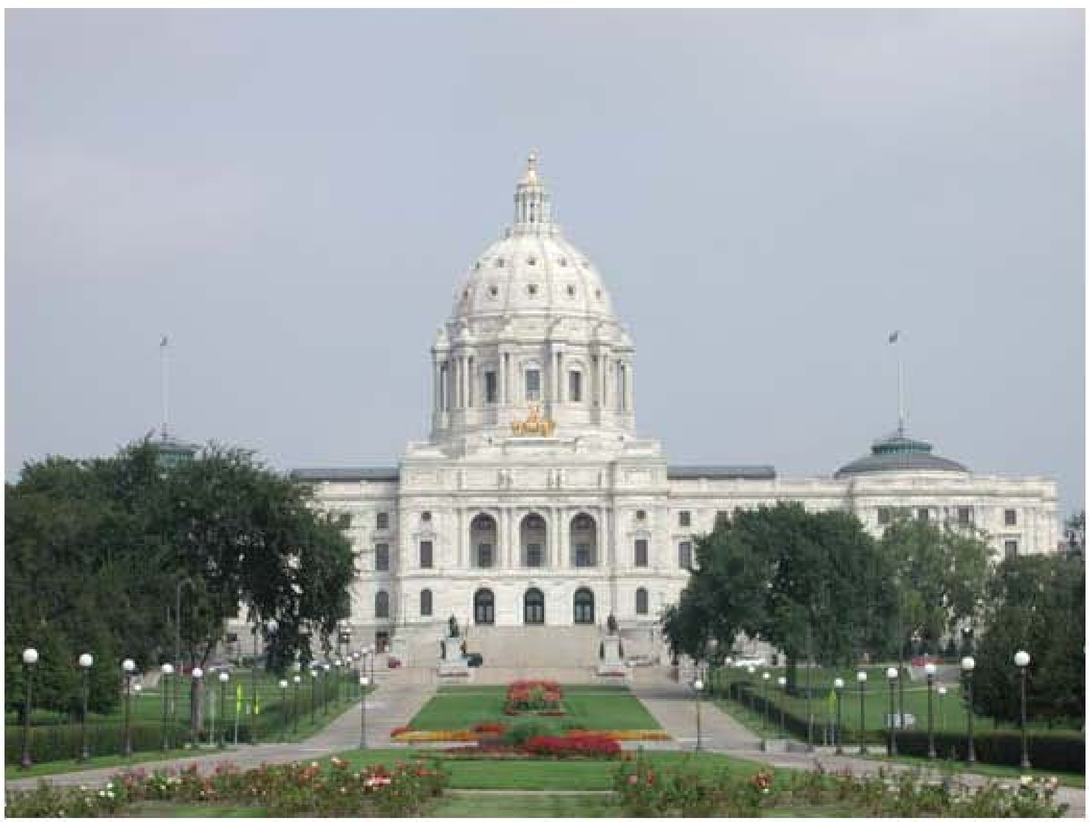
O L A **OFFICE OF THE LEGISLATIVE AUDITOR**
STATE OF MINNESOTA

Financial Audit Division Report

Department of Employment and Economic Development

Fiscal Years 2002 through 2004



MAY 26, 2005 **05-31**

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

OLA

OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Matt Kramer, Commissioner
Department of Employment and Economic Development

We examined selected areas of the Department of Employment and Economic Development (DEED) for the period July 1, 2001, through June 30, 2004. Our audit scope was limited to the federal Trade Adjustment Assistance (TAA) Program, Indian Business Loan Program, and unemployment insurance employer receivables. We emphasize that this has not been a comprehensive audit of DEED.

The Report Summary highlights our overall audit conclusions on the areas examined. The specific audit objectives and conclusions are contained in the individual chapters of this report.

We would like to thank DEED staff for their cooperation during this audit.

/s/ James R. Nobles	*/s/ Claudia J. Gudvangen*
James R. Nobles Legislative Auditor	Claudia J. Gudvangen, CPA Deputy Legislative Auditor

End of Fieldwork: February 18, 2005

Report Signed On: May 23, 2005

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Audit Participation

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

Claudia Gudvangen, CPA	Deputy Legislative Auditor
Brad White, CPA, CISA	Audit Manager
Ken Vandermeer, CPA	Auditor-in-Charge
Scott Tjomsland, CPA	Team Leader
George Deden, CPA	Auditor

Exit Conference

We discussed the finding and recommendation with the following representatives of the Department of Employment and Economic Development at an exit conference on May 10, 2005:

Dennis Yecke	Deputy Commissioner
Kathy Nelson	Unemployment Insurance Division Director
Bonnie Elsey	WorkForce Services Director
Keith Goodwin	Customer Services Director
Paul Moe	Business and Community Services Director
John Stavros	Chief Financial Officer
Tim Langlie	Accounting Director
Judy Kislenger	Accounting Manager

Report Summary

Findings:

- The Department of Employment and Economic Development (DEED) did not adequately restrict access to the Trade Adjustment Assistance Program's computer system, allowing several staff with unnecessary ability to change benefit payments. (Finding 1, page 6)

- DEED did not implement effective procedures clarifying when security interest filings are required and documenting collection efforts on delinquent Indian business loans. (Finding 2, page 9)

The audit report contained two audit findings related to internal controls and finance-related legal compliance.

Audit Scope:

Audit Period:
Fiscal Years 2002 – 2004

Selected Audit Areas:
- Trade Adjustment Assistance (TAA) Program Benefits
- Indian Business Loan Program
- Unemployment Insurance Employer Receivables

Agency Background:

DEED is Minnesota's principal economic development agency. It manages the unemployment insurance, which collects an employer payroll tax and pays benefits to laid-off workers. DEED also administers several federal programs and a variety of economic development loans.

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Chapter 1. Introduction

The Office of the Legislative Auditor selected the Department of Employment and Economic Development (DEED) for audit based on an annual assessment of state agencies and programs. We examined various criteria used to determine the entities to audit; including the size and type of each agency's financial operations, length of time since the last audit, changes in organizational structure and key personnel, and available audit resources.

Agency Overview

The mission of DEED is to support the economic success of individuals, businesses, and communities by improving opportunities for growth. The department is comprised of four main divisions as follows:

- **Business and Community Development Division** provides financial and technical services to businesses, communities, and economic development professionals for expansion or relocation in Minnesota. It promotes international trade, finances business expansions and improvements in community infrastructure, and assists communities and development organizations with strengthened capacity to undertake development. The division also manages the Indian Business Loan Program, which provides funding for economic development of Indian owned and operated businesses.
- **Unemployment Insurance Division** provides temporary income to eligible applicants filing for unemployment benefits. The department charges and collects a payroll tax from employers to finance benefit payments to individuals.
- **Workforce Partnerships Division** provides training and support services to unemployed and dislocated workers, financial assistance for businesses seeking to upgrade the skills of their workforce, and grants to help ease a critical shortage of workers in the health and human services industry. It works primarily through outside service providers to offer these services to businesses and individuals. The division also manages the Trade Adjustment Assistance Program, which provides cash and training benefits to workers who have lost their jobs due to adverse effects of foreign trade.
- **Workforce Services Division** delivers workforce development programs including state services for the blind, rehabilitation services, workforce exchange services, labor market information, and disability determination services. Many of these services are provided through the Minnesota WorkForce Centers located throughout the state.

Matt Kramer is the current DEED commissioner. DEED was created as a result of the July 2003 merger of the Minnesota Department of Trade and Economic Development and the Minnesota Department of Economic Security.

Department of Employment and Economic Development

Audit Approach

We analyzed DEED data for financial trends, identified new or discontinued programs, and also surveyed management preference for areas of audit focus. Two program areas were selected for our audit scope: the federal Trade Adjustment Assistance Program and the Indian Business Loan Program. In addition, to supplement our annual statewide audit work on the Unemployment Insurance Fund, we reviewed collection practices for pursuing delinquent employer receivables.

We conducted our audit in accordance with *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of DEED's internal controls relevant to the audit objectives. We used the guidance contained in *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission, as our criteria to evaluate agency controls. The standards also require that we plan the audit to provide reasonable assurance that DEED complied with financial-related legal provisions that are significant to the audit. In determining the department's compliance with legal provisions, we considered requirements of laws, regulations, contracts, and grant agreements.

To meet these audit objectives, we gained an understanding of DEED's financial policies and procedures. We considered the risk of misstatements in the accounting records and noncompliance with relevant legal provisions. Accounting data was analyzed to identify unusual trends or significant changes in financial operations. We also examined documentation supporting the agency's internal controls and compliance with laws, regulations, contracts, and grant provisions.

Chapter 2. Trade Adjustment Assistance Program

Chapter Conclusions

DEED controls ensured that the Trade Adjustment Assistance (TAA) Program's cash benefit and training payments were authorized and paid to eligible recipients, appropriately recorded in the accounting records, and in compliance with significant finance-related legal provisions. However, the department did not adequately restrict computer access for nine current and one former employee who can change benefit amounts.

For the items tested, DEED complied with material finance-related legal provisions concerning benefits paid from the TAA Program.

Audit Objective

The objective of our audit of the TAA Program was to answer the following questions:

- Did the department's controls ensure that the TAA Program's benefit payments were properly authorized and paid to eligible recipients, appropriately recorded in the accounting records, and in compliance with applicable finance-related legal provisions?

- Did the department comply with material finance-related legal provisions regarding TAA Program benefits paid?

Background Information

The Trade Adjustment Assistance (TAA) Program (federal program CFDA 17.245) assists workers who have lost their jobs as a result of increased foreign imports or production shifts out of the United States. Individuals certified as eligible may receive one or more federal program benefits to assist in returning to employment.

To obtain benefits associated with the TAA Program, a trade-affected group must file a petition with the Division of Trade Adjustment Assistance of the U.S. Department of Labor. The federal agency determines if an employer was adversely affected by foreign trade and will either deny or certify the petition. Once the petition is certified, group members can apply for benefits through their state workforce agency. In Minnesota, DEED is the designated state workforce agency for the administration of the TAA Program. Program benefits may include a cash payment in the form of a weekly trade readjustment allowance (TRA) check, or other TAA benefits such as work search, relocation, or job training services.

Department of Employment and Economic Development

DEED uses separate computerized systems to manage TRA cash support benefits paid to program recipients and TAA training and services paid to program providers. Table 2-1 shows total TAA program costs by type of benefit during the past three state fiscal years.

Table 2-1
TAA Program Expenditures
Fiscal Years 2002 to 2004

	2002	2003	2004
TRA Cash Support Benefits (1)	$3,105,856	$5,845,026	$12,136,568
TAA Service/Training Benefits	3,254,676	3,947,654	6,443,613
Total	$6,360,532	$9,792,680	$18,580,181

Note (1): For the combined three fiscal years, these amounts included a total of $775,000 in service/training benefits that were paid out of the TRA subsystem. These payments were for subsistence and transportation benefits to qualified recipients.

Source: DEED Accounting System Fund Ledgers for the TAA Program as of June 30, 2004.

Current Finding and Recommendation

1. The department did not review access granted to employees nor restrict some individual's ability to update TRA benefits in its computer system.

DEED did not restrict certain security clearances to the TRA cash benefit payment subsystem and did not have a process to periodically review access it provided. Specifically, one former employee still had security clearances that allowed payment processing. Nine current employees outside the TRA unit had similar capabilities. The employees were provided the access in order to assist with an anticipated higher volume of transactions. However, the present volume of benefits does not require this level of assistance and, as a result, the security clearances provided to these staff were unnecessary. Failure to appropriately restrict security clearances increases the risk that inappropriate transactions could be processed. These unnecessary clearances lead us to determine there was no ongoing monitoring or review of access granted. A periodic comparison of employee job responsibilities and security privileges is necessary to validate access granted, especially as duties and responsibilities change.

Recommendation

- *DEED should periodically review computer system privileges and restrict employee access to update the Trade Adjustment Assistance Program's TRA benefit payments based on job responsibilities.*

Chapter 3. Indian Business Loan Program

Chapter Conclusions

DEED's controls ensured that cash available for Indian business loans was accurately allocated to the tribes, loans were authorized and paid to eligible recipients, and individual loan balances were accurately calculated. The department developed certain procedures to minimize delinquencies; however, we found that it was unclear whether security interest filings were needed on supplemental loans pledging the same collateral. Also, the department did not have policies defining what information should be documented when pursuing delinquent loans.

Audit Objective

The primary objective of our review of the Indian Business Loan Program was to answer the following questions:

- Did DEED controls ensure that it accurately allocated cash balances available to the tribes, that new loans were authorized and paid to eligible recipients, and that it accurately maintained individual loan ledger balances?
- Did DEED establish adequate collection practices to control delinquent business loans?

Background Information

Minnesota Statutes 116J.64 established the Indian Business Loan Program to provide eligible applicants with a portion of the financial resources needed to start or expand a business enterprise. The Legislature originally gave administrative responsibilities for the program to the Minnesota Indian Affairs Council (MIAC). In 2003, the Legislature transferred those duties to DEED, which began administering the program in August 2003.

To be eligible for a loan from the Indian Business Loan Program, applicants must be enrolled members of a federally-recognized and Minnesota-based band or tribe. Applicants may use an Indian business loan to finance up to 75 percent of an eligible project. Eligible projects include financing new construction, renovation, site acquisition, purchasing machinery, equipment and inventory, and establishing working capital. To acquire a loan, eligible businesses submit loan applications and a detailed business plan to the department. After the department receives completed loan applications, it sends the information to the tribal council at each applicant's band or tribe for final approval.

The Legislature provided three methods for generating loan resources:

- Twenty percent of the tax collections on severed mineral interests are allocated to the program. Severed mineral interests involved situations where the mineral interest in a property is owned separately from the land.
- The program retains the interest earned on invested treasurer's cash balances in its account.
- The program retains the loan principal and interest payments it collects on outstanding loan balances.

The tax and interest receipts credited to the program are allocated between each Minnesota tribe based on the number of enrolled members. Each tribe can disburse loans to member businesses from its allocated loan resources, and it retains the loan principal and interest payments collected on its outstanding loans.

Table 3-1 shows the activity of DEED's Indian Business Loan Program for fiscal year 2004.

Table 3-1
Indian Business Loan Program
Cash Activity of June 30, 2004

Cash Balance – July 1, 2003	$ 0
Receipts:	
Transfers In (from MIAC)	1,184,263
Mineral Interest Receipts	9,778
Investment Income	10,529
Loan Principal	78,074
Loan Interest	17,402
Resources Available	$1,300,046
Disbursements:	
Loans Issued	(270,425)
Administrative Expenses	(2,014)
Cash Balance – June 30, 2004	$1,027,607

Source: Minnesota Accounting and Procurement System (MAPS).

Table 3-2 shows the loans receivable activity for the Indian Business Loan Program from July 1, 2003, to June 30, 2004.

Table 3-2
Indian Business Loan Program
Loan Receivable Activity as of June 30, 2004

Loan Portfolio transferred in from MIAC	$1,411,829
Loans Issued	270,425
Loan Repayments	(78,074)
Loan Write-offs	(142,330)
Loans Receivable – June 30, 2004	$1,461,850

Note: As of June 30, 2004, there were 30 loans outstanding in the program.

Source: DEED Indian Business Loan Program records.

Department of Employment and Economic Development

Current Finding and Recommendation

2. The department did not file security interests on supplemental loans pledged with the same collateral and did not fully document collection efforts for Indian business loans.

The department did not file security interests on collateral designated for two supplemental Indian business loans. It was unclear whether security interests must be filed when additional loans are secured with identical collateral as earlier loans issued to the business. In addition, the department did not document all collection efforts on delinquent loans. Without adequate controls over collection efforts, excessive write-offs of uncollectible amounts may occur.

Security interests on collateral must be filed to protect the department's ability to minimize losses in the event of a loan default. *Minnesota Statutes* 336.9 requires that the security interest be filed with the Secretary of State. However, at the time of our audit, the department had not filed security interests for two of the four new loans it issued in fiscal year 2004. These two loans were supplemental borrowing that pledged the same collateral as the first loans the businesses received; creating uncertainty about the security interest filing requirement. In addition, the department did not document certain collection efforts, such as contact with borrowers via telephone, electronic mail, or personal visits. It did, however, retain demand letters sent to delinquent borrowers documenting formal collection efforts. Based on these written demand letters and discussions with staff, we believe the department made reasonable efforts towards collecting delinquent loans. However, without sufficient documentation, we could not determine if those collection efforts were timely and consistent for all delinquent loans.

Establishing a formal policy would ensure that the timing and method of collection efforts is consistent for all loans and could protect the department against any accusations of discrimination or unfair collection practices. A formal policy would also help the department ensure that it fulfills all necessary collection activities, including clarifying whether filing security interests with the Secretary of State is required when supplemental loans are issued and secured by the same collateral.

Recommendation

- *The department should improve control over delinquent Indian business loans by:*
  - *obtaining legal clarification regarding filing of security interests with the Secretary of State when collateral pledged on a supplemental Indian business loans is the same as an earlier loan.*
  - *fully documenting the type and timing of collection efforts for delinquent loans.*

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Chapter 4. Unemployment Insurance Employer Receivables

Chapter Conclusions

DEED's controls ensured that it pursued collection of unpaid employer billings for unemployment insurance or took other recovery actions deemed necessary. For the items tested, DEED complied with significant finance-related legal provisions concerning collections and recoveries.

Audit Objective

The primary objective of our audit of the department's unemployment insurance employer receivables was to answer the following questions:

- Did the department's controls provide reasonable assurance that it pursued collection of unpaid balances or took other recovery actions deemed necessary?
- Did the department comply with applicable policies and legal provisions for the items tested, including ancillary charges and allowable adjustments?

Background

There are two types of employers that are required to remit funds to the department's Unemployment Insurance Division: contributory and reimbursing employers.

- Contributory employers pay unemployment insurance premiums based on a pre-established payroll tax rate. Contributory employers file tax reports quarterly and remit payments by the end of the month following each quarter. In the event of lay offs, separated employees may receive unemployment benefits from the Unemployment Insurance Fund. The amount of unemployment benefits paid impacts the future unemployment insurance tax rate charged to contributory employers.
- Reimbursing employers are typically state agencies, local government units, and other nonprofit organizations, which are not required to file tax returns or remit premiums. However, in the event of layoffs, the Unemployment Insurance Fund will pay benefits that are subsequently billed to the employer on a reimbursement basis.

Employers file their tax returns and remit payments either electronically or manually. For the employers filing electronically, tax information is automatically received by the department and posted to employer history accounts. For the manual filings and remittances, the department contracts with a bank to process the tax information and handle the checks for approximately 40 days after the end of the calendar quarter. The department's tax unit manages returns and checks received after 40 days.

The department uses the Report Processing System, an internally developed mainframe application for tracking tax return information and amounts due. The system has built-in edits that compare amounts remitted with the amounts due. In the event of a discrepancy or an employer's failure to remit payment along with the tax return, a bill is generated. Employers who have not sent a tax return and have not notified the department that its business has been dissolved are assigned an estimated tax and are charged penalties for nonfiling. The department has statutory authority to file estimated returns and charge penalties for nonfiling employers. Approximately $40 million of unpaid contributory employer remittances and estimated receivables and $2 million of reimbursements from public sector and nonprofit employers are typically outstanding at the end of each quarter.

The department also engages in collection activities for delinquent employer accounts. A special unit handles overdue accounts, using highly-customized commercial collections software. Collection efforts begin when any appeals or bankruptcy proceedings have been finalized. When attempts to collect on a voluntary basis have been ineffective, the department sends a final demand notice and resorts to other legal recovery methods allowed by state statute. These methods involve levies on employer bank accounts, liens on real estate assets, and determinations of personal liability for officers or owners of the businesses with delinquent accounts. Furthermore, the department works on accounts in litigation or appeal and makes referrals to the Minnesota Collection Enterprise for recovery when delinquencies exceed one year. The department also has the authority to waive or compromise accounts if such action is deemed in the best interest of the state. After all collection activities have been exhausted, the account is moved to inactive status and is written off after six years. During this time, the liens placed on employer property remain in effect and often result in a successful collection if the employer intends to sell or refinance the underlying asset.

We had no written findings as a result of our work in this area.

Status of Prior Audit Issues As of March 2005

Most Recent Financial Audit Division Audit

Legislative Audit Report 05-17, issued March 10, 2005, examined the Department of Employment and Economic Development's activities and programs material to the State of Minnesota's *Comprehensive Annual Financial Report* or the Single Audit for the year ended June 30, 2004. The scope included the Unemployment Insurance Fund and other federal programs administered by the department. The report contained four findings, and the department is working towards resolution of the concerns raised.

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 metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.

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positively Minnesota
Department of Employment and Economic Development

May 20, 2005

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

Dear Mr. Nobles:

The following information is offered in response to your revised draft report dated May 16, 2005, for the selected areas of the Department of Employment and Economic Development for the period July 1, 2001, through June 30, 2004.

Auditor's Finding 1. The department did not review access granted to employees nor restrict some individual's ability to update TRA benefits in its computer system.

Auditor's Recommendation:

- DEED should periodically review computer system privileges and restrict employee assess to update the Trade Adjustment Assistance Program's TRA benefit payments based on job responsibilities.

Response:

We agree. DEED reviewed the security clearance file, and deleted those employees that did not require access to the TRA benefit payment subsystem. DEED will determine an appropriate schedule for future review of security clearances.

Responsible Person: Kathy Nelson 651-296-1692

Auditor's Finding 2. The department did not file security interests on supplemental loans pledged with the same collateral and did not fully document collection efforts for Indian business loans.

Auditor's Recommendation:

- The department should improve control over delinquent Indian business loans by:

  -- obtaining legal clarification regarding filing of security interests with the Secretary of State when collateral pledged on a supplemental Indian business loan is the same as an earlier loan.

  -- fully documenting the type and timing of collection efforts for delinquent loans.

Response:

The loans referenced in the report were made to borrowers that had previous loans with the program. These initial loans were secured by comprehensive security agreements and UCC filings that include language covering hereafter acquired equipment purchases. When additional equipment purchases were made and financed by subsequent program loans, those loans would be secured by the previous UCC filings. However, DEED has filed additional UCC's with the Secretary of State on both of these loans. DEED has also changed its procedures and will ask for advice from the Attorney General's Office on any program loans to properly secure the State's interest.

We agree. DEED changed its policy and procedures to document efforts on delinquent and defaulted loans to include all contacts with borrowers including telephone, electronic mail and personal visits.

Responsible Person: Paul A. Moe 651-297-1391

If you have questions or comments, please contact John Stavros, Chief Financial Officer at 651-296-3965.

Sincerely,

Matt Kramer
Commissioner

cc: Kathy Nelson, Director, Unemployment Insurance Division
Paul A. Moe, Director, Community and Business Finance Office
John Stavros, Chief Financial Officer