



STATE OF NORTH CAROLINA

EMPLOYMENT SECURITY COMMISSION

STATEWIDE FEDERAL COMPLIANCE AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2008

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

EMPLOYMENT SECURITY COMMISSION
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AUDITOR'S TRANSMITTAL

The Honorable Beverly E. Perdue
Members of the North Carolina General Assembly
Mr. Moses Carey, Jr., Chairman
Employment Security Commission

We have completed certain audit procedures at the Employment Security Commission related to the State of North Carolina reporting entity as presented in the *Single Audit Report* for the year ended June 30, 2008. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

In the *Single Audit Report*, the State Auditor presents the results of tests of internal control and compliance with laws, regulations, contracts, and grants applicable to the State's major federal programs. Our audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards*, issued by the Comptroller General of the United States and the Single Audit Act.

Our audit objective was to render an opinion on the State of North Carolina's administration of major federal programs and not the Commission's administration of major federal programs. However, the report included herein is in relation to our audit scope at the Commission and not to the State of North Carolina as a whole.

The audit findings referenced in the report are also evaluated to determine their impact on the State's internal control and the State's compliance with rules, regulations, contracts, and grants. If determined necessary in accordance with *Government Auditing Standards* or the Single Audit Act, these findings are reported in the State's *Single Audit Report*.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor



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**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133**

Mr. Moses Carey, Jr., Chairman
Employment Security Commission

Compliance

As part of our audit of the State of North Carolina's compliance with the types of requirements described in the *OMB Circular A-133 Compliance Supplement* that are applicable to each of its major programs for the year ended June 30, 2008, we have performed audit procedures at the Employment Security Commission. Our report on the State of North Carolina's compliance with requirements applicable to each major program and on internal control over compliance in accordance with OMB Circular A-133 is included in the State's *Single Audit Report*. Our federal compliance audit scope at the Employment Security Commission included the following:

- Unemployment Insurance
- Employment Service Cluster
- Trade Adjustment Assistance

The audit results described below are in relation to our audit scope at the Commission and not to the State of North Carolina as a whole.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of compliance with those requirements.

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONTINUED)**

The results of our audit procedures at the Employment Security Commission disclosed instances of noncompliance that are required to be reported in accordance with OMB Circular A-133 and which are described in findings 1 and 3 in the Audit Findings and Responses section of this report.

Internal Control Over Compliance

Management is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

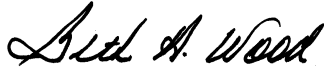
A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in findings 1, 2, 3, 4, and 5 in the Audit Findings and Responses section of this report to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the Audit Findings and Responses section of this report, we consider findings 1 and 3 to be material weaknesses.

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE
IN ACCORDANCE WITH OMB CIRCULAR A-133 (CONCLUDED)**

Management's responses to the findings identified in our audit are included in the Audit Findings and Responses section of this report. We did not audit the responses, and accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, Commissioner Carey, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



Beth A. Wood, CPA
State Auditor

March 4, 2009

AUDIT FINDINGS AND RESPONSES

Matters Related to Federal Compliance Objectives

The following findings and recommendations were identified during the current audit and discuss conditions that represent deficiencies in internal control and/or noncompliance with laws, regulations, contracts or grants.

1. UNEMPLOYMENT INSURANCE PROGRAM REPORTS NOT AGREED TO UNDERLYING DATA

Amounts reported on the Unemployment Insurance program reports did not agree to the underlying data. Controls over data reported on the Unemployment Insurance (UI) federal reports were inadequate to ensure that amounts reported were accurate and complete. Reporting erroneous or incomplete data could affect performance measures or economic statistics determinations. The results of our tests disclosed the following:

- a. *ETA 227 Overpayment Detection and Recovery Activities Report*: We attempted to replicate the information reported on the December 2007 ETA 227 report, but the audit results did not agree to amounts reported. This report provides information on overpayments of claims and the state agency's activities in detection methods. Differences in selected line items are shown below.

		Number of Cases		Dollar Amount	
		Reported	Audit results	Reported	Audit results
Overpayments Established – Causes	Fraud (UI only)	1,253	1,806	\$3,265,529	\$3,068,659
	Nonfraud (UI only)	4,356	4,588	\$2,342,964	\$2,154,872
Overpayments Established – Methods of Detection	Controllable	1,225	1,742	\$3,200,777	\$3,006,038
	Non-controllable	54	101	\$145,437	\$143,306

The Commission did not retain the extract files used to prepare the ETA 227 report and was unable to explain the differences noted above.

Our systems applications review revealed that the programmer is allowed to remove transactions from the database used to generate this report and no audit trail is maintained. This adds to the difficulty in explaining differences on the report. In addition, the edit check over manually entered dates did not function

AUDIT FINDINGS AND RESPONSES (CONTINUED)

properly and some dates were outside the reporting period and the century. As a result, the ETA 227 report may not contain the appropriate data due to incorrect dates.

- b. *ETA 581 Contribution Operations:* The Commission failed to provide the transaction data and the audit of the ETA 581 report could not be performed. This financial report provides information on volume of work, the state agency performance in determining the taxable status of employers and other information pertinent to the overall effectiveness of the tax program. The Commission stated that the transaction data that supports the ETA 581 report is not retained in a manner readily accessible for audit, and current retention methods require significant costs to rebuild the data from backup tapes.
- c. *ETA 2208A Quarterly UI Contingency Report:* There is no review and approval over the preparation of the ETA 2208A Report. The ETA 2208A is a quarterly special report of staff years worked and paid by the UI program. The risk of reporting incorrect information increases when there is no review of the report by someone other than the preparer.

Controls are necessary to ensure that the information system provides complete, accurate, and valid information consistent with the financial reporting requirements. Title 29 CFR Subtitle A, 97.42(b) requires the state agency to retain transaction data for at least three years.

Federal Award Information: Award # UI-16758-08-55-A-37 - Award year 10/01/2007 – 12/31/2010.

Recommendation: The Commission should take appropriate action to ensure data for the federal reports are accurate, complete, and retained in accordance with the federal reporting requirements. Reports should be reviewed to determine that the report is accurate.

Agency's Response: 1a - ETA 227 Overpayment Detection and Recovery Activities Report: ESC will retain ETA 227 transactions for a minimum of 3 years. ESC will write invalid overpayments to a separate file for audit purposes prior to the deletion of such records from the overpayment master file. ESC will review and correct the existing audit trail program. ESC agrees that programmers should not have the authority to alter the data included in the ETA 227 report. Such access or authority is not available to ESC IS staff. ESC will determine the valid date range for manually entered dates and will implement edits to assure that these dates fall within the determined range.

1b - ETA 581 Contribution Operations: While ESC does retain the data necessary for the replication of ETA 581, we agree that the information is not available in a format that makes it easily auditable. ESC IS staff are currently reviewing the requirements for accomplishing this recommendation. The results will be provided to ESC senior management for consideration.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Ic - ETA 2208A Quarterly UI Contingency Report: ESC has implemented a review and approval process of the UI-3 Report effective with the FY2009 1st Quarter report.

2. INADEQUATE CONTROLS OVER FEDERAL REPORTS IN THE TRADE ADJUSTMENT ASSISTANCE PROGRAM

Control weaknesses over data reported in the performance and special reports for the Trade Adjustment Assistance federal program increases the risk that the reports contain inaccurate and incomplete data. The risk of reporting erroneous data could affect performance measures or economic statistics determinations. Weaknesses identified in the systems application review are identified below:

- *Trade Act Participant Report (TAPR)*: Two divisions within the Commission are responsible for producing the underlying data that supports the electronically submitted TAPR. There is no verification or reconciliation of the underlying data to ensure completeness of the data. Failure to perform a reconciliation of data could result in lost or corrupt transactions.
- *ETA 563 Quarterly Determinations, Allowance Activities, and Employability Services Report, and Alternative Trade Adjustment Activities Report (ATAAR)*: The programmer who maintains the program for creating these two reports has direct access to underlying data that supports the federal reports and is responsible for generating the federal reports. Failure to segregate duties could result in manipulation of the underlying data and transactions may be lost or removed.

In addition, there is no verification that the extracted data supports any of these reports and the extract files used to generate the reports are not retained.

Controls are necessary to ensure that the information system provides complete, accurate, and valid information consistent with the financial reporting requirements. In addition, 29 CFR 97.42(b) requires the state agency to retain transaction data for at least three years.

Federal Award Information: Award # TA-16817-08-55-A-37 - Award year 10/01/2007 – 09/30/2010.

Recommendation: The Commission should take appropriate action to ensure data for the performance and special reports are valid, complete, and retained in accordance with the federal reporting requirements.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Agency's Response: Trade Act Participant Report (TAPR): When transmitting the TAPR data to the ESC LMI staff, IS staff will send an e-mail to the designated LMI TAPR staff that will contain the following elements:

1. Record Count
2. File size
3. Report quarter to which the data applies
4. Request for verification by LMI of control totals
5. A reminder to retain both the e-mail and all files for audit purposes

ETA 563 Quarterly Determination Allowance Activities and Employability Services Report, and Alternative Trade Adjustment Activities Report (ATAAR): ESC agrees to implement division of roles and responsibilities where practical and to introduce additional supervisory oversight as compensating control where appropriate.

ESC will create and retain requested extracts of the data for auditing purposes in accordance with federal guidelines.

3. EMPLOYMENT SERVICES PROGRAM REPORTS NOT AGREED TO UNDERLYING DATA

Amounts reported on the Employment Services program reports did not agree to the underlying data. Controls over data reported on these performance reports were inadequate to ensure that amounts reported were accurate and complete. The risk of erroneous reporting due to unreliable data could affect performance measures, or economic statistics determinations.

We attempted to replicate both the federal ETA 9002 *Quarterly Reports* and VETS 200 *Veterans' Employment and Training Services Quarterly Report* for the quarter ended December 2007, however the audit results did not agree to amounts reported. Both the ETA 9002 and VETS 200 are used to report services, activities, and outcomes of services for eligible persons and veterans.

On the ETA 9002D report line item 6, the entered employment rate for total veterans and eligible persons was 53% and the audit result rate was 57%. On the VETS 200C report line item 19, the entered employment following staff assistance services rate for total veterans and eligible persons was 54% and the audit result was 42%. In addition, we were unable to generate any results for key line items regarding the employment retention rate at six months and average earnings.

The programmer has direct access to underlying data that supports the federal reports, maintains the program used to prepare the data input to the federal application, generates the reports, verifies the accuracy of the federal report, and submits it to the federal agency. Failure to segregate duties could result in manipulation of the underlying data and transactions may be lost, removed or corrupt. In addition, other weaknesses for the reports are identified below:

AUDIT FINDINGS AND RESPONSES (CONTINUED)

- The use of record counts to ensure completeness of the file transfer from the mainframe to the secondary system could not be verified. As a result, transactions that should be included in the reporting period could be missing from the population.
- Edit checks over manually entered birth dates of program participants are not sufficient to prevent inaccurate information on the federal reports. As a result, some birth dates were blank, in the future, or outside the century.
- There is no verification that the extracted data supports the ETA 9002D and VETS 200C reports and the extract files used to generate federal report are not retained as required in the federal Data Preparation Handbook. Failure to retain the extract files associated with the reports significantly reduces the auditability of the underlying data.

Controls are necessary to ensure that the information system provides complete, accurate and valid information consistent with the financial reporting requirements. In addition, 29 CFR 97.42(b) requires the state agency to retain transaction data for at least three years.

Federal Award Information: CFDA 17.207-Award #ES-16224-07-5-A-37 – Award year 10/01/2007 – 12/31/2008; CFDA 17.801 & 17.804-Award # E-9-5-8-5060 - Award year 10/01/2007 – 12/31/2008.

Recommendation: The Commission should take appropriate action to ensure data for the performance reports are valid, complete, and retained in accordance with the federal reporting requirements.

Agency's Response: ESC agrees to implement the division of roles and responsibilities where practical and to introduce additional supervisory oversight as a compensating control where appropriate.

As a compensating control, documents will be retained that demonstrate consistency between the mainframe record count and the record count of the processed data.

ESC will determine the valid date range for manually entered dates and will implement edits to assure that these dates fall within the determined range.

ESC will create and retain requested extracts of the data for auditing purposes in accordance with federal guidelines.

4. FEDERAL DEBARMENT STATUS VERIFICATION NOT PERFORMED

The Commission did not verify the federal debarment status for vendors with local office leases prior to awarding the contract. There were 68 local offices with rental expenditures totalling \$1,314,493 charged to the Employment Services Cluster federal

AUDIT FINDINGS AND RESPONSES (CONTINUED)

program. None of the vendors tested were currently debarred and there were no questioned costs.

The Commission did not have controls in place to ensure that covered transactions (contracts and procurements in excess of \$25,000) regarding local office leases were made only to vendors that were eligible to participate in federal programs. Inadequate controls increase the risk that contracts could be made with debarred or suspended parties resulting in questioned costs.

Title 29 CFR Part 98 requires verification for procurement transactions, expected to equal or exceed \$25,000, to ensure that the recipients of federal funds are not suspended or debarred. This verification may be accomplished by checking the Excluded Parties List System maintained by the General Services Administration, collecting a certification from the entity, or adding a clause or condition to the covered transaction with that entity.

Federal Award Information: (Award # ES-14882-07-55 - Award period 07/01/2007 – 06/30/2020)

Recommendation: The Commission should establish and implement procedures to ensure compliance with federal suspension and debarment regulations.

Agency's Response: We currently have approximately 61 different landlords that we lease office space from in various towns and cities across the state. Some of these landlords are local or county government. We took the list of landlords and checked them all to make sure that they were not on the state debarment list or the federal debarment list as of February 23, 2009. Each lease file was documented that debarment status had been checked. All new landlords will be checked for debarment as new leases are acquired. The verification will be documented in the lease file.

5. EQUIPMENT RECORDS NOT IN COMPLIANCE WITH FEDERAL REQUIREMENTS

The Commission's asset management system is incomplete and inaccurate. The risk that items could be lost, stolen, or misappropriated without detection increases when the asset database is not properly maintained. The following issues were identified during the audit:

- The federal or state funding source was not listed for all assets in the asset management database. Thirteen of these items were purchased with Employment Service/Wagner-Peyser funds and valued at \$100,620.
- Assets listed in the asset management data base did not contain correct asset descriptions. Our inspection tests revealed four of 18 asset items with incorrect asset descriptions. A book binding machine and computer were described as a miscellaneous building and a router and fiber optic distribution system were described as a hub.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

Title 29 CFR 97.32 requires property records to be maintained that include a description of the property, the source of property, and percentage of federal participation in the cost of the property.

Federal Award Information: (Award # ES-14882-07-55 - Award period 07/01/2007 – 06/30/2020)

Recommendation: The Commission should strengthen procedures to ensure that the asset description, source, and federal participation cost of the property are properly maintained in the asset management database system.

Agency's Response: We received appropriation codes from Finance & Budget for all assets that were in Magic that did not have any funding source listed. These appropriation codes were entered into Magic for each asset missing these codes. There are currently no assets in Magic that do not have the correct federal or state funding source.

There were four (4) assets found there were entered into the inventory system when it began (mid 1990s) that contained incorrect or generic descriptions. Of these four (4) assets, one (1) was sent to surplus on December 9, 2008. The descriptions on the other three (3) have been updated. In order to update or change descriptions, we had to create a new record in the inventory catalog. This meant that since part numbers were not available to us, we created “dummy” part numbers (i.e. Part No. 2012009 is a Fiber Optic Wiring Distribution System).

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