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Ms. Sharon Moffett-Massey, Director
State of Michigan Department of Licensing and Regulatory Affairs
Unemployment Insurance Agency,
State of Michigan Office of the Auditor General
State of Michigan Office of Financial Management

In planning and performing our audit of the financial statements of the State of Michigan Department of Licensing and Regulatory Affairs, Unemployment Insurance Agency (Agency) – Unemployment Compensation Fund, Contingent Fund, and Obligation Trust Fund (Funds) as of and for the year ended September 30, 2014, in accordance with auditing standards generally accepted in the United States of America, we considered the Funds' internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Funds' internal control. Accordingly, we do not express an opinion on the effectiveness of the Funds' internal control.

A deficiency in internal control 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 and correct misstatements on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected by the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above. However, we identified a deficiency in internal control that we consider to be a significant deficiency as discussed within this letter.

This communication is intended solely for the information and use of management of the Funds, the Office of the Auditor General, the Office of Financial Management, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Andrews Hooper Pavlik PLC

December 5, 2014
Auburn Hills, Michigan

Current Year Recommendations

Significant Deficiency

Federal Program Account Reconciliations

During our review of account balances, we noted that federal program account balances in MiDAS did not reconcile to the actual revenue and expenditure activity that occurred throughout the year. Management investigated the differences and determined that penalties for federal program benefits had been incorrectly recorded in federal program account balances, rather than penalty account balances. In addition, management determined that restitution write-offs recorded during the year erroneously reduced federal revenues and expenditures. The write-off should have impacted receivables and unemployment expenditures. These errors went undetected by management due to the fact that the Agency was not reconciling federal revenue and expenditure accounts throughout the year. We recommend that the Agency implement procedures to reconcile activity in the federal revenue and expenditure accounts on a monthly basis throughout the fiscal year.

Management's Response:

The coding problem with restitution write-offs has been identified. The automated process will be re-configured to accurately account for the federal programs. The accounting section is scheduled to do a full review and reconciliation of all the activity accounts during Fiscal Year 2015.

Other Matters

Experience Rate Reference Material

During our testing, we noted errors in the Experience Rate Calculation reference pages from the LARA website. The reference page for the Chargeable Benefits Component (CBC) states that CBC is calculated by dividing 60 months of benefits paid by 60 months of taxable payroll. However, to properly calculate CBC, 36 months of benefits paid is divided by 36 months of taxable payroll. We also noted that the Nonchargeable Benefits Component (NBC) reference page indicates that employers with no benefit charges for 6 years (72 months) should have an NBC of 0.9%. However, the number should read 0.09%. We recommend that the Agency review and make any necessary corrections to the Experience Rate Calculation reference pages on the LARA website.

Management's Response:

The information on the LARA website regarding the calculation of the CBC will be revised. The Communications area has been notified in regard to the needed update.

Experience Rate Internal Testing

During our testing of the tax department's internal testing of employer's experience rates, we noted that a worksheet used to document the results of one test could not be located. After expanding our sample, it appears that the missing worksheet was an isolated incident. However, we recommend that the Agency review their process for maintaining each year's worksheets and ensure that all documents are maintained in accordance with applicable policies.

Management's Response:

A new procedure has been developed in regard to the annual tax rate testing worksheets that requires the signatures of both the preparer and a reviewer, in addition to a follow-up review by a supervisor. This three-tier review will ensure that all worksheets are accounted for in the future.

<u>Employer Loose Payments</u>

During our testing of employer loose payments, we noted that one payment was classified under the incorrect employer in the MiDAS system. We recommend the Agency to review the controls in place to ensure loose payments are allocated to the correct employer.

Management's Response:

Procedures have been modified directing Chase to process loose payments without employer or FEIN number. These items will result in a MiDAS "Suspense" work item where Agency controls are in place to research the missing employer/FEIN number to ensure lockbox received payments are properly recorded.

<u>Issuance of Form UIA 1107</u>

During our testing of penalties assessed, we noted one instance where Form UIA 1107, Notice of Error in Reported Wages/Taxes, was not sent to an employer after an error was identified on their Form UIA 1028. The employer's Form UIA 1028 was recognized as an amended report by MiDAS because the employer had already submitted an estimated report for that quarter. Per the Agency, Form UIA 1107 is not currently sent when an error is identified on an amended report. We recommend that the Agency make corrections to the MiDAS system so that submissions of Form UIA 1028 are not recognized as amended if an estimated report has been submitted for that quarter. In addition, we recommend that corrections be made to the MiDAS system so that Form UIA 1107 is generated when an amended Form UIA 1028 with an error is submitted.

Management's Response:

An SQR (service request) (#11502) has been opened to generate a Form UIA 1107 for amended reports filed through MIWAM and the Lockbox if there are calculation and/or SSN errors to ensure the employer is warned of imminent penalties.

<u>Penalties Assessed on Employers with Multiple Chargeable Locations</u>

During our testing of penalties assessed, we noted two instances where employers with multiple chargeable locations were assessed incorrect penalty amounts. Penalties assessed incorrectly include negligence, wage report, and non-reporting penalties. We recommend that the Agency review accounts that have multiple chargeable locations for proper calculation and assessment of penalties.

Management's Response:

On a quarterly basis, the Agency will develop a data cube and identify all employers with multiple chargeable locations who have been assessed penalties. Supervision will sample these accounts to determine if the calculation and assessment of penalties is proper.

<u>Manual Adjustments to Employer Accounts</u>

During our testing of penalties assessed, we noted two instances where employers were assessed negligence penalties even though MiDAS indicated that the employer had timely submitted Form UIA 1028, Tax/Wage Report. We noted that the negligence penalty was initially assessed due to an error made by the Agency, which was later corrected. The penalty should have been removed when the error was corrected. We noted these errors were for employers who submitted paper copies of Form UIA 1028. We recommend that the Agency improve documentation of manual adjustments made to employer accounts and for manual adjustments to be reviewed for accuracy and approved before they are posted.

Management's Response:

The Agency has identified an issue where the posting of some amended reports caused the negligence penalty to repost, after the original negligence penalty related to an estimated report was removed. SQR 24324 was opened to resolve this issue. Until this SQR is completed, supervision will sample and review accounts with manual adjustments for accuracy, before the adjustments are posted. Please note that all employers are required to file electronically starting in 2015 and there should be very few instances where paper versions of Form UIA 1028 would be accepted.

<u>Misrepresentation Penalties</u>

During our testing of misrepresentation penalties, we noted several instances where claimants were not charged the correct penalty due to error in the calculation performed by MiDAS. While the errors identified were all insignificant (both individually and in the aggregate), they indicate underlying programming issues within MiDAS that could affect future restitution calculations. We recommend that an internal IT review be performed to identify and correct these issues so that all penalties are calculated correctly and consistently in the future.

Management's Response:

The finding relates to cases in which multiple issues for the same claimant were done on the same day. An SQR will be created to ensure that same day decisions are handled properly.

Overpayment Reference Material

We noted the Overpayment FAQ section of Frequently Asked Questions on the LARA website does not state that any subsequent overpayment due to fraud, after the first fraud occurrence, will have a penalty assessed of four times the amount of the overpayment, regardless of whether the overpayment amount is under or over $500. We recommend that the Agency review and make any necessary corrections to the Overpayments FAQ section of Frequently Asked Questions on the LARA website.

Management's Response:

The Agency will review the FAQs and update the information on the LARA website regarding overpayments.

Inter-Agency Warrant Requests

We noted one instance where an Inter-Agency Warrant Request was not signed by management prior to the initiation of an inter-fund transfer, which is in violation of Agency policy. We recommend that the Agency review controls in place to ensure that all Inter-Agency Warrant Requests are signed and dated by management before transfer are initiated.

Management's Response:

We have noted this and have reviewed our controls. The Agency will review all transfers to insure that all requests are signed and dated by management before transfers are initiated.

Status of Prior Year Recommendations

Control Review of Actiondata, Inc.

We previously recommended that the Agency resume its review of Actiondata, a subcontractor of JP Morgan Chase, on a biannual basis, beginning this fiscal year. The agency determined that it was not necessary to perform a review of Actiondata during the current fiscal year, as their contract with JP Morgan Chase will expire on April 1, 2015. We are in agreement with this assessment. This comment has been adequately resolved and we make no further recommendation in this area.

Management's Response:

No further action required.
Monarch Reporting

We previously recommended that the Agency perform a review of the Monarch and benefit system to determine the cause for the inconsistencies noted and correct any errors. We noted in the current year that the Agency has implemented a new system that successfully eliminated the need for staff to manually enter federal program codes. This comment has been adequately resolved and we make no further recommendation in this area.

Management's Response:

No further action required.

Experience Rate Testing and Documentation

We previously recommended that the Agency implement a policy that establishes the required number or percentage of employers to be tested for experience rate accuracy and document the rationale for this number or percentage. In addition, we recommended that the Agency document and retain documentation for all experience rate testing performed. We noted that the Agency increased both the number of technicians performing testing and the number of tests performed in the current year. This comment has been adequately resolved and we make no further recommendation in this area.

Management's Response:

No further action required.

Non-chargeable Benefits Account Testing

We previously recommended that the Agency establish a review policy that ensures the amounts charged to NBA are properly recorded in the system to reflect the appropriate separation reason and to add notes related to any exceptions outside of the Agency's policy. We noted in the current year that the new system has been implemented and procedures are in place to document any changes within the NBA calculations. The comment has been adequately resolved and we make no further recommendation in this area.

Management's Response:

No further action required.

Receivable and Allowance Accounts

We previously recommended that the receivable and allowance accounts be reviewed by writing off old receivable balances that will most likely not be collected or enforcement procedures be implemented to collect these amounts. We repeat our recommendation in this area.

Management's Response:

Significant progress was made during the year in the area of Employer Receivable, CWC Receivables, and Federal Programs. Additional work is needed in the area of Restitution Receivables. We will review the reserve methodology. In addition, the automated write-off process for restitution receivables will be implemented in Fiscal Year 2015. The automatic write-off process will greatly reduce the uncollectable amounts included in the Restitution Receivables.