

Independent Auditors' Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards*

State of Michigan

Department of Labor and Economic Opportunity,
Unemployment Insurance Agency,
Office of the Auditor General and
State Budget Office

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the State of Michigan, Department of Labor and Economic Opportunity, Unemployment Insurance Agency – Compensation Fund (Fund), as of and for the year ended September 30, 2020, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements, and have issued our report thereon dated March 10, 2021.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Fund's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances 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 Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's 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 *material weakness* is a deficiency, or a 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, on a timely basis. A *significant deficiency* is a deficiency, or a 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. As described below, we did identify certain deficiencies in internal control that we consider to be material weaknesses.

Finding 2020-001: Reconciliation of Bank and General Ledger Accounts

Criteria: A strong system of internal control dictates that all general ledger activity be accurately recorded and available for review on a timely basis. This includes a formal bank reconciliation be prepared and reviewed timely with the appropriate review and sign off as evidence of the completeness, accuracy, and timeliness of the reconciliation. The regular reconciliation and timely review of financial activity during the year reduces the risk that errors, fraud, or misuse of funds could go undetected and/or uncorrected.

Condition: For several months during the fiscal year, management was unable to reliably access general ledger activity. Furthermore, management was unable to record certain benefit payments correctly in the general ledger, which affected reporting of cash; expenses; revenues; due from federal government; and federal, state, and other withholdings for several months throughout the year.

Cause: The implementation of program changes to the Fund's benefit system for new federal benefits, in response to the Coronavirus pandemic, resulted in functionality issues described in the Condition section above.

Effect: Management was unable to reconcile certain bank and general ledger accounts on a timely basis during the year.

Recommendation: We recommend management strengthen internal controls over their procedures for program changes to their information systems such that functionality issues do not limit controls over financial reporting.

Views of Responsible Officials and Planned Corrective Actions: Management agrees the general ledger is a significant internal control and understands the impact a delay in automation corrections has on the reporting of financial activity. The Agency will modify the current process in place for requesting automation services (SQR's), to ensure requests that involve internal controls are identified and given priority status.

Expected completion date is September 30, 2021.

Finding 2020-003: Claim Progression and Eligibility Requirements

Criteria: The federal government set a prescribed claim progression and eligibility requirements for federal programs resulting from the Coronavirus pandemic. If a claimant is eligible for regular unemployment compensation, the claimant is ineligible for receiving benefits under the Pandemic Unemployment Assistance (PUA), Pandemic Emergency Unemployment Compensation (PEUC), or Extended Benefits (EB) programs. In addition, claimants must exhaust all rights to benefits under the previous claim type within the progression to become eligible for the subsequent claim type.

Condition: In certain instances, the benefit system allowed for the payment of benefits under the PUA, PEUC, and EB programs when claimants were eligible for regular unemployment compensation or prior to the exhaustion of the previous claim type within the progression.

Cause: Proper controls were not set within the benefit system to ensure proper eligibility and claim progression.

Effect: Payments of benefits under federal programs have no net effect on the net position of the Fund since the expenditure is offset by a reimbursing federal revenue, whereas payments under regular unemployment compensation reduce the net position of the Fund. Additionally, improper payments of benefits under federal programs create unallowed federal costs.

Recommendation: We recommend that the Agency improve controls in the benefit system to ensure proper eligibility and claim progression.

Views of Responsible Officials and Planned Corrective Actions: The Agency will review the current process in place for testing automation changes to determine the appropriate controls to be implemented.

The review of the SQR process will be completed by September 30, 2021. The implementation of the new controls will be complete by March 31, 2022.

Finding 2020-004: Claimant Eligibility

Criteria: As a condition of federal awards, management of the Fund has agreed to comply with the eligibility requirements described in federal law, regulations, and the provision of grant agreement and contracts, and to also maintain internal control to provide reasonable assurance of compliance within these requirements.

Condition: For several months of the year, management was unable to determine the amount of payments to ineligible claimants, including imposter fraud (identity theft) activity.

Cause: During the Coronavirus pandemic, the Fund experienced an unprecedented level of claims as a result of record levels of unemployment and new federal programs offering extended and additional benefits, including to workers not previously eligible for unemployment insurance. These factors and others, including the addition of third-party contractors, numerous system changes, and program requirements that limited the verification of claimant information, increased the likelihood that the benefits were paid to ineligible claimants and further exposed the Fund to the risk of imposter fraud.

During this same time, management also chose to prioritize the payment of unemployment compensation benefits and limit certain existing internal controls previously used to identify ineligible payments.

Effect: Failure to comply with the eligibility requirements results in noncompliance with the terms of the award.

Recommendation: We recommend that management review policies and procedures for responding to the sudden increase in unemployment claims. If decided, management should document in advance when conditions necessitate limiting certain internal controls and how such actions best balance expedient payment and payment integrity to eligible individuals.

Views of Responsible Officials and Planned Corrective Actions: The Agency's existing policies and procedures, for the most part, did not adequately cover the PUA program - which is not a traditional UI program. For PUA, the Agency was essentially implementing an entirely new unemployment program - in the middle of the pandemic. Although states were expected to utilize current UI systems, several elements that support controls for UI (i.e.: covered wages and employment verification) were not a requirement for PUA. It should also be noted that as all states have struggled with the implementation of this specific non-traditional UI program, guidance has continually been updated changing the program requirements resulting in eligibility having to be reconsidered for affected claimants. Although it would be impossible to plan for a similar scenario in the future, the Agency does intend to identify critical controls in the claims process to ensure existing policies and procedures prevent them from being erroneously impacted by new program changes.

The identification of key controls, and necessary policy updates will be completed by March 31, 2022.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described below.

Finding 2020-002: Offsets of Future Unemployment Compensation Payments

Criteria: Offsets of future unemployment compensation payments to recover prior overpayments are limited to the recovery of the prior overpayment amount in accordance with federal guidance.

Condition: Unapplied offset recoveries attributable to subsequent period adjustments to the original benefit overpayment were used to recover penalties and interest.

Cause: A parameter was not established in the benefit system to prevent the allocation of unapplied recoveries to penalties and interest after overpayment amounts due were satisfied.

Effect: Interest and penalties due under federal and state law were recovered from offsets of unemployment compensation payments.

Recommendation: We recommend that the Agency add a parameter to the automated system to ensure adjustments to benefit offsets are only applied to the recovery of prior overpayment amounts.

Views of Responsible Officials and Planned Corrective Actions: Management agrees with the finding. Although the majority of conditions that originally permitted unapplied offsets to post to penalty and interest have been addressed; an uncommon condition has not yet been resolved. The details of the unapplied recoveries issue were reviewed by Agency Services and SQR 29541 was submitted.

The estimated completion date of the remaining SQR is the end of the 2021 fiscal year.

Findings 2020-03 and 2020-04 are also considered instances of noncompliance or other matters required to be reported under *Government Auditing Standards*.

Fund's Response to Findings

The Fund's response to the findings identified in our audit is described above. The Fund's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Fund's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Andrews Hooper Paulik PLC

Auburn Hills, Michigan
March 10, 2021