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OFFICE OF THE
INSPECTOR GENERAL
PHILADELPHIA, PA

Mr. Michael T. Hill
Regional Inspector General for Audit
Office of Inspector General
The Wanamaker Building
100 Penn Square East, Suite 602-B
Philadelphia, PA 19107

Dear Mr. Hill:

This letter is the State of Wisconsin Department of Workforce Development's (DWD) response to the draft report that your office issued last month that is entitled "Audit of Indirect Costs Charged to Department of Labor Grants Awarded to the Department of Workforce Development for State Fiscal Years Ending June 30, 1998, 1999, and 2000". The report number is 03-02-006-03-315 and it was issued on May 31, 2002.

DWD's response to each of the findings is in the attachment to this letter. Our response to each of the recommendations follows.

Recommendation 1: The cognizant DOL Grant Officer(s) direct DWD to refund the $3,819,850 in unallowable costs questioned in this report, pursuant to OMB Circular A-87, Attachment E, paragraph E.4. (findings 1, 2, 3, and 4).

DWD Response: DWD does not agree with this recommendation (except for a part of finding 3 for the reasons that are documented for each of the findings in the attachment to this letter. DWD agrees to refund to DOL for a portion of the unallowable costs associated with the Applications Database Server cost pool that were allocated to the DOL grant as detailed under finding 3 in the attachment to this letter.

Recommendation 2: The cognizant DOL Grant Officer(s) direct DWD to adjust its billings to DOL grant for FY 2001 and 2002 indirect costs to preclude further overcharges of indirect costs attributed to the findings in this report (findings 1, 2, 3, and 4.

DWD Response: DWD agrees to adjust the portion of the Division of Workforce Excellence (DWE) and the Division of Unemployment Insurance (DUI) Applications Database Server cost pools that are related to ASD services that should have been allocated on a per FTE basis (finding 3). No further adjustments are necessary since the other items in the audit report are in conformance with OMB Circular A-87 as explained in the attachment to this letter.

Recommendation 3: The Assistant Secretary for Employment and Training directs DWD to develop and implement written internal control policies and procedures to ensure that its methodology for charging indirect costs to DOL grants fully complies with the reasonableness, allocability, and allowablility criteria mandated by OBM Circular A-87. (Findings 1, 2, 3, and 4). These internal control policies and procedures should ensure that:

A: DWD Office of Legal Counsel costs are direct-charged to the benefiting cost objectives rather than being included in the General Administration cost pool and allocated to DOL grants on a basis other than "relative benefits received." (Finding 1).

DWD Response: DWD disagrees with this finding. DWD's methodology for allocating the costs associated with the Office of Legal Counsel allocates costs on the basis of relative benefits received and provides for consistent treatment of like costs as detailed in the attachment to this letter.

B: DWD's General Administration pool costs are adjusted annually to actual costs in accordance with OMB Circular A-87, and the implementing guidelines set forth in ASMBC-10 (Finding 1).

DWD Response: DWD does not agree with this finding because DWD General Administration is considered a billed service and DWD is in full compliance with the requirements for billed services that are contained in A-87 as fully explained in the attachment to this letter

C: DWD ASD-Finance cost pool costs are allocated to all projects within DUI through the divisional overhead rate (Finding 2).

DWD Response: DWD does not agree with this audit finding. DUI allocated its ASD-Finance cost pool costs in the DUI division overhead cost pool for all of the years being audited. The allocation methodology was incorrectly stated in DWD's cost allocation plans that will be revised and resubmitted to the appropriate federal agencies.

D: Application/Database Servers cost pool costs are allocated to all projects within DUI and DWE through the divisional overhead rate. (Finding 3).

DWD Response: DWD does not agree with this recommendation as it relates to applications that only benefit DOL grants activities. These applications should continue to be charged 100% to DOL Grants. DWD agrees with the recommendation as it relates to the DUI and DWE share of Administrative Division applications that should be charged through the divisional overhead rate.

E: Costs are not shifted from one project to another to overcome fund deficiencies (Finding 4).

DWD Response: DWD does not agree with this recommendation as it relates to finding 4 because the costs that were shifted to Wagner-Peyser are allowable costs to Wagner-Peyser and this shifting is allowed under OMB Circular A-87 Attachment A, Section C.3.c as detailed in the attachment to this letter.

If you have any questions or concerns regarding our response, please contact Kipp Sonnentag, DWD's Controller, at (608) 266-7272.

Sincerely,

Jennifer Reinert
Secretary

Cc Eric Baker,
Kim Markham,
Larry Studesville,
Kipp Sonnentag,
Tom Smith,
Howard Bernstein,
Ron Hunt,
Ron Thorson,
Maureen Hlavacek,
Mary Rowin,
Bruce Hagen,
Al Jaloviar

Finding 1: General Administration Pool Costs Charged to DOL Grants were overstated.

This finding consists of Part A that relates to the allocation of the costs associated with DWD's Office of Legal Counsel and Part B that relates to adjusting the General Administration cost pool charges to actual costs.

Part A – Office of Legal Counsel

DWD does not agree with this finding. DWD's methodology for allocating the costs associated with the Office of Legal Counsel allocates costs on the basis of relative benefits received and provides for consistent treatment of like costs – the detailed justifications follow.

This finding states in part: "we believe that the amount of legal work that the Office of Legal Counsel staff perform for DUI and DWE clearly demonstrates that FTEs are not an acceptable basis for allocating the Office of Legal Counsel costs to DOL grants on the basis of "relative benefits received", as required by OMB Circular A-87". This statement appears to be based on discussions that the auditors held with legal staff during which the auditors surmised that employees of the Office of Legal Counsel only spend about 5 percent of their time on issues directly related to DUI and DWE programs. According to Howard Bernstein, the head of DWD Legal Counsel, "this finding flatly contradicts my recollection of my discussion with the contract auditor hired by the DOL, in which I stated that the cost allocation estimate was a very fair approximation of the amount of legal work performed by OLC for DWE and DUI during this period". Mr. Berstein believes that the allocation of 38% of legal costs to the DWE/DUI grants is a reasonable reflection of the amount of legal work that was performed for DOL programs. Mr. Bernstein also verified his impression of the amount of work done for DUI and DWE by reviewing the OLC work logs for 1998-2000 that contain over 400 entries. Discarding duplicate entries and minor items, he identified 127 cases, mostly labor representation matters, in which a significant amount of legal work was done on behalf of a DWD program. Of these, 65 involved services for DWE or DUI. While work logs do not reflect all of the legal office staff effort, the data indicates that the overall effort was probably much closer to the 38% actually charged than to the 5% that is quoted in the audit report.

This finding also quotes the following from OMB Circular A-87:

"OMB Circular No. A-87, Attachment A, paragraph C.1.f specifically states that costs must "Be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost if any cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect costs." Similarly, Attachment E, paragraph A.1 states, in part, that "A cost may not be allocated to a Federal award as an indirect cost if any other cost incurred for the same purpose, in like circumstances has been assigned to a Federal award as a direct costs."

The audit report implies that DWD is not following the previous quotes from OMB Circular A-87 because the "DUI has its own staff of attorneys who direct charge their time to the grants on which they work" while the costs associated with the Office of Legal Counsel are allocated through the PR-S General Administration fee. The DUI staff attorneys do not serve the same purpose as the DWD Legal Counsel attorneys. DUI staff attorneys specialize in UI legal and program issues and they do not provide legal services in relation to labor representation and other general management legal issues that are processed by the Office of Legal Counsel (open records law, open meetings law, administrative rules).

The audit report also states that "the implementation guide (ASMB C-10) specifically recommends that legal services be charged/allocated to cost objectives on the basis of "direct hours, (i.e., treated as a direct cost rather than being included in an indirect cost pool)". This is only a recommendation and the implementation guide also states that "any method of distribution can be used which will produce an equitable distribution of cost. In selecting one method over another, consideration should be given to the additional effort required to achieve a greater degree of accuracy."

Part B – Adjusting the General Administration Cost Pool to Actual

DWD does not agree with this finding because DWD General Administration is considered a billed service and DWD is in full compliance with the requirements for billed services that are contained in A-87.

This finding questions the amount that DWD allocated to the DOL grants because the amounts allocated were not adjusted to actual costs. The references from OMB Circular A-87 listed in the audit report do not apply to the methodology that DWD utilizes for the General Administration Cost Pool. This cost pool is a billed service that is provided by DWD. Attachment E (State and Local Indirect Cost Rate Proposals) to OMB Circular A-87, Section F.2 states that:

> "In some cases, governmental units provide and bill for services similar to those covered by central service costs allocation plans (e.g. computer centers). Where this occurs, the governmental unit should be guided by the requirements in Attachment C relating to the development of billing rates and documentation requirements, and should advise the cognizant agency of any billed services. Reviews of these types of services (including reviews of costing/billing methodology, profits or losses, etc.) will be made on a case-by-case basis as warranted by the circumstances involved."

DWD is adhering to the requirements in Attachment C for all of its PR-S cost pools of which General Administration is one. The methodology has also been approved in the Negotiation Agreement between DWD and the US Department of Labor, Office of Cost Determination.

Attachment C, Section G.4 states the following on adjustments to billed central services:

> "Billing rates used to charge Federal awards shall be based on the estimated costs of providing the services, including an estimate of the allocable central service costs. A comparison of the revenue generated by each billed service (including total revenues whether or not billed or collected) to the actual allowable costs of the service will be made at least annually, and an adjustment will be made for the difference between the revenue and the allowable costs. These adjustments will be made through one of the following adjustment methods: (a) a cash refund to the federal Government for the Federal share of the adjustment, (b) credits to the amounts charged to the individual programs, (c) adjustments to future billing rates, or (d) adjustments to allocated central service costs."

DWD adjusts for cash surpluses/deficits by adjusting the next years billing rates that the previous quote from A-87 provides as an option – c) adjustments to future billing rates.

The audit report states that DWD's rate-setting process is "*unnecessarily complex*." The current procedures for setting the billing rates reflect the essential factors needed to accurately adjust the rates for the actual cash balances, the allowable working capital reserve, the estimated activity, and the extent to which each cost pool provides services to other cost pools. Since the current procedures only include essential factors necessary to a valid rate-setting process, no "*unnecessarily complex*" factors are involved. Eliminating any factor from DWD's current rate-setting procedures would only reduce the accuracy and validity of DWD's annual billing rates.

Furthermore as previously stated, DWD's current billing rate-setting methodology has been reviewed and approved by the U.S. Department of Labor, Office of Cost Determination (DOL/OCD). Contrary to the auditor's opinion, the Negotiation Agreement between DWD and DOL/OCD included no recommendation for simplification of DWD's current rate-setting methodology.

The audit report states that "DWD's working capital needs are not relevant to the point at issue in this finding". However, federal regulations indicate that billed central services can include working capital reserves in addition to the full recovery of costs, as specified under the following [OMB A-87, Attachment C, Section G.2.]:

> "*Working Capital Reserves.*"
> *"Internal service funds are dependent upon a reasonable level of working capital reserve to operate from one billing cycle to the next. Charges by an*

internal service activity to provide for the establishment and maintenance of a reasonable level of working capital reserve, in addition to the full recovery of costs, are allowable. A working capital reserve as part of retained earnings of up to 60 days cash expenses for normal operating purposes is considered reasonable. A working capital reserve exceeding 60 days may be approved by the cognizant Federal agency in exceptional cases."

Finding 2: DUI did not allocate its share of the DWD ASD-Finance indirect cost pool to all DUI cost objectives on the basis of relative benefits received.

DWD does not agree with this audit finding. DUI allocated its ASD-Finance cost pool costs in the DUI division overhead cost pool for all of the years being audited. The allocation methodology was incorrectly stated in the DWD's cost allocation plans that will be revised and resubmitted to the appropriate federal agencies.

Finding 3: DUI and DWE did not allocate their share of the DWD Application/Database Servers indirect cost pool to all DUI and DWE cost objectives on the basis of relative benefits received.

Through the Applications/Database Server cost pool, DUI and DWE fund:

- Applications that they directly manage. DWD disagrees that these applications should be allocated on a FTE basis through the division overhead allocation process because they only benefit DOL grants activities and are appropriately 100% funded by DOL Grants.

- Their share of Administrative Division applications. DWD agrees that these applications should be allocated on a FTE basis through the division overhead allocation process.

The specific applications directly managed by each division and funded from the Applications/Database cost pool are provided in the following paragraphs.

Division of Unemployment Insurance. Application and database charges incurred by DUI relate to four areas -- the Oracle database, the Interactive Voice Response (IVR) system, Lotus Notes, and the Internet.

- DUI staff accesses the Oracle database to inquire, update, and create initial and continued unemployment claim information.
- The Interactive Voice Response system is used by unemployment claimants to file initial or continued unemployment claims.
- The Lotus Notes application is used to track state legislation affecting the unemployment insurance program as well as the critical indicators of the unemployment insurance program.

- DUI's charges for the Internet were based on the number of hits made to the Unemployment Insurance website. The website contains general information about the program as well as on-line employer reporting.

Division of Workforce Excellence. In SFY 1998-2000, DWE incurred application and database costs for JobNet and apprenticeship programs:

- The majority of the application and database cost (96 percent of the cost in SFY 1999, for example) is associated with JobNet. JobNet is an Internet application that links employers and job seekers. Using the DOL grant to fund JobNet is consistent with section 7.a.3.D of the Wagner-Peyser Act which states that ninety percent of the sum allotted to each state pursuant to section 6 may be used for developing and providing labor market and occupational information.
- A small portion of the application and development cost is associated with the apprenticeship program. Using the DOL grant to fund the apprenticeship program is consistent with sections 7.a.1 and 7.a.2 of the Wagner-Peyser Act which state that ninety percent of the sum allotted to each state pursuant to section 6 may be used:

  1. For job search and placement services to job seekers including counseling, testing, occupational and labor market information, assessment and referral to employers
  2. For appropriate recruitment services and special technical services for employers.

Finding 4: DWD used manual vouchers to improperly shift cost from a non-DOL program to DOL Grants.

DWD does not agree with this finding. The questioned costs are for information technology upgrades that enhanced the database used to track trainees, employers and training programs and are related to the apprenticeship program. This activity is an allowable charge to Wagner-Peyser per:

> Section 7.a.3.E of the Wagner-Peyser Act which states that ninety percent of the sums allotted to each state pursuant to section 6 may be used for developing a management information system and compiling and analyzing reports therefrom.

The apprenticeship program is an allowable charge to Wagner-Peyser per:

> Sections 7.a.1 and 7.a.2 which state that ninety percent of the sum allotted to each state pursuant to section 6 may be used 1) for job search and placement services to job seekers including counseling, testing, occupational and labor market information, assessment, and referral to employers and 2) for appropriate recruitment services and special technical services for employers.

Since the activities and program covered by these manual vouchers are allowable charges to Wagner-Peyser, the shifting of costs to Wagner-Peyser is allowable under OMB Circular A-87 Attachment A, Section C.3.c which states:

> "Any costs allocable to a particular Federal award or cost objective under the principles provided for in this Circular may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons. However, this prohibition would not preclude governmental units from shifting costs that are allowable under two or more awards in accordance with existing program agreements."

We believe, as the audit report states, that these general principles are also applicable in this particular case even though it involves shifting of costs from a state program to a federal award i.e. this shifting of costs is acceptable because the costs are also allowable under Wagner-Peyser.