Audit Results From
CAFR and Single Audit Procedures

Department of Labor and Workforce Development

For the Year Ended
June 30, 2004

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

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Department of Labor and Workforce Development
For the Year Ended June 30, 2004

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For the Year Ended June 30, 2004

EXECUTIVE SUMMARY

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FINDING 1 The Department of Labor and Workforce Development did not monitor all if its Workforce Investment Act (WIA) subrecipient contracts as required by the *Code of Federal Regulations* and the Department of Finance and Administration's (F&A) Policy 22, *Subrecipient Contract Monitoring*. Ten of 21 high risk subrecipient contracts identified as requiring monitoring (48%) were not monitored by the department during the fiscal year.

FINDING 2 The department did not always document or maintain documentation of the initial verification of identity of unemployment compensation claimants. Also, additional wage information obtained from employers by the Employer Accounts Section was not entered into the ESCOT (Employment Security Combined Online Technology) system by the Data Entry section. In addition, controls over the processing of Unemployment Insurance benefit claims need improvement.

FINDING 3 The Department of Labor and Workforce Development did not properly prepare and submit federal reports, in a timely manner, in accordance with the requirements of the United States Department of Labor. Also, there was no review of the reports submitted by the Accounting Manager by the Unemployment Insurance Report and Compliance Supervisor and no comparison of the information in the department's accounting records with the information reported on the *Financial Status Reports*.

FINDING 4 The Department of Labor and Workforce Development did not request and obtain enough federal funds to cover the Trade Adjustment Assistance (TAA) program administrative costs. Cash receipts from the federal government were smaller than the department's actual cash outlays at June 30, 2004, by $422,056.96. Also, there were no written drawdown procedures and drawdown duties were not adequately segregated.

FINDING 5 The Department of Labor and Workforce Development requested and received too much federal funding for the Unemployment Insurance program's administrative costs. Cash receipts from the federal government exceeded the department's actual cash outlays at June 30, 2004, by $1,150,814.09. Also, written drawdown procedures need to be updated and drawdown duties were not adequately segregated.

This report addresses reportable conditions in internal control and noncompliance issues found at the Department of Labor and Workforce Development during our annual audit of the state's financial statements and major federal programs. For the complete results of our audit of Tennessee, please see the State of Tennessee *Comprehensive Annual Financial Report* for the Year Ended June 30, 2004, and the State of Tennessee *Single Audit Report* for the year Ended June 30, 2004. The scope of our audit procedures at the Department of Labor and Workforce Development was limited. During the audit for the year ended June 30, 2004, our work at the Department of Labor and Workforce Development focused on the Employment Security Trust Fund, a major fund in the *Comprehensive Annual Financial Report* of the State of Tennessee. Our audit of the fund included determining whether the department had an adequate system of internal control over financial reporting. We also performed certain audit procedures to obtain reasonable assurance about whether the State of Tennessee's financial statements were fairly presented. In addition, our work at the Department of Labor and Workforce Development focused on three major federal programs: Workforce Investment Act Cluster, Unemployment Insurance, and Trade Adjustment Assistance. We audited these federally funded programs to determine whether the department complied with certain federal requirements and whether the department had an adequate system of internal control over the programs to ensure compliance. Management's response is included following each finding.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

June 9, 2005

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable James G. Neeley, Commissioner
Department of Labor and Workforce Development
Andrew Johnson Tower, 8th Floor
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith are the results of certain limited procedures performed at the Department of Labor and Workforce Development as a part of our audit of the *Comprehensive Annual Financial Report* of the State of Tennessee for the year ended June 30, 2004, and our audit of compliance with the requirements described in the U.S. Office of Management and Budget Circular A-133 Compliance Supplement.

Our review of management's controls and compliance with laws, regulations, and the provisions of contracts and grants resulted in certain findings which are detailed in the Findings and Recommendations section.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/mb
05/017

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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December 3, 2004

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have performed certain audit procedures at the Department of Labor and Workforce Development as part of our audit of the financial statements of the State of Tennessee as of and for the year ended June 30, 2004. The scope of our work included the Employment Security Trust Fund, a major fund in the Comprehensive Annual Financial Report of the State of Tennessee. Our objective was to obtain reasonable assurance about whether the State of Tennessee's financial statements were free of material misstatement. We emphasize that this has not been a comprehensive audit of the Department of Labor and Workforce Development.

We also have audited certain federal financial assistance programs 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. The following table identifies the State of Tennessee's major federal programs administered by the Department of Labor and Workforce Development. We performed certain audit procedures on this program as part of our objective to obtain reasonable assurance about whether the State of Tennessee complied with the types of requirements that are applicable to each of its major federal programs.

Major Federal Program Administered by the Department of Labor and Workforce Development For the Year Ended June 30, 2004 (in thousands)

CFDA Number	Program Name	Federal Disbursements
17.225	Unemployment Insurance	$651,185
17.245	Trade Adjustment Assistance	$31,958
17.258 17.259 17.260	Workforce Investment Act Cluster	$60,856

Source: State of Tennessee's Schedule of Federal Financial Assistance for the year ended June 30, 2004.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards contained in Government Auditing Standards, issued by the Comptroller General of the United States.

We have issued an unqualified opinion, dated December 3, 2004, on the State of Tennessee's financial statements for the year ended June 30, 2004. We will issue, at a later date, the State of Tennessee Single Audit Report for the same period. In accordance with Government Auditing Standards, we will report on our consideration of the State of Tennessee's internal control over financial reporting and our tests of its compliance with certain laws, regulations, and provisions of contracts and grants in the Single Audit Report. That report will also contain our report on the State of Tennessee's compliance with requirements applicable to each major federal program and internal control over compliance in accordance with OMB Circular A-133.

As a result of our procedures, we identified certain internal control and/or compliance issues related to the major federal programs at the Department of Labor and Workforce Development. Those issues, along with management's response, are described immediately following this letter. We have reported other less significant matters involving the department's internal control and instances of noncompliance to the Department of Labor and Workforce Development's management in a separate letter.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

FINDINGS AND RECOMMENDATIONS

1. <u>The Department of Labor and Workforce Development did not monitor all of its Workforce Investment Act subrecipient contracts</u>

Finding

The Department of Labor and Workforce Development did not monitor all if its Workforce Investment Act (WIA) subrecipient contracts as required by the *Code of Federal Regulations* and the Department of Finance and Administration's (F&A) Policy 22, *Subrecipient Contract Monitoring*.

Testwork performed on a sample of subrecipient contracts revealed that 10 of 21 high-risk WIA subrecipient contracts, identified by the department as requiring monitoring (48%), were not monitored during the fiscal year. The *Code of Federal Regulations*, Title 20, Section 667.400, requires the department monitor its subrecipients to determine compliance with the Workforce Investment Act. Policy 22 establishes guidelines for the uniform monitoring of subrecipients that receive state and/or federal funds from state departments, agencies, and commissions. The policy requires the Department of Labor and Workforce Development to submit an annual monitoring plan to F&A for review, comment, and approval by September 30 each year. This plan should identify all subrecipients, state which subrecipients' contracts require monitoring, describe the risk criteria utilized to select subrecipients for monitoring purposes, and assign a level of risk to each subrecipient. The department prepared and submitted the annual monitoring plan as required.

The monitoring program is a key internal control for the Workforce Investment Act program. It should be a priority for upper management. Failure to monitor subrecipient contracts increases the probability that the program could be charged for unallowable costs and activities and that fraud could occur and go undetected. The department has also not complied with the *Code of Federal Regulations* and the Department of Finance and Administration's Policy 22.

Recommendation

The Commissioner should ensure that all subrecipients who have been identified as high-risk in the department's annual monitoring plan submitted to the Department of Finance and Administration are monitored. Monitoring should be conducted in accordance with the *Code of Federal Regulations* and the Department of Finance and Administration's Policy 22, *Subrecipient Contract Monitoring*.

Management's Comment

We concur. Prior to February 2004, the Department of Finance and Administration was responsible for monitoring the department's contracts in accordance with the Office of Management and Budget (OMB) Circular A-133 and the Department of Finance and Administration's Policy 22. In February 2004, Finance and Administration decentralized this function and shifted the responsibility for monitoring Department of Labor and Workforce Development (DOLWD) contracts to the department. However, the number of staff members transferred was not sufficient to conduct the required monitoring.

Currently the DOLWD monitoring unit is fully staffed, and we have developed a monitoring tracking system to ensure that the department meets its monitoring obligations as outlined in the monitoring plan for the program year ending September 30, 2005.

2. For the fiscal year ended June 30, 2004, controls over the Unemployment Insurance Program need to be strengthened

Finding

The Department of Labor and Workforce Development is responsible for administering the state's Unemployment Insurance Program. This program provides benefits to unemployed workers for periods of involuntary unemployment. Testwork on the program for the fiscal year ended June 30, 2004, revealed the following weaknesses:

a. The department did not always document or maintain documentation of the initial verification of identity of unemployment compensation claimants, nor has the *Unemployment Insurance Procedures Manual* been updated to reflect current procedures. Claimants may apply for unemployment compensation in person at a local unemployment office, over the phone, or via the Internet. Interviewers who interview claimants at the local unemployment office are required to see each claimant's social security card and one other form of identification. The types of identification observed are required to be recorded on the initial claim form. The Call Center, which is located in Nashville, processes all phone and Internet applications. Claimants who apply for unemployment compensation benefits in this manner are required to provide their social security number and employment history. An interviewer verifies the claimant's identity by matching the information provided by the claimant with information in the department's ESCOT (Employment Security Combined Online Technology) system. The ESCOT system contains information from employer wage reports, which give details of the claimant's previous employers and total wages received from these employers. If the information provided by the claimant agrees with the information in ESCOT, the interviewer is not required to observe a social security card as stated in the *Unemployment Insurance Procedures Manual*. This procedure would also apply to claimants who are interviewed at the local employment office, and the interviewer's agreement of claimant-provided information with employer-provided information in ESCOT would also be documented on the initial claim form. Per the Call Center Manager, the interviewer should note this agreement in the interviewer comment section of the unemployment application in ESCOT for all phone and Internet claimants. However, the *Unemployment Insurance Procedures Manual* has not been updated to include written procedures for documenting verification of identity of claimants through ESCOT, when a social security card and one other form of identification are not observed. Testwork was performed on 60 initial claims for unemployment compensation. The interviewer did not document the method of verifying a claimant's identity on the initial claim form for four claimants (7%) who applied for unemployment compensation at a local office. Also, the interviewer did not document agreement of claimant-provided information with employer-provided information in ESCOT for seven claims taken over the phone or via the Internet (12%). This information should have been noted in the interviewer comment section of the unemployment application.

The *Code of Federal Regulations,* Title 20, Section 603.3(a), states:

> The State unemployment compensation agency shall require, as a condition of eligibility for unemployment benefits, that each claimant for benefits furnish to the agency his/her social security number . . . and the agency shall utilize such numbers in the administration of the unemployment compensation program so as to associate the agency's records pertaining to each claimant with the claimant's social security number.

Section 3210 of the Unemployment Insurance Procedures Manual states:

> When an individual files an initial claim for unemployment insurance benefits, the local office will attempt to verify the claimant's identity. This verification will include asking to see the Social Security Card. In addition to the Social Security Card, ask the claimant to produce one other form of identification. The type of ID used will be recorded on the initial claim form.

Section 3211 of the Unemployment Insurance Procedures Manual states:

> If the claimant does not have his social security card but the [ESCOT Preliminary Monetary Determination Inquiry screen] PEQ1 indicates a match between his name, SSN, and employment history, verification by looking at the card will not be necessary.

Testwork also revealed that one initial claim form and related supporting documentation could not be located by the Director of Benefit Operations.

b. Additional wage information obtained from employers by the Employer Accounts Section was not entered into the ESCOT system by the Data Entry section. As a result, benefit amounts and the related employer's liability were not redetermined in the ESCOT system. The information obtained from the employers' wage reports is used to determine the claimants' weekly and maximum unemployment insurance benefit and to determine the employer's liability. Section 5905 of the *Unemployment Insurance Procedures Manual* says the agency will redetermine the claim after new or additional information is received. For 2 of 60 Unemployment Insurance (UI) claimants tested (3%), Employer Accounts received additional employer wage reports but Data Entry failed to add the information to the claimants' records. As a result, one claimant's benefit should have been increased by $2.00 per week. There was no effect on the other claimant as they were already receiving the maximum weekly benefit amount. Also, the liability percentage of the three employers related to the two cases noted above was not adjusted to reflect the additional information.

c. Controls over the processing of unemployment compensation benefit claims need improvement. The interviewer can make changes to the claimant's records on the Change Benefit Screen in the ESCOT system. This screen contains the claimant's address, employer number, benefit decision date, and benefit decision code. Almost all interviewers have capabilities to update this screen. The benefit decision code is used to document approval or disapproval of a claimant's receipt of unemployment compensation benefits. Based on discussions with the Nashville Call Center Director and the Internal Audit Director, no specific field on this screen is restricted and even though an interviewer may have access to a particular screen, the interviewer may not have authority or permission to change a particular field within the screen. Interviewers do not have authorization to change the final benefit decision code; however, the interviewers are not restricted within the ESCOT system from changing the benefit decision code. The lack of restriction leaves this area open for potential inappropriate authorization of benefits for ineligible claimants or denial of benefits for eligible claimants. The Nashville Call Center Director stated that the ESCOT system prints a daily report that shows all changes made and who made the changes; however, it does not appear that management reviews the report daily to make sure only authorized changes were made. In addition, an Internal Audit Investigation Report was issued in June 2004 as a result of a $550 overpayment to a claimant that was not detected until the claimant that received the check notified the Call Center that they should not have received this benefit. The report attributed the overpayment to the interviewer's lack of training and experience. The Internal Audit Section recommended that management evaluate training at the Call Center and provide additional training and closer supervision to less experienced staff. In the department's answer to the Internal Audit investigation, the Call Center felt that this was an isolated case but has agreed to provide additional training and feedback to less experienced staff, as well as more supervisory review. However, it appears that this error was also possibly caused by an interviewer at the Call Center having the ability to change benefit decision codes to which they should not have had access.

If interviewers do not verify the identity of unemployment compensation claimants and document the process used to identify the claimant, there is an increased risk of fraud and ineligible claimants could receive benefits that they are not entitled to. These procedures are essential controls over the integrity of the unemployment insurance program. Failure to redetermine claimant benefits, when new or additional information becomes available, may result in the claimant being over or underpaid and an employer's liability may be accessed incorrectly. Also, if interviewers are given access to screen fields and the ability to change information that they are not authorized to change, claimants may receive benefits for which they ineligible. There is also an increased risk for errors and fraud to occur and to go undetected.

Recommendation

The Commissioner should instruct the Director of Benefit Operations to review and update the *Unemployment Insurance Procedures Manual*, where applicable. The manual should include written procedures for documenting verification of identity of claimants through agreement of claimant-provided information with employer-provided information in ESCOT, when a social security card and one other form of identification are not observed. The Director of Benefit Operations should ensure that all local unemployment offices and the Call Center comply with the *Unemployment Insurance Procedures Manual.* Verification of the identity of all claimants should be documented. Also, the department should maintain all supporting documentation for all initial claims.

The Data Entry Operations Supervisor should ensure that all new and additional wage information received from employers by the Employer Accounts Section is entered in the ESCOT system so that the redetermination process is completed in a timely manner. In addition, the Commissioner should assign an Information Systems Manager to make appropriate changes to the ESCOT system to restrict screen field access to what is appropriate for the interviewers. Exception reports should be generated on a regular basis and reviewed by an appropriate level of management.

Management's Comment

We concur. We have reminded departmental staff of the importance of documenting the verification of claimant identity.

Updating the Unemployment Insurance Procedures Manual occurs routinely. We will notify the Director of Benefit Operations of the concerns of the auditors so these concerns can be included in the updating process.

We are taking steps to ensure that supplemental wages are added to the ESCOT system in a timely manner. We have also begun programming to automate the redetermination process to insure that claimant weekly benefit amounts and employer charges are adjusted to reflect additional wage information. We feel that these steps will prevent similar errors in the future.

We will discuss with UI Information Technology staff the issue of changing ESCOT to restrict access to certain decision codes. While it is more common for Adjudicators to issue decisions and update final decision codes, authorization to do so is not restricted to Adjudicators. There are instances when Interviewers must and do make these decisions, and are required to change final decision codes to insure timely payment of benefits. This is a management decision based on staffing levels, work flow, and the experience of individual Interviewers. Staffing levels in local offices make the restriction of decision code fields unworkable at this time. Once all claims are consolidated at the Claims Center, it will be more practical to establish levels of access based on the classification and experience level of the employee.

3. For the fiscal year ended June 30, 2004, controls over federal reports for the Unemployment Insurance Program needed improvement

Finding

The Department of Labor and Workforce Development did not properly prepare and submit federal reports, in a timely manner, in accordance with the requirements of the United States Department of Labor.

The department uses the Standard Form 269, *Financial Status Report,* to report the status of funds for the Unemployment Insurance program. Testwork performed on the *Financial Status Reports* submitted by the department revealed the following instances of noncompliance with the grantor's reporting requirements.

a. The indirect cost rate shown on 20 of 20 *Financial Status Reports* tested (100%) for the period July 1, 2003, to June 30, 2004, was incorrect. The instructions for the *Financial Status Reports* require the department to report the approved indirect cost rate for the reporting period. The Indirect Cost Negotiation Agreement states that the approved indirect cost rate for the period July 1, 2003, to June 30, 2004, was 10.45%. However, the rate shown on 20 reports and used to prepare the *Financial Status Reports* ranged from 8.87% to 21.40%.

b. Ten of 20 *Financial Status Reports* tested (50%) for the period July 1, 2003, to June 30, 2004, were not submitted according to the grantor's reporting deadline. The *ET Handbook,* No. 336, instructs the department to submit the *Financial Status Reports* to the United States Department of Labor within 30 days after the end of the reporting quarter. However, 10 of the *Financial Status Reports* tested were not submitted timely. Testwork determined that the *Financial Status Reports* were submitted within 33 to 89 days after the end of the reporting quarter.

The department's failure to properly prepare and submit the *Financial Status Reports* in a timely manner was caused by the Accounting Manager's failure to follow the reporting instructions. Also, there was no review of the reports submitted by the Accounting Manager by the Unemployment Insurance Report and Compliance Supervisor and no comparison of the information in the department's accounting records with the information reported on the *Financial Status Reports*. In addition, the Accounting Manager stated the 30-day filing deadline imposed by the United States Department of Labor is impractical because the departmental reports used to prepare the *Financial Status Reports* are not available until approximately 25 days after the end of each month. The Accounting Manager felt that five days was not sufficient time to prepare and submit the quarterly *Financial Status Reports.*

Inaccurate and untimely *Financial Status Reports* hinder the department from presenting usable information to its grantor and prevent the department's compliance with the grantor's reporting requirements. Also, when staff fails to comply with the grantor's reporting requirements, the department could be subject to disciplinary measures and/or sanctions. To blame the federal government for requiring timely reports reflects a tone at the top which is not only inconsistent with an appropriate control environment, but suggests a serious flaw in management's identification of the fundamental problem.

Recommendation

The Commissioner should ensure that the Accounting Manager follows the instructions for completing the Financial Status Reports. The Accounting Manager's work should be reviewed and reconciled to the department's accounting records prior to submission to the United States Department of Labor. All reports should be submitted in a timely manner, in accordance with reporting requirements established by the grantor.

Management's Comment

We concur.

The calculated indirect cost rate was used instead of the approved rate in effect for the quarter reported. We did this to report the actual indirect cost charged to the Unemployment Insurance program as shown on CAS Report 61. The calculated rate will always be different from the approved rate due to our process of estimating indirect cost based on the prior month expenditures. However, we will begin using the approved rate.

Also, the SF 269 reports have not been submitted within 30 days after the end of the reporting quarter. However, our reports have usually been submitted within 40 days. We will increase our efforts to prepare the reports in the 30-day time period. The challenge to doing this is that the report from which we get the information is scheduled to be run 25 days after the end of the month, but sometimes is run even later. In federal fiscal year 2004, we received the necessary reports with only a day or two to prepare the *Financial Status Reports*.

For Quarter Ending	CAS 61 Report*	SF 269 Due Date	Time to Prepare
December 2003	1/28/04	1/30/04	Two days to submit
March 2004	4/28/04	4/30/04	Two days to submit
June 2004	7/30/04	7/30/04	Due that day
September	10/27/04	10/30/04	Three days to submit

* Status of Obligational Authority

4. <u>The Department of Labor and Workforce Development did not request enough federal funds to cover Trade Adjustment Assistance (TAA) administrative costs and controls over cash drawdowns need improvement</u>

Finding

The Department of Labor and Workforce Development did not request and obtain enough federal funds to cover the Trade Adjustment Assistance (TAA) program administrative costs. They also had no written drawdown procedures and drawdown duties were not adequately segregated.

Testwork performed on administrative costs drawdowns revealed the following:

a. The department incorrectly calculated the administrative costs drawdowns because of various human and computerized worksheet errors. Examples of these errors include the use of incorrect formulas, the use of incorrect allocation percentages, and the use of incorrect numbers from the accounting records. As a result, administrative costs were under drawn by $422,056.96. The *Code of Federal Regulations,* Title 31, Section 205.33(a) states, "The timing and amount of funds transfers must be as close as is administratively feasible to a State's actual cash outlay for direct program costs . . ." The department did not draw down enough funds to meet actual federal cash outlays and as of December 2004, the department had not attempted to recover this money.

b. There are no written TAA administrative costs drawdown procedures. Written procedures are necessary to ensure that administrative costs drawdowns are consistently and correctly performed.

c. There was also an inadequate segregation of duties. The Accountant for Fiscal Services performs all aspects of the administrative costs drawdowns. The employee prepares all the documents for the cash drawdowns and performs the drawdowns from the Payment Management System. There is no independent review of the Trade Adjustment Assistance administrative costs drawdowns before a drawdown occurs.

When the department does not draw down sufficient federal funds, state funds are used to cover federal disbursements and the department is in violation of the *Code of Federal Regulations.* Also, when written drawdown procedures do not exist and duties are not adequately segregated, there is an increased risk that errors will occur and go undetected.

Recommendation

The Administrator for Administration and the Accounting Manager should develop written procedures describing the appropriate administrative costs drawdown process, and duties should be segregated appropriately. The Administrator for Administration should ensure that the Accounting Manager conducts and documents an independent review of all administrative costs drawdown calculations before the drawdown occurs to ensure that correct data are used in the drawdown calculation. The drawdown calculation should be free of human and worksheet errors.

Management's Comment

We concur.

We have made changes to the program that is used to calculate administrative drawdowns. These changes should reduce both human and computerized errors. We have addressed the following concerns that you expressed:

1. **Incorrect formulas were used at times.** Inadvertently, values were keyed where formulas were, resulting in an over-write of the formula. As a safeguard, the cells having formulas have been protected to disallow input to them.

2. **Incorrect allocation percentages were used.** The percentages utilized in the drawdown spreadsheets had been rounded due to the concerns of previous auditors that the sum of the percentages did not equal 100%. As a result, the amount of payroll costs allocated did not equal to 100% of the payroll costs. Due to their concerns, the percentages had been rounded to six decimal places. We have now made changes so that the percentages are no longer rounded.

3. **Incorrect numbers were used from the accounting records.** Incorrect numbers were obtained at different times for different reasons. (a) Previously, when listing the amounts from our Cost Accounting System (CAS), there was no check figure to assure that all programs had been input. There is now a summary page that has been created to check the total of the programs input. (b) Although a general review of the support papers was performed, there was no detailed review of the entire draw process. There is now a detailed review of the draw process, with a review checklist that is to be signed and dated. (c) At times, staff used the CAS 91 *Costs by Program Report* (the alternative report used for drawdowns during time constraints) and the manual addition of monthly closing entries. This led to differences with the final CAS 61 *Status of Obligational Authority Report*, which has all costs included. The detailed review checklist will also address this issue.

We have updated the written procedures and reassigned staff to assure that there is a proper segregation of duties. We have established an independent review of drawdowns so that if any errors occur they can be found and corrected quickly.

We are also in the process of analyzing the TAA program, and will take the necessary action to resolve the under/over draws in that program once the analysis is completed.

5. **<u>For the fiscal year ended June 30, 2004, the Department of Labor and Workforce Development requested and received too much federal funding for the Unemployment Insurance (UI) program's costs and controls over cash drawdowns need improvement</u>**

Finding

The Department of Labor and Workforce Development requested and received too much federal funding for the Unemployment Insurance program's administrative and participant benefit payment costs. Also, written drawdown procedures need to be updated and drawdown duties were not adequately segregated.

Testwork performed on administrative costs drawdowns revealed the following:

a. The department incorrectly calculated the administrative costs cash drawdowns because of various computerized worksheet and human errors. Examples of these errors include the use of incorrect formulas, the use of incorrect allocation percentages, and the use of incorrect numbers from the accounting records. As of June 30, 2004, these errors produced an over-draw of $1,150,814.09 of federal funds by the department. The *Code of Federal Regulations,* Title 31, Section 205.33(a), states, "The timing and amount of funds transfers must be as close as is administratively feasible to a State's actual cash outlay for direct program costs . . ." When federal receipts exceed federal disbursements, the state is not in compliance with federal cash management principles and may be required to pay the federal government interest on the excessive receipts. No interest had accrued on this amount as of June 30, 2004. However, as of December 2004, the department had not returned the money owed to the federal government. Interest began accruing on the overdrawn funds in July 2004 and will continue to accrue until the funds are repaid. In addition, 1 of 60 participant benefit payment drawdowns tested (2%) was calculated incorrectly. This error resulted in an overdraw of funds in the amount of $15,640.51. Interest began accruing on the overdrawn amount as of August 2003. As of June 30, 2004, total interest accrued on this amount was $159.41. The amount of overdrawn funds has not been repaid as of March 31, 2004, and interest has continued to accrue.

b. The department does not have updated written procedures that reflect the practices that are currently used for the Unemployment Insurance administrative costs cash drawdowns. These procedures were no longer current and were not being used by the department.

c. There was also an inadequate segregation of duties. One employee performs all aspects of the administrative costs drawdowns. The employee prepares all the documents for the cash drawdowns and performs the drawdowns from the Payment Management System. There is no independent review of the Unemployment Insurance administrative costs drawdowns before the drawdown occurs.

When the department overdraws federal funds, the state becomes liable for any funds drawn in excess of cash disbursements and any related interest. Also, the department is in violation of the *Code of Federal Regulations.* When written drawdown procedures do not reflect current operations and duties are not adequately segregated, there is an increased risk that errors will occur and go undetected.

Recommendation

The Administrator for Administration and the Accounting Manager should update the written procedures describing the appropriate administrative costs drawdown process, and duties should be segregated appropriately. The Administrator for Administration and the Accounting Manager should also assign a staff member to conduct an independent review of all administrative costs drawdown calculations before the drawdown occurs to ensure that correct data are used in the drawdown calculation. The drawdown calculation should be free of human and worksheet errors.

Management's Comment

We concur.

We have made changes to the program that is used to calculate administrative drawdowns. These changes should reduce both human and computerized errors. We have addressed the following concerns that you expressed:

1. **Incorrect formulas were used at times.** Inadvertently, values were keyed where formulas were, resulting in an over-write of the formula. As a safeguard, the cells having formulas have been protected to disallow input to them.

2. **Incorrect allocation percentages were used.** The percentages utilized in the drawdown spreadsheets had been rounded due to the concerns of previous auditors that the sum of the percentages did not equal 100%. As a result, the amount of payroll costs allocated did not equal to 100% of the payroll costs. Due to their concerns, the percentages had been rounded to six decimal places. We have now made changes so that the percentages are no longer rounded.

3. **Incorrect numbers were used from the accounting records.** Incorrect numbers were obtained at different times for different reasons. (a) Previously, when listing the amounts from our Cost Accounting System (CAS), there was no check figure to assure that all programs had been input. There is now a summary page that has been created to check the total of the programs input. (b) Although a general review of the support papers was performed, there was no detailed review of the entire draw process. There is now a detailed review of the draw process, with a review checklist that is to be signed and dated. (c) At times, staff used the CAS 91 *Costs by Program Report* (the alternative report used for drawdowns during time constraints) and the manual addition of monthly closing entries. This led to differences with the final CAS 61 *Status of Obligational Authority Report*, which has all costs included. The detailed review checklist will also address this issue.

We have updated the written procedures and reassigned staff to assure that there is a proper segregation of duties. We have established an independent review of drawdowns so that if any errors occur they can be found and corrected quickly.

We have completed an analysis of the UI draw-downs, and determined that there was an excess of cash receipts in the Unemployment Insurance administrative program from Fiscal Year 2003 to January 2005, (the latest CAS report available at the time) in the amount of $121,733.17. This amount was returned to the U.S Department of Labor on March 31, 2005. In addition, an under-draw in the UI benefit costs draw-downs was requested for a receipt date of April 4, 2005.

STATUS OF PRIOR AUDIT FINDINGS

State of Tennessee *Single Audit Report* for the year ended June 30, 2003

There were no prior audit findings.