

**Audit Results From
CAFR and Single Audit Procedures**

Department of Labor and Workforce Development

**For the Year Ended
June 30, 2006**

**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

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**Department of Labor and Workforce Development
For the Year Ended June 30, 2006**

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**Department of Labor and Workforce Development
For the Year Ended June 30, 2006**

EXECUTIVE SUMMARY

Finding

FINDING The Assistant Director of Unemployment Benefit Operations and Technical Services failed to properly monitor the preparation of the federal reports for the Trade Adjustment Assistance program and therefore did not reduce the risk that the reports would contain incorrect information.

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, 2006, and the State of Tennessee *Single Audit Report* for the year ended June 30, 2006. 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, 2006, 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 two major federal programs: Unemployment Insurance, and Trade Adjustment Assistance_Workers. 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 the finding.



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

John G. Morgan
Comptroller

May 3, 2007

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, 2006, 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 a finding which is detailed in the Finding and Recommendation section.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/cj
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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT

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December 21, 2006

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, 2006. 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 these programs 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, 2006
(in thousands)**

<u>CFDA Number</u>	<u>Program Name</u>	<u>Federal Disbursements</u>
17.225	Unemployment Insurance	\$457,018
17.245	Trade Adjustment Assistance_Workers	\$27,133

Source: State of Tennessee's Schedule of Expenditures of Federal Awards for the year ended June 30, 2006.

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 21, 2006, on the State of Tennessee's financial statements for the year ended June 30, 2006. 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 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.

The Honorable John G. Morgan
December 21, 2006
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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,

A handwritten signature in black ink that reads "Arthur A. Hayes, Jr." The signature is written in a cursive style with a large, prominent initial "A".

Arthur A. Hayes, Jr., CPA
Director

FINDING AND RECOMMENDATION

Supervisors failed to properly monitor the preparation of the federal reports for the Trade Adjustment Assistance program and therefore did not reduce the risk that the reports would contain incorrect information

Finding

As noted in the previous audit, the department submitted the Trade Act Participant Report (TAPR) files to the U.S. Department of Labor without any supervisory review. In addition, the department submitted the quarterly *Employment and Training Administration (ETA) 563 Quarterly Determinations, Allowance Activities and Reemployment Services Under the Trade Act* report to the U.S. Department of Labor without a documented supervisory review. Also, we could not verify information contained in the TAPR files.

The Trade Adjustment Assistance (TAA) program assists individuals who become unemployed due to the effects of foreign competition. This program provides participants either with training to enable them to enter a new trade or business, or additional unemployment benefits if training is deemed to not be practicable. The program staff pays participants a weekly trade readjustment allowance and provides for job skills training from local educational institutions, if the participants can benefit from the training. If training is available, but not within a normal commuting distance, the program will provide a travel and subsistence allowance. The program also provides participants with a job search allowance and a relocation allowance if needed.

The U.S. Department of Labor requires the department to report quarterly on the program's performance. According to the U.S. Department of Labor, Employment and Training Administration, *Trade Act Participant Report (TAPR): General Reporting Instructions and Specifications*:

Grantees [states] are required to maintain standardized individual records containing characteristics, activities and outcomes information for all individuals who receive services or benefits financially assisted by the Trade Adjustment Assistance (TAA) program.

The primary purposes of the TAPR are to:

1. Establish a standardized set of data elements, definitions, and specifications that can be used to describe the characteristics, activities, and outcomes of individuals served by the TAA program;
2. Facilitate the collection and reporting of valid, consistent, and complete information on an individual in order to support the overall management, evaluation, and continuous improvement of the programs at the local,

state, and federal levels; and

3. Share program performance results with consumers, taxpayers, Congress and others with an interest in the TAA program.

The TAPR establishes a core set of data that must be collected and maintained by grantees. These records are comprised of client information that is matched to outcome information obtained from Unemployment Insurance (UI) and other administrative wage records, or from other supplemental data sources as appropriate. . . . Electronic TAPR files are due to ETA no later than 45 calendar days after the end of each quarter of reporting. Each TAPR file must consist of individual records for all TAA participants who have exited [the program] during a particular quarter.

During the fiscal year ending June 30, 2006, an Unemployment Insurance Specialist prepared, reviewed, and submitted the quarterly TAPR files on participants that exited the TAA program between July 1, 2003, and June 30, 2004, with no documented supervisory review.

Management concurred with the prior audit finding and stated, “Future TAPRs will be prepared by a staff person and reviewed by the Acting Director of Job Service Program Support, prior to submission to the United States Department of Labor.” However, a documented supervisory review was not implemented until after August 2006 due to changes in staff.

States are required to review the accuracy of their TAPR records through data validation software provided by the ETA. This validation is performed annually. The *Employment and Training Administration (ETA) TAA Data Validation Handbook* states:

Data element validation confirms the accuracy of key data elements in the TAPR by examining a sample of participant records to assess whether the data in the sampled records are correct. When a record is selected for validation, state staff compare specified data elements in the TAPR record to source documentation for that participant. . . . Error rates are computed by determining the degree to which the accuracy of selected data elements is supported by evidence in the case files or by other sources (such as wage records).

The Department of Labor and Workforce Development performs an annual data validation on the data reported in the quarterly TAPR files. We reviewed the most recent federally mandated annual data validation for the year ended June 30, 2004, which evaluated 155 cases of participants that exited the program from July 1, 2003, to June 30, 2004. These cases were selected at random by the U.S. Department of Labor. In determining the accuracy of the data used to complete the TAPR, the U.S. Department of Labor tested 17 data elements. These data elements include information such as veteran status, dislocation date, and completion of training. The U.S. Department of Labor considers error rates above 5% to be unacceptable. The error rates for the Department of Labor and Workforce Development’s review ranged from 0% to 74.5%. Specifically, five data elements contained an error rate above 5%. In the prior audit, ten data elements contained an error rate above 5%. Because of the large error rate on the annual

data validation and the computer programming errors, we could not determine the accuracy of the data compiled for the quarterly TAPR files for fiscal year ending June 30, 2006.

Management also stated in its response to last year's finding that it was developing a more integrated system {EMILE} for gathering the necessary information for the report. At that time, management expected to have the project completed by June 2006. The department later decided to use eCMATS (enhanced Consolidated Management and Tracking System), a more cost efficient system. Management expected this project to be completed by July 2006; however, the department did not complete the project until November 1, 2006. As a result, the department will not be able to submit the report to the U.S. Department of Labor using the new system until March 2008.

The U.S. Department of Labor requires the department to submit the *Employment and Training Administration (ETA) 563 Quarterly Determinations, Allowance Activities and Reemployment Services Under the Trade Act* report quarterly. The report lists the quarterly activities of each mass layoff petition that has been filed in the state. The Assistant Director of Unemployment Benefit Operations and Technical Services oversees the submission of the ETA 563 report. Like the TAPR report, we found no evidence that the Assistant Director of Unemployment Benefit Operations and Technical Services reviewed the report before the Statistical Analyst III submitted it to the grantor. We were unable to determine the accuracy of any of the information on the report for the quarter ended June 30, 2006, because of a lack of supporting documentation. In the process of gathering supporting documentation for the report, an Information Systems Consultant discovered errors in the data. We were told by the Assistant Administrator of Employment Security that parts of the ETA 563 report that contained errors were corrected and resubmitted; however, the Assistant Administrator of Employment Security did not provide this documentation by the end of fieldwork.

The lack of effective controls over TAA reporting increases the risk that the department will submit unreliable reports. Without reliable information about program activities, management cannot know if it is achieving the required objectives of the program and the risk of reporting inaccurate information to federal officials is increased.

Recommendation

The Commissioner should instruct the Administrator of the Employment Security Division and the Administrator of Information Technology to work together for the rapid deployment of the new computer application that will be used to prepare the Trade Act Participant Report (TAPR) files and the quarterly *Employment and Training Administration (ETA) 563 Quarterly Determinations, Allowance Activities and Reemployment Services Under the Trade Act* report. The Director of Job Services Program Support should consider performing a data validation of the TAPR each quarter and the Director of Job Services Program Support should ensure that all information is accurate. Until the error rates decline, the Commissioner should instruct the Director of Job Services Program Support to review the report and provide the Administrator of the Employment Security Division with assurance that the Director has reviewed the report and the information is accurate. In addition, the Assistant Director of Unemployment Benefit Operations and Technical Services should perform a documented review

of the quarterly ETA 563 reports prior to submitting the reports to the grantor to reduce the risk that the reports would contain incorrect information.

Management should ensure that other risks are adequately identified and assessed in management's documented risk assessment activities. Management should identify specific staff to be responsible for the design and implementation of internal controls to adequately mitigate those risks and to prevent and detect exceptions timely. Management should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and management should take prompt action should exceptions occur. All controls and control activities, including monitoring, should be adequately documented.

Management's Comment

We concur that some Trade Act Participant Reports (TAPR) and ETA 563 Reports have contained incorrect information.

We appreciate the fact that the auditors recognized steps the department has taken to improve the process that produces the TAPR. As of August 2006, there is a documented supervisory review in place. The 2006 TAPR data validation had fewer significant data element errors than the 2005 TAPR data validation, and the largest of these, 74.5%, was caused by the insertion of zeros in fields that the computer expected to be blank. (As only ones and twos represented valid outcomes—completed training or did not complete training, it did not matter whether a field contained a blank or a zero to indicate that the person was still in training or did not participate in training.) Since November 1, 2006, the TAA program has been running on eCMATS, which will provide a more integrated system for gathering the necessary information for the TAPR.

Regarding the ETA 563, the Assistant Director of Unemployment Benefit Operations and Technical Services explained to the auditors his process for reviewing the report. He reviewed the information on-line and communicated any concerns with Information Technology staff. After corrections are made and the report is verified by an edit check, the report is sent. The Assistant Director reviews the revised report to assure that all problems are corrected. Because most of this communication was electronic, there is little documentation of what occurred.

Employment Security Division staff are working with Information Technology staff to address the programming issues that produce the incorrect information. The ability to address the programming issues is affected by the availability of both monetary and staff resources to apply to these issues and other priorities of the Department.

STATUS OF PRIOR AUDIT FINDINGS

State of Tennessee *Single Audit Report* for the year ended June 30, 2005

The *Single Audit Report* contained two findings pertaining to the Department of Labor and Workforce Development. The updated status of these findings as determined by our audit procedures is described below:

Resolved Audit Finding

The prior audit finding dealing with the purchase of computer equipment for the Unemployment Insurance program has been resolved.

Repeated Audit Finding

The current audit disclosed that the Department of Labor and Workforce Development has not corrected the previous finding concerning the monitoring of federal reports. This finding will be repeated in the *Single Audit Report* for the year ended June 30, 2006.

OBSERVATIONS AND COMMENTS

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

Auditors and management are required to assess the risk of fraud in the operations of the entity. The risk assessment is based on a critical review of operations considering what frauds could be perpetrated in the absence of adequate controls. The auditors' risk assessment is limited to the period during which the audit is conducted and is limited to the transactions that the auditors are able to test during that period. The risk assessment by management is the primary method by which the entity is protected from fraud, waste, and abuse. Since new programs may be established at any time by management or older programs may be discontinued, that assessment is ongoing as part of the daily operations of the entity.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. It is management's responsibility to design, implement, and monitor effective controls in the entity. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditor testing is limited and is usually targeted to test the effectiveness of particular controls. Even if controls appear to be operating effectively during the time of the auditor testing, they may be rendered ineffective the next day by management override or by other circumventions that, if left up to the auditor to detect, will not be noted until

the next audit engagement and then only if the auditor tests the same transactions and controls. Furthermore, since staff may be seeking to avoid auditor criticisms, they may comply with the controls during the period that the auditors are on site and revert to ignoring or disregarding the control after the auditors have left the field.

The risk assessments and the actions of management in designing, implementing, and monitoring the controls should be adequately documented to provide an audit trail both for auditors and for management, in the event that there is a change in management or staff, and to maintain a record of areas that are particularly problematic. The assessment and the controls should be reviewed and approved by the head of the entity.

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit*, promulgated by the American Institute of Certified Public Accountants requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.