

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

Department of Labor and Workforce Development

**For the Year Ended
June 30, 2007**

**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, 2007**

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**Department of Labor and Workforce Development
For the Year Ended June 30, 2007**

EXECUTIVE SUMMARY

FINDING The Assistant Director for Benefit Operations/Unemployment Insurance Technical Support and an Unemployment Program Specialist III did not maintain an audit trail for some federal reports for the Trade Adjustment Assistance program and therefore did not reduce the risk that the reports would contain incorrect information. Also, management has not yet fully corrected the Trade Act Participant Reports data elements, resulting in high error rates for certain data elements in the annual data validation.

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 the State of Tennessee, please see the State of Tennessee *Comprehensive Annual Financial Report* for the year ended June 30, 2007, and the State of Tennessee *Single Audit Report* for the year ended June 30, 2007. 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, 2007, our work at the Department of Labor and Workforce Development focused on the Employment Security Proprietary Fund, a major fund in the *Tennessee Comprehensive Annual Financial Report*. 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 included one major federal program: Trade Adjustment Assistance_Workers. We audited this federally funded program to determine whether the department complied with certain federal requirements and whether the department had an adequate system of internal control over the program 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

April 29, 2008

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
220 French Landing Drive
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, 2007, 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/ajm
08/022



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT

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December 7, 2007

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, 2007. The scope of our work included the Employment Security Proprietary 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 one of 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 this major federal program.

**Major Federal Program Administered by the
Department of Labor and Workforce Development
For the Year Ended June 30, 2007
(in thousands)**

<u>CFDA Number</u>	<u>Program Name</u>	<u>Federal Disbursements</u>
17.245	Trade Adjustment Assistance_Workers	\$32,586

Source: State of Tennessee's Schedule of Expenditures of Federal Awards for the year ended June 30, 2007.

The Honorable John G. Morgan
December 7, 2007
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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 7, 2007, on the State of Tennessee's financial statements for the year ended June 30, 2007. 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 an internal control issue related to the major federal program at the Department of Labor and Workforce Development. The department's administration has responded to the audit finding; we have included the response following the finding. We will follow up the audit to examine the application of the procedures instituted because of the audit finding. 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,

A handwritten signature in black ink that reads "Arthur A. Hayes, Jr." in a cursive style.

Arthur A. Hayes, Jr., CPA
Director

AAH/ajm

FINDING AND RECOMMENDATION

Supervisors did not maintain an audit trail for special federal reports or appropriately review the Trade Act Participant Report, which could result in the reports being materially misstated

Finding

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 provides participants with additional unemployment benefits when training is not practical. When the participants can benefit from training, the local community colleges provide the job skills training. If training is available but not within a normal commuting distance, the program staff will provide a travel and subsistence allowance in accordance with program guidelines. The program also provides participants with a job search allowance and a relocation allowance if needed.

Employment and Training Administration (ETA) 563 and the Alternative Trade Adjustment Assistance Activities Reports

Based on our review and testwork, we found that supervisors did not maintain an audit trail for two federal reports associated with the Trade Adjustment Assistance (TAA) federal program: Employment and Training Administration (ETA) 563, *Quarterly Determinations, Allowance Activities and Employability Services Under the Trade Act*; and the *Alternative Trade Adjustment Assistance Activities Report* (ATAA Activities Report). Management is required to submit these reports in accordance with the special reporting requirements identified in the *Code of Federal Regulations* (CFR), Title 20, Part 617, Section 57; CFR Title 29, Part 97, Section 40; and the Training and Employment Guidance Letter No. 2-03. The ETA 563 details quarterly activities for each mass layoff petition in the state, while the ATAA Activities Report details quarterly activities regarding ATAA participation in the state. We examined the ETA 563 for the quarter ending March 31, 2007, and the ATAA Activities Report for the quarter ending June 30, 2007.

The Assistant Director for Benefit Operations/Unemployment Insurance Technical Support, who is responsible for reviewing the ETA 563 before it is submitted to the United States Department of Labor (USDOL), stated that an audit trail of supporting documentation was not maintained because the USDOL changed the ETA 563 report format. In the past audit periods, the ETA 563 contained petition numbers; however, states are now only required to report a summary of activities. When transitioning to the new ETA 563 report format, the Assistant Director for Benefit Operations/Unemployment Insurance Technical Support compared the ETA 563 for the same quarter using both formats (detailed and summary) to ensure that the new format was reporting the correct amounts. Once the department began using the new format, the department did not maintain the historical information that supported the ETA 563 submitted to the USDOL. Also, the current review performed by the Assistant Director for

Benefit Operations/Unemployment Insurance Technical Support is more analytical in nature, looking for abnormal trends, and not necessarily a review for accuracy.

An Unemployment Program Specialist III is responsible for preparing the ATAA Activities Report, which is a new requirement for this audit period. The information for these reports is generated from Employment Security Combined Online Technology (ESCOT) and enhanced Consolidated Management and Tracking System (eCMATS); however, the information maintained in these systems is current and does not include historical information. Therefore, the department's in-house Information Systems personnel could not generate the historical information to support the report for the audit period.

The *Code of Federal Regulations*, Title 20, Part 617, Section 57(a), states:

Each State agency will make and maintain records pertaining to the administration of the Act as the Secretary requires and will make all such records available for inspection, examination and audit by such Federal officials as the Secretary may designate or as may be required by law. Such recordkeeping will be adequate to support the reporting of TAA activity on reporting form ETA 563

...

In addition, the Employment and Training Administration of the USDOL issued a Training and Employment Guidance Letter No. 2-03 in August 2003 which instructed "that the state maintain a manual or automated benefit history for the ATAA recipient for a period of no less than three years for audit purposes."

On October 30, 2007, in reaction to our current testwork, the department's Administrator of Employment Security sent a request to the Information Systems personnel asking them to maintain an audit trail for these reports. The Employment Security Division IT Director responded that this process would begin on January 4, 2008. We also found as part of our current testwork that management had improved supporting documentation for these reports which will be due for fiscal year ending June 30, 2008.

However, without an adequate audit trail for either report, we could not determine which petitions management had reported in the ETA 563 due March 31, 2007, or which participants that management had reported in the ATAA Activities Report due June 30, 2007. Without reliable documented information about program activities, management is unable to provide evidence to its grantor and/or its external and internal auditors that the department is achieving the required objectives of the program as reported. Furthermore, the risk of reporting inaccurate information to federal officials is increased.

Trade Act Participant Report

Also, as noted in two prior audits, we reported that the department had submitted the Trade Act Participant Report (TAPR) files to the U.S. Department of Labor without any supervisory review and that we could not verify information in the TAPR files.

Management concurred with the prior finding and stated

. . . 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.

See the appendix for management's comments to the finding reported for the year ended June 30, 2005.

States are required to review the accuracy of their Trade Act Participation Report (TAPR) records through data validation software provided by the Employment and Training Administration. The TAPR is submitted quarterly to the U.S. Department of Labor, Employment and Training Administration, and provides information on services and benefits that program participants received and the outcome achieved. Validation of data contained in the quarterly TAPR is performed annually. The *Employment and Training Administration 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).

Our current review found that management is performing supervisory reviews of the TAPR. However, we found that management has not yet been able to fully correct the TAPR data element errors. We reviewed the most recent federally mandated annual data validation (*TAA Data Validation Summary and Analytical Report*). This validation evaluated records of 150 participants that exited the TAA program between July 1, 2004, and June 30, 2005. 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's validation worksheet lists 17 data elements. These data elements include information such as veteran status, dislocation date, and completion of training. The error rates for the Department of Labor and Workforce Development's review ranged from 0% to 82.6%. Specifically, eight data elements contained an error rate above 5%. In the prior audit, the error rates ranged from 0% to 74.5% with five data elements containing an error rate above 5%. The Director of Job Service Program Support stated

that the errors were due to programming errors. For example, the computer was programmed incorrectly to use the “Date of Application” in one data element tested instead of the correct “Date of Program Participation.” In order to address these high error rates, in August 2006 the Director of Job Service Program Support and his staff started examining data elements on a quarterly basis and began transitioning participant information into the enhanced Consolidated Management Activity and Tracking System (eCMATS). According to management, the programming errors noted above were fixed in the transition to the new eCMATS system. In a 2006 letter to the Commissioner of the Department of Labor and Workforce Development from the Employment and Training Administration, ETA stated that they “believe the actions taken by the state will help to ensure complete and accurate participant and outcome data are reported to ETA.”

Although the department has begun corrective action by incorporating the participant reporting into eCMATS, management will not know for sure that corrective action has been successful until they perform the next annual data validation. Because of the large error rates (error rates above 5 %) resulting from the annual data validation, the Employment and Training Administration has not been provided accurate and critical performance data. These data are used to direct incentives and sanctions and to meet ETA’s responsibilities under the Government Performance and Results Act. The next annual data validation must be completed by February 2008.

Recommendation

The Assistant Director for Benefit Operations/Unemployment Insurance Technical Support should maintain an adequate audit trail to support the amounts reported in the ETA 563, *Quarterly Determinations, Allowance Activities and Employability Services Under the Trade Act*, and the Unemployment Program Specialist III should maintain an adequate audit trail to support the amounts reported in the *Alternative Trade Adjustment Assistance Activities Report*. The Administrator for Employment Security should ensure that an adequate audit trail for both reports is maintained. Also, the Administrator for Employment Security should monitor the process being implemented to correct the Trade Act Participant Report to ensure the accuracy of data elements tested in the data validation. Error rates exceeding 5% should be properly investigated.

In addition, the Commissioner should ensure that the management’s risk assessment adequately identified the risk noted above. Management should implement effective controls to ensure compliance with applicable requirements, assign staff to be responsible for ongoing monitoring of the risks and mitigating controls, and take action if deficiencies occur.

Management's Comment

We concur in part.

We concur that we did not maintain an audit trail during fiscal year 2007 that would have allowed the state auditors to determine which petitions management had reported in the ETA 563 due March 31, 2007, or which participants that management had reported in the ATAA Activities Report due June 30, 2007. USDOL does not require this level of detail in these two reports. We complied with USDOL requirements regarding the content, the format, and the deadlines for these two reports. The reports do not affect our funding streams and are not material in our view. USDOL does not require an audit trail.

We do not concur that the audit trail information requested by the auditors is necessary to provide evidence that the department is achieving the required objectives of the program since the ETA 563 and the ATAA reports do not show performance data. However, to assist the auditors, the Administrator for Employment Security requested the Information Technology Division to do the programming necessary to develop the requested audit trail. This information is now stored on a CD for the use of the auditors.

We concur that supervisory reviews have not fully corrected TAPR data element errors. As your report states, most of the data element errors are due to programming errors. The Information Technology Division continues to work to correct these errors. In addition, we continue to believe that the quality of the TAPR will improve as more and more data used in the TAPR is taken from eCMATS. We have already seen improvements this year as the TAA data validation submitted on February 1, 2008, contained only three elements with error rates above 5 percent.

Auditor's Rebuttal

The Office of Management and Budget (OMB) provides a compliance supplement as "an invaluable tool to both Federal agencies and auditors in setting forth the important provisions of Federal Assistance programs. This tool allows Federal agencies to effectively communicate items that they believe are important to the successful management of the program and legislative intent." While management may not view the ETA 563 and the *Alternative Trade Adjustment Assistance Activities Report* as material reports, these reports are specifically listed in the reporting section of the Trade Adjustment Assistance program by the United States Department of Labor (USDOL). In addition, Part III of the compliance supplement suggests that for these types of reports, auditors "trace the data to records that accumulate and summarize data." As stated in the finding, the department did not maintain an audit trail and we were unable to trace the report data as suggested by OMB's compliance supplement. Again, management concurred with the finding that they did not maintain the audit trail.

Also, management states that while the "USDOL does not require this level of detail in these reports," there is an expectation that the department maintain documentation to support information contained in any and all federally required reports. As stated in the finding:

The *Code of Federal Regulations*, Title 20, Part 617, Section 57(a), states:

Each State agency will make and maintain records pertaining to the administration of the Act as the Secretary requires and will make all such records available for inspection, examination and audit by such Federal officials as the Secretary may designate or as may be required by law. Such recordkeeping will be adequate to support the reporting of TAA activity on reporting form ETA 563

...

Although these federal reports may not directly affect funding streams, management is required to submit these reports in accordance with special reporting requirements to the United States Department of Labor. The USDOL uses this information to evaluate the state's performance and project needs, perform comparative analysis, to assist with policy development, and to conduct statutorily required studies.

STATUS OF PRIOR AUDIT FINDINGS

State of Tennessee *Single Audit Report* for the year ended June 30, 2006

The *Single Audit Report* contained one finding pertaining to the Department of Labor and Workforce Development. The updated status of that finding as determined by our audit procedures is described below.

Resolved Portion of the Audit Finding

The prior audit finding dealing with the monitoring of federal reports has been resolved.

Repeated Portion of the Audit Finding

The current audit disclosed that the Department of Labor and Workforce Development had not corrected the previous finding concerning high data validation error rates. This portion of the finding will be repeated in the *Single Audit Report* for the year ended June 30, 2007.

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 auditor's 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 commissioner.

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99 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, and 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 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.

APPENDIX

Previous Responses From Management to Repeated Audit Findings Included in This Report

Current Finding

Supervisors did not maintain an audit trail for special federal reports or appropriately review the Trade Act Participant Report, which could result in the reports being materially misstated

Management's Comment

For the Year Ended June 30, 2005

We concur. The responsibility for preparing the TAPR has been transferred to our Job Service Program Support section. 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. Procedures used to generate the TAPR will be monitored on a continuous basis to assure report accuracy. Results of annual TAA data validation will be used as alerts to correct report deficiencies. EMILE is projected to be implemented in June 2006. That should facilitate increased report accuracy. Then all of the data for the TAPR will be obtained from a single database, rather than from three separate ones, which do not currently interface.