



OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

**Department of Employment and
Economic Development
Federal Program Compliance
Year Ended June 30, 2007**



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



Financial Audit Division Report

**Department of Employment and
Economic Development
Federal Program Compliance
Year Ended June 30, 2007**

March 28, 2008

08-11

FINANCIAL AUDIT DIVISION

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Department of Employment and Economic Development Federal Program Compliance

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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, CFE	Audit Manager
Ken Vandermeer, CPA, CFE	Auditor-In-Charge
Pat Ryan	Team Leader
John Hakes, CPA	Senior Auditor
Lat Anantaphong	Auditor
Tracia Gimbut	Auditor
Kayla Peterson	Auditor
Emily Wiant	Auditor
Zach Yzermans	Auditor

Exit Conference

We discussed the results of the audit with the following representatives of the Department of Employment and Economic Development at an exit conference on March 12, 2008:

Dan McElroy	Commissioner
Cindy Farrell	Chief Financial Officer
Tim Langlie	Accounting Director
Kathy Nelson	Program Director, Unemployment Insurance
David Niermann	Assistant Director, Workforce Development
Meredith Udoibok	Assistant Director, Business and Community Development

Department of Employment and Economic Development Federal Program Compliance

Report Summary

Conclusions:

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 2007. However, the department had the following weaknesses:

Findings:

- The department did not effectively control access to personnel functions and accuracy of data supporting payroll and travel transactions charged to its federal programs. ([Finding 1, page 4](#))
- PRIOR FINDING PARTIALLY RESOLVED: The department did not consistently monitor subrecipient expenditures for the federal Community Development Block Grant Program (CFDA 14.228). ([Finding 2, page 5](#))
- PRIOR FINDING PARTIALLY RESOLVED: The department did not accurately report project expenditures for the federal Community Development Block Grant Program (CFDA 14.228). ([Finding 3, page 6](#))

Audit Scope:

Programs material to the State of Minnesota's financial statements and federal program compliance for fiscal year 2007:

- Unemployment Insurance Fund
- Federal Programs, including:
 - Unemployment Insurance Administration
 - Employment Services Cluster¹
 - Workforce Investment Act Cluster
 - Vocational Rehabilitation
 - Community Development Block Grants
 - Social Security Disability Insurance

¹A cluster of programs is a group of closely related programs that have similar compliance requirements and are treated as a single program.

Agency Background:

In fiscal year 2007, the Department of Employment and Economic Development recorded unemployment insurance tax revenues totaling \$890 million and paid benefits totaling \$736 million. The department also managed federal programs totaling approximately \$199 million.



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. Dan McElroy, Commissioner
Department of Employment and Economic Development

We have performed certain audit procedures at the Department of Employment and Economic Development as part of our audit of the basic financial statements of the State of Minnesota for the year ended June 30, 2007. We also audited the department's compliance with applicable requirements governing the administration of federal awards for the year ended June 30, 2007, as described in the U.S. Office of Management and Budget's *Circular A-133 Compliance Supplement*. 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.

The Department of Finance is primarily responsible for statewide financial reporting. The department prepares the *Comprehensive Annual Financial Report* that contains the state's basic financial statements and our opinion on those statements. The Department of Finance also annually prepares the *Minnesota Financial and Compliance Report of Federally Assisted Programs*. 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.

The scope of our audit work included the following:

- Material fiscal year 2007 financial activities of the Unemployment Insurance Fund, including unemployment taxes (\$890 million), other revenues (\$56 million), and unemployment benefits (\$736 million).
- Selected federal programs administered by the Department of Employment and Economic Development, as identified in Table 1, and including a review of the department's compliance with federal requirements in areas such as cash management, recipient eligibility, allowable costs, and financial reporting.

We emphasize that this has not been a comprehensive audit of the Department of Employment and Economic Development.

Department of Employment and Economic Development Federal Program Compliance

Table 1
Audited Federal Programs Administered by the
Department of Employment and Economic Development
Fiscal Year 2007
(in thousands)

<u>CFDA</u> ¹	<u>Program Name</u>	<u>Federal Expenditures</u>
17.225	Unemployment Insurance ²	\$774,871
84.126	Vocational Rehabilitation	\$ 39,832
	<u>Workforce Investment Act Cluster:</u> ¹	
17.260	Workforce Investment Act-Dislocated Worker	\$ 13,162
17.259	Workforce Investment Act-Youth	9,626
17.258	Workforce Investment Act-Adult	<u>8,641</u>
	Total Workforce Investment Act Cluster	\$ 31,429
14.228	Community Development Block Grant	\$ 27,586
	<u>Employment Services Cluster:</u>	
17.207	Employment Services	\$ 19,332
17.801	Disabled Veterans Outreach	1,296
17.804	Local Veterans Employment Representative	<u>1,471</u>
	Total Employment Services Cluster	\$ 22,099
96.001	Social Security Disability Insurance	\$ 21,197

¹The 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.

²Expenditures include unemployment insurance benefits and over \$44 million of federal administrative reimbursements.

Source: Department of Employment and Economic Development's accounting system for fiscal year 2007.

Conclusions

We issued an unqualified audit opinion,¹ dated December 7, 2007, on the State of Minnesota's basic financial statements for the year ended June 30, 2007. In accordance with *Government Auditing Standards*, we also issued our report, dated February 11, 2008, on our consideration of the State of Minnesota's internal control over financial reporting and our tests of compliance with provisions of laws, regulations, contracts, and grants. That report included a concern identified through our audit work at the Department of Employment and Economic Development. The audit revealed a weakness in the department's internal controls that did not prevent or detect a significant misstatement. Specifically, the Department of Employment and Economic Development did not properly measure fiscal year 2007 liabilities in its preliminary schedule of expenditures of federal awards. We reported this weakness to the Department of

¹ An unqualified audit opinion means that we concluded that the state fairly presented its financial data in its basic financial statements.

Department of Employment and Economic Development Federal Program Compliance

Finance in the *Report on Internal Controls Over Statewide Financial Reporting* as Finding 11. You can obtain a copy of this report on our website at www.auditor.leg.state.mn.us. It is report number 08-02.

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 2007. However, the department had the following weaknesses:

Findings and Recommendations

1. The Department of Employment and Economic Development did not effectively control access to personnel functions and accuracy of data supporting payroll and travel transactions charged to its federal programs.²

The department did not adequately restrict incompatible access to update both personnel and payroll functions and allowed some accounting staff unnecessary access to update personnel records. In addition, the department did not detect errors in the data entry of timesheet hours and travel claims in the state's payroll system. The federal government requires adequate controls over costs charged to federal programs.

- The department did not restrict access to the state's personnel/payroll system to allow segregation of duties between the personnel and payroll functions. The department allowed one employee excessive access to update both functions and provided two additional accounting staff unnecessary access to update personnel records. Only department human resources staff have job responsibilities justifying the need for access to update personnel data. State policies³ do not allow incompatible access and require agencies to limit employee access to those who need it to perform their job duties.
- The department did not have effective controls to detect data entry errors of hours reported on employee timesheets or reimbursement of travel claims. The department misrecorded hours worked and leave taken for seven employees tested and misrecorded reimbursement data for two travel reimbursements. To detect these kinds of errors, state policies⁴ require an independent review of a payroll transaction report for accuracy. The policy allows either a complete review of all employees or the review of a statistical sample of transactions. The department verifies its payroll transactions on a sample basis, but its sample selection is not statistical. The errors identified in the audit suggest that the department's sample selection method does not result in the review of a sufficient number of transactions.

² These internal control weaknesses affect all federal programs managed by the department, including CFDA's 14.228, 17.207, 17.225, 17.258, 17.259, 17.260, 17.801, 17.804, 84.126, and 96.001.

³ SEMA4 Operating Policy and Procedure HR045.

⁴ SEMA4 Operating Policy and Procedure PAY0028 requires a review of the payroll register report.

Department of Employment and Economic Development Federal Program Compliance

Recommendation

- *The Department of Employment and Economic Development should improve internal control over federal payroll transactions by:*
 - *eliminating incompatible access to update personnel and payroll functions and restricting personnel access to those assigned human resources duties; and*
 - *verifying a statistical sample of timesheet hours and travel reimbursements to ensure the accuracy of data entered into the payroll system.*

2. PRIOR FINDING PARTIALLY RESOLVED: The Department of Employment and Economic Development did not consistently monitor subrecipient expenditures for the federal Community Development Block Grant Program (CFDA 14.228).

Department staff assigned to monitor subrecipient compliance with Community Development Block Grant Program requirements did not ensure that subrecipients had an audit of housing and urban development funds. The program provides federal grants to small cities for housing and economic improvement projects. Under federal authority, the state has issued rules to govern grant application, awarding, and monitoring. Department staff monitors projects' progress and verifies that cities complied with federal grant requirements. As reported in our 2005 and 2006 audits, the department's program monitors were not consistent in their monitoring practices.

The department continued to have some monitoring weaknesses. The department did not ensure subrecipients had compliance audits of their federal grant money. Although one city had a federal compliance audit for calendar year 2006, the audit did not include the city's Community Development Block Grant totaling \$591,916. More significantly, the department failed to identify the audit deficiency for two consecutive years. Federal guidelines require that organizations who receive over \$500,000 annually submit an independent *Office of Management and Budget's Circular A-133* audit report within nine months of their year end. Subrecipient audits are a key way that the state and federal governments assure that funds are used in accordance with program requirements. Without effective monitoring and oversight of audits completed, ineligible costs and noncompliance with federal regulations could occur without detection.

Recommendation

- *The Department of Employment and Economic Development should comply with federal Community Development Block Grant Program requirements and ensure that grant recipients have an OMB A-133 compliance audit.*

Department of Employment and Economic Development Federal Program Compliance

3. PRIOR FINDING PARTIALLY RESOLVED: The Department of Employment and Economic Development did not accurately report project expenditures for the federal Community Development Block Grant Program (CFDA 14.228).

As reported in 2005 and 2006, the department continued to have problems with timely and accurate filings of the program's key federal financial report submitted to the federal government. The department again submitted inaccurate data on its Community Development Block Grant 2006 *Performance and Evaluation Report* to the federal Housing and Urban Development Agency. On the report for the period ending September 30, 2006, the department incorrectly included several expenditures that were paid from October 2006 through January 11, 2007; these expenditures should have been included in the 2007 federal reporting period. In addition, it submitted the report two weeks after the December 31, 2006, due date. The department has been working with federal officials to resolve the issue for its September 30, 2007, report that was due on December 31, 2007.

Recommendation

- *The Department of Employment and Economic Development should comply with federal Community Development Block Grant Program requirements by submitting a timely and accurate Performance and Evaluation Report to the federal Housing and Urban Development Agency.*

This report is intended for the information 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 March 28, 2008.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA, CISA
Deputy Legislative Auditor

**Department of Employment and Economic Development
Federal Program Compliance**

**Status of Prior Audit Issues
As of January 18, 2008**

Fiscal Year 2006 Statewide/Single Audit

Legislative Audit Report 07-07, issued in March 2007, examined the Department of Employment and Economic Development's compliance with requirements for major federal programs for the fiscal year ended June 30, 2006. Four issues were identified as a result of our audit work at the Department of Employment and Economic Development. The department resolved three of those issues relating to unemployment insurance controls over tax adjustments and employer refunds, retention of military and federal employee unemployment eligibility records, and the need for required suspension and debarment certification in its vocational rehabilitation grant contracts. However, we continued to encounter problems with the monitoring of compliance audits of cities that received federal funding and reporting project expenditures for the federal Community Development Block Grant Program. Those issues are repeated as Findings 2 and 3 in this report.

March 17, 2008

Mr. James R. Nobles
Legislative Auditor
First Floor, Centennial Office Building
658 Cedar Street
St. Paul, MN 55155

Dear Mr. Nobles:

The following is the Department of Employment and Economic Development's (DEED) response to audit findings for the year ended June 30, 2007.

Finding 1. The Department of Employment and Economic Development did not effectively control access to personnel functions and accuracy of data supporting payroll and travel transactions charged to its federal programs.

Recommendation:

The Department of Employment and Economic Development should improve internal control over federal payroll transactions by:

- eliminating incompatible access to update personnel and payroll functions and restricting personnel access to those assigned human resources duties; and
- verifying a statistical sample of timesheet hours and travel reimbursements to ensure the accuracy of data entered into the payroll system.

Response:

We agree with the recommendation. The department will eliminate incompatible and unnecessary access to update personnel and payroll functions by March 31, 2008. In addition, the department will implement new processes to improve its review of timesheet hours and travel reimbursements by June 30, 2008.

Responsible Person: Cindy Farrell, Chief Financial Officer

Finding 2. PRIOR FINDING PARTIALLY RESOLVED: The Department of Employment and Economic Development did not consistently monitor subrecipient expenditures for the federal Community Development Block Grant Program (CFDA 14.228).

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Recommendation:

The Department of Employment and Economic Development should comply with federal Community Development Block Grant Program requirements and ensure that grant recipients have an OMB A-133 compliance audit.

Response:

We agree with the recommendation. The audit received from one city did not include CDBG funding. DEED staff will be more conscientious when obtaining and reviewing audits submitted to make sure that CDBG funds are included. If CDBG funds are not listed in the independent audit, staff will require the city to timely resubmit a revised audit report.

Responsible Person: Reed Erickson, Small Cities Development Program Director

Finding 3. PRIOR FINDING PARTIALLY RESOLVED: The Department of Employment and Economic Development did not accurately report project expenditures for the federal Community Development Block Grant Program (CFDA 14.228).

Recommendation:

The Department of Employment and Economic Development should comply with federal Community Development Block Grant Program requirements by submitting a timely and accurate Performance and Evaluation Report to the federal Housing and Urban Development Agency.


Response:

We agree with the recommendation. The department is now in compliance with federal CDBG requirements with its submission of the 2007 Performance and Evaluation Report (PER). The federal fiscal year 2007 PER report was submitted timely and did not include obligations incurred after September 30th.

Responsible Person: Reed Erickson, Small Cities Development Program Director

If you have questions or comments, please contact Cindy Farrell, Chief Financial Officer at Cindy.Farrell@state.mn.us or 651-259-7085.

Sincerely,



Dan McElroy
Commissioner