audit report. At this point in time, monitoring is complete for 19 of the 20 grant recipients. The remaining fiscal review for the 4th grant recipient has been assigned and will be conducted in June, which will bring the department to full compliance. The annual programmatic reviews had already been completed for all of the 20 grant recipients prior to the audit. A complete copy of the identified scanned electronic image of the master grant agreement has been placed in our tracking system and is a replica of the original paper grant agreement. The Department will implement a new tracking procedure to ensure that grant monitoring and annual fiscal and programmatic reviews are timely completed and that grantees will receive fiscal monitoring notification during the first month of each new state fiscal year. Bonnie Elsey, Workforce Development Division director, will oversee resolution of the finding by June 30, 2013.

Audit Finding 2: The DEED paid expenses totaling \$213,660 after the federal period of availability for two unemployment insurance (CFDA 17.225) grant awards.

Recommendation

- *The department should work with the federal government to resolve the costs charged after the period of the grant award.*

Response: The payment identified was delayed because the vendor did not deliver the equipment in a timely manner and the department wanted to ensure that the equipment was set up and working properly prior to payment. The department will ensure that program areas will closely monitor periods of availability for the grant award and payables staff will review project codes for grants scheduled to end to reduce the risk of payments after the period of availability for the grant award. In the future, it is expected that payments will be made within the period of availability for the grant award or timely extensions will be requested as appropriate. Julie Freeman, chief financial officer, will oversee resolution of the finding by September 30, 2013.

Audit Finding 3: The DEED overcharged the federal unemployment insurance (CFDA 17.225) program for \$77,088 of indirect costs.

Recommendation

- *The department should resolve the overpaid amount in fiscal year 2012 and develop controls that ensure indirect costs are accurately charged to federal programs.*

Response: The final indirect cost rate was approved by the Department of Labor late in the state fiscal year. DEED had to make adjustments to ensure that payroll expenditures aligned with the approved rate. DEED also had to factor in the timing of the Minnesota Management and Budget (MMB) cost allocation process to ensure that project codes were correctly charged. There was a stringent timeframe to complete this work prior to fiscal year close. The implementation of the new SWIFT system / functionality impacted the timeliness of the MMB cost allocation process and required fine tuning the processes to improve performance and cycle time. The cost allocation process has been occurring more timely and streamlined now so it is expected this process will go more smoothly in the future. Also, to further mitigate this risk in the future, DEED plans to implement a payroll adjustment deadline to allow adequate time for adjustments and prevent a recurrence. The indirect cost overcharges represent approximately .13% of the total budget. Julie Freeman, chief financial officer, will oversee resolution of this finding by September 30, 2013.

Audit Finding 4: Prior Finding Not Resolved: The DEED did not identify and recover \$24,500 of overpaid unemployment insurance (CFDA 17.225) benefits to four applicants.

Recommendations

- *The department should recover \$24,500 of unemployment benefit overpayments to the four applicants identified.*
- *The department should develop controls providing for an independent review of benefits manually posted by staff; or improve queries or exception reports that allow the department to detect benefits paid to unemployed workers that exceed the number of weeks allowed by each benefit program.*

Response: In response to the last year's overpayment finding, DEED developed a control report which identifies applicants with maximum benefit amounts above the limit. Although under the overarching umbrella of overpayment, this year's overpayment finding is unrelated to the prior year finding. Overpayment determinations have been issued and federal funds will be repaid when collected from the applicants. DEED will implement an additional control report to help ensure that the overpayment scenario identified during the audit work is not repeated. During SFY 2012, the Minnesota Unemployment Insurance (UI) Program paid benefits on regular state Unemployment Insurance plus multiple federal programs. The federal rules governing priority and timeline for programs are very complex and moving applicants between programs requires manual intervention. DEED accurately establishes thousands of benefit accounts using manual intervention. The four overpaid accounts amount to 0.0016% of the \$1.5 billion of benefits paid during the fiscal year. Rick Caligiuri, Unemployment Insurance Division director, will oversee resolution of the finding by September 30, 2013.

Audit Finding 5: The department's grants funded from the Vocational Rehabilitation Cluster (CFDA 84.126 and 84.390) had financial control weaknesses.

Recommendation

The department should improve controls over Vocational Rehabilitation grants by:

- *reimbursing grantees costs for expenditures incurred after grant funds are encumbered;*
- *performing the required financial reconciliations during the grant period;*
- *ensuring that grantees submit progress reports prior to reimbursing them;*
- *requiring grantees to submit budget modifications when individual line item expenditures exceed the approved budget.*

Response: DEED will reinforce the need for grant coordinators to communicate with financial services staff to ensure that grantees do not perform services prior to the effective date of each grant agreement or the date on which funds have been encumbered. Grantees shall be notified that reimbursements are delayed pending submission of progress reports. DEED will perform financial reconciliations as outlined under Office of Grants Management policy or seek exceptions. Appropriate staff will receive grantee monitoring training and current practices will be assessed to determine oversight gaps. While one grantee exceeded expenditures for two budget categories, all of the costs were allowable and within the total budget. DEED will require grantees to seek approval for budget category adjustments prior to cost reimbursement. Kim Peck, Vocational Rehabilitation Services director, will oversee resolution of the finding by December 31, 2013.

Audit Finding 6: The DEED did not properly update federal equipment purchases in the state's accounting system.

Recommendation

The department should update equipment identification, custodian, and locations in the asset management module.

DEED updated its asset management policy and procedures in August 2012 and will ensure that staff with asset management responsibility have clear expectations and are properly trained. A list of the identified assets has been obtained and DEED will make the corrections in the asset management module within SWIFT to include

the missing information and to itemize the assets that were not broken out. Also, DEED will ensure that assets purchased for client use are assigned the proper category and account code to prevent inclusion in the SWIFT asset management module as a state-owned asset. All of these changes will assist in facilitating an accurate physical inventory. Julie Freeman, chief financial officer, will oversee resolution of the finding by December 31, 2013.

If you have any questions or need additional information, please contact Julie Freeman, chief financial officer, at Julie.freeman@state.mn.us or 651-259-7081.

Regards,

A handwritten signature in black ink that reads "Kathryn Clark Sieben". The signature is written in a cursive, flowing style.

Kathryn Clark Sieben
Commissioner