



DELAWARE UNEMPLOYMENT COMPENSATION FUND

SPECIAL REPORT
SUPPLEMENT TO THE FY24 ACFR

DELAWARE UNEMPLOYMENT COMPENSATION FUND FISCAL YEAR 2024

Preface

On December 27, 2024, CliftonLarsonAllen, LLP (CLA) issued its opinions on the State of Delaware Annual Comprehensive Financial report (ACFR) for the fiscal year ended June 30, 2024. For the second consecutive year, CLA included a disclaimer of opinion* in its Independent Auditors' Report on the ACFR based on findings* of material weakness* in internal control* for the Delaware Unemployment Compensation Fund (DUCF). The basis for disclaimer of opinions on Business-Type Activities and Unemployment Fund is as follows:

The State's Department of Labor was unable to provide sufficient appropriate audit evidence for the balances and financial activity of the account balances of the unemployment fund. The State's records do not permit us, nor is it practical to extend or apply other auditing procedures, to obtain sufficient appropriate audit evidence to conclude that the account balances and related cash flows in the business-type activities and unemployment fund were free from material misstatement. As a result of these matters we were unable to determine whether further audit adjustments may have been necessary in respect to the unemployment fund account balances, and the elements making up the statement of activities and cash flows.

Similar to Delaware's last ACFR, DOLUI was unable to provide detailed accounting records for the Statements of Net Position, Activities, and Cash Flows* of the DUCF, even though these financial statements are presented in the current ACFR. Consequently, CLA has once again determined that the DUCF is unauditible.

This disclaimer of opinion has been issued following more than a year of efforts by DOLUI, the Division of Accounting (DOA), and external CPA firms, closely monitored by AOA. This multi-agency effort sought to construct missing or incomplete accounting records for FY23 and FY24, institutionalize internal controls, address prior audit findings, and prepare DOLUI for an imminent system modernization. Despite ongoing efforts, as of the release of the FY24 ACFR, progress has been minimal and the work continues.

In addition to the accounting work at DOLUI, the disclaimer follows the internal distribution of a forensic accounting report contracted by the Department of Labor, addressing a theft of funds from the DUCF in 2023. The forensic accounting report reveals extensive and detailed findings of internal control deficiencies that make DOLUI systems vulnerable.

This special report, as an accompaniment to the FY24 ACFR, will offer context on the disclaimer, present a timeline of events at DOLUI since the issuance of the FY23 ACFR on March 20, 2024, summarize the findings of the forensic accounting engagement, and present our recommendations.

The AOA expresses its gratitude to Secretary Karryl Hubbard and the Department of Labor for its unwavering cooperation, dedication, and transparency throughout this process.

**Defined in definitions page at the conclusion of this document*

DELAWARE UNEMPLOYMENT COMPENSATION FUND FISCAL YEAR 2024

Delaware Unemployment Compensation Fund – Background

[Click here to read AOA's Special Report on the Delaware Unemployment Compensation Fund for FY23.](#)

The DUCF is a proprietary fund* containing employer and grant contributions to Delaware's unemployment insurance program. Thousands of Delaware employers contribute to this fund, which pays out unemployment benefits to Delawareans every week. As of June 30, 2024, this fund had cash assets of approximately \$360.5 million. For inclusion in the ACFR, DOLUI works with DOA to compile a trial balance* in accordance with United States Generally Accepted Accounting Principles*.

CLA, the independent contractor hired to complete the audit of the ACFR, issued findings* on the financial reporting of DOLUI for fiscal years 2020, 2021, 2022, and 2023, in addition to the disclaimer of opinion on the DUCF issued in fiscal year 2023. The findings are included in the State of Delaware's Federal Uniform Guidance audit for each year and are classified as either material weaknesses* or significant deficiencies* in internal controls* over financial reporting.

DOLUI has a proprietary fiscal structure in which the systems recording financial transactions in the DUCF are separate from First State Financials, the State of Delaware's accounting software. This structure leaves DOLUI responsible for its own oversight with little transparency to AOA.

The fiscal system used by DOLUI is obsolete and is undergoing a modernization process. This process will require full and accurate accounting records to be transferred from the outdated system to the replacement system. Beginning in 2020, internal controls and accounting practices to create those records within DOLUI broke down. As noted in the FY23 ACFR Report on Internal Control "...audit procedures identified several material misstatements to various accounts and balances that are indicative of systemic accounting and financial reporting deficiencies in internal control, which ultimately led to a disclaimer of opinion over the Unemployment Insurance Trust Fund and Business-type Activities."

Division management failed to train and oversee staff in basic accounting duties like review and approval of journal entries, bank account reconciliations, and data being recorded in relevant systems. These problems created a control environment which was easily overridden and allowed for a theft of funds from the DUCF in early 2023. Separately, the lack of accounting work led to the disclaimer of opinion on the DUCF issued in the FY23 ACFR.

DELAWARE UNEMPLOYMENT COMPENSATION FUND FISCAL YEAR 2024

Accounting Work Timeline

Prior to the issuance of the FY23 ACFR, DOLUI and DOA contracted with CPA firm BDO to create an auditable trial balance for the DUCF. This work, paid for with an initial purchase order of \$500,000 of funds derived from the American Rescue Plan Act, began in December 2023. On March 7, 2024, due to a lack of detail within the trial balance produced by BDO, CLA made its decision to include a disclaimer of opinion on the DUCF. Subsequently, additional funds were allocated to the project, and the purchase order was increased to \$1,270,000.

With AOA auditors on-site to observe, work continued at DOLUI to construct an auditable trial balance for FY23 and prepare internal systems for modernization. BDO completed its second draft of the FY23 trial balance in August 2024. After review, AOA determined that this trial balance was ready for the application of an Agreed-Upon Procedures* (AUP) engagement. The AUP, which is currently ongoing, engagement was meant to establish a baseline of DOLUI's FY23 accounting records for auditability and modernization purposes. The procedures for this engagement were finalized on October 4, 2024, and fieldwork began on October 8, 2024. Early in the engagement, AOA noted a prior period adjustment* of \$54.1 million was made to decrease net position.

Fieldwork for the FY24 ACFR began on September 16, 2024, and DOLUI failed to present auditable records to CLA for the FY24 activity of the DUCF. In November 2024, CLA and AOA reached consensus to once again disclaim an opinion on DOLUI. In December 2024, DOA presented CLA and AOA a FY24 trial balance that included another prior period adjustment of \$19.9 million to increase net position.

Both prior period adjustments were recorded in the FY2024 financial statements for DUCF within the State's ACFR, with the reasoning being the adjustments were made primarily to restate the employer overpayment accounts.

DELAWARE UNEMPLOYMENT COMPENSATION FUND FISCAL YEAR 2024

Forensic Accounting Engagement Timeline

In January 2023, accounting records at DOLUI indicate that an employee overrode internal controls relating to Employers at DOLUI. Subsequently, that employee directed staff to create two fraudulent employer refund checks for \$86,827.31 on January 17, 2023, and \$94,357.37 on March 16.

Between March 31 and April 2, 2023, DOL Human Resources was made aware of the fraudulent checks and placed that employee on Administrative Leave. Subsequently, DOL reported the suspected fraud to the Delaware State Police on April 6, 2023. The State Police conducted an investigation but did not interview the suspected employee due to their passing on April 3, 2023.

In response to the theft, DOL and AOA contracted Public Accounting Firm Belfint Lyons & Shuman P.A., who began fieldwork for a forensic accounting engagement on July 17, 2023. In late 2023, when AOA became aware of the broad problems in internal control at DOLUI, BLS was instructed to pause fieldwork. Fieldwork resumed on April 25, 2024, and BLS presented a draft report to DOL and AOA in December 2024.

The purpose of this forensic accounting engagement was to find any potential additional misappropriations and to identify internal control weaknesses at DOLUI. In order to achieve these objectives, auditors examined activities within DOLUI Employer Contributions Operations in the time period of February 4, 2019, through April 4, 2023.

DELAWARE UNEMPLOYMENT COMPENSATION FUND FISCAL YEAR 2024

Forensic Accounting Engagement Findings

BLS reviewed database records, bank statements, personnel files, emails, supporting documents, and conducted interviews to perform their testing for this engagement. BLS found no evidence of additional misappropriation, but outlined findings of weaknesses in internal control at DOL:

Finding 1 – Human Resources and Contractor Management

Through ineffective management controls, Employee 2 was hired and assigned duties by Employee 1 via a staffing agency.

Finding 2 – Segregation of Duties

Employee 1 inappropriately changed the systems responsibilities of Employee 2 without oversight.

Finding 3 – Override of Internal Controls

Employee 1 overrode internal controls to make changes to an employer's name and address and directed employees to make two fraudulent payments for refunds to that employer.

Finding 4 – Bank Reconciliations

DOLUI did not reconcile its bank accounts in a timely manner, including the bank account from which the initial fraudulent check was disbursed.

Finding 5 – Employer Refund Processing

Unemployment tax refunds to employers did not include sufficient supporting documentation.

Finding 6 – Information Technology Controls

DOLUI internal controls over database access do not provide appropriate control over transaction processing, creating risk of unapproved transactions.

Finding 7 – Unavailable Policies and Procedures

DOLUI documented policies and procedures were inaccessible or unfamiliar to employees, especially newer employees.

DELAWARE UNEMPLOYMENT COMPENSATION FUND FISCAL YEAR 2024

Key Observations

1. In March 2024, AOA issued a special report outlining problems at DOLUI including ineffective internal controls, opaque fiscal systems, a failure to follow established policy by management, and a history of not addressing audit findings. As of December 27, 2024, these issues have not been meaningfully rectified, despite months and millions of dollars in external intervention.
2. As AOA continues its work at DOLUI with the FY24 ACFR and an AUP Engagement, further discrepancies and unsubstantiated records have been discovered. Some of these anomalies are represented in large prior period adjustments in FY24.
3. The internal circulation of a forensic accounting report relating to a theft of funds from the DUCF has revealed even more extensive issues in internal control at DOLUI. This report's findings, if unaddressed, create a roadmap for fraud, waste, and abuse – not only at DOLUI, but potentially in other areas of State government.

DELAWARE UNEMPLOYMENT COMPENSATION FUND FISCAL YEAR 2024

Recommendations

1. AOA recommends that the Corrective Action Plan should be updated so that records can be audited for fiscal years 2023 and 2024 so FY25 can have the statement of net position audited with the statements of activities and cash flows carrying a modified opinion. In AOA's view, this plan must cover areas including, but not limited to:
 - a. Moving forward, all daily accounting reports must match daily employer contributions and benefit payments. All monthly accounting journal entries must be reviewed and entered into an accounting software database. Supporting documents must be filed for all entries, and cumulative receipts and disbursements must be filed so those records are reconcilable and available for audit.
 - b. All information in existing DOLUI databases must be inspected with the assistance of IT specialists. This information must be evaluated for accuracy.
 - c. All banking information and financial activity must be accounted for in detail for fiscal years 2023 and 2024.
 - d. Data for all contributing employers, benefit claimants, and combined wage claims reported in other states should be reviewed for accuracy. Refunds should subsequently be paid out if appropriate.
2. DOLUI should continually foster open and transparent communication channels between it and oversight entities, particularly AOA and DOA to ensure seamless data flow and enhance oversight capabilities.
3. DOLUI should establish robust internal controls as a part of their basic day-to-day operations. DOA should establish a monthly monitoring requirement to ensure accounting work within DOLUI continues.

AOA will continue to identify and evaluate current internal controls over each unit of DOLUI to see how information flows to management. AOA also plans to observe the Corrective Action Plan for the DOLUI DUCF program to determine if the records for fiscal year 2025 are auditable or require another disclaimer of opinion on the ACFR.

The risks associated with a disclaimer opinion on a portion of the State's ACFR are numerous and can have significant implications for various stakeholders. Addressing the underlying issues and improving financial reporting practices is essential to mitigate these risks ensuring credibility and the public's trust.

DEFINITIONS

Agreed-Upon Procedures (AUP) – An engagement where the auditor issues a report of findings based on specific procedures performed on the subject matter.

Annual Comprehensive Financial Report (ACFR) – The financial statements of all State of Delaware funds, departments, organizations, bureaus, boards commissions, elected offices, and legal entities. Refer to 29 Del. C. §2906.

Corrective Action Plan – Management’s official response correcting audit findings.

Disclaimer Of Opinion – A statement issued by independent external auditors saying that they cannot express an opinion on financial statements.

Federal Uniform Guidance – A government-wide framework for grants management that provides an authoritative set of rules and requirements for federal awards.

Findings – Conditions reported from auditors to management which raise concerns about the operations of the entity.

Generally Accepted Accounting Principles – The default accounting standards used by companies and governmental organizations in the United States.

Internal Controls – Policies and procedures governing financial and performance operations.

Journal Entries – Records of transactions, either economic or non-economic, intended for input into a trial balance.

Material Weaknesses – A deficiency or deficiencies in internal controls that greatly increases the likelihood of serious error in a financial statement.

Proprietary Fund – A fund separate from the Delaware General Fund that is reported in a similar fashion to a business operating in the private sector.

Significant Deficiencies – A deficiency or deficiencies in internal controls that slightly increases the likelihood of serious error in a financial statement.

Statements Of Net Position, Activities, And Cash Flows – Basic financial statements that auditors review to express an opinion.

Trial Balance – An internal financial statement listing the account balances of all the general ledger accounts.