APPENDIX D

AGENCY RESPONSE TO DRAFT REPORT

Employment Development Department
EDD
State of California

Arnold Schwarzenegger
Governor

September 1, 2006

Mr. Michael T. Hill
Regional Inspector General for Audit
Office of Inspector General
The Public Ledger Building, Suite 1072
150 S. Independence Mall West
Philadelphia, PA 19106

Dear Mr. Hill:

Please find enclosed the California Employment Development Department (EDD) response to the draft report from the U.S. Department of Labor, Office of Inspector General Audit of Direct Labor Costs Charged to Employment and Training Grants. The EDD appreciates the opportunity to review and address the report findings.

Enclosed are responses to the report findings. If you have any questions, or need additional information, please contact William Dougherty, Chief, Accounting Section, at (916) 654-7311.

Sincerely,

Frank Collins
Deputy Director
Administration Branch

Enclosures

cc: William Dougherty, MIC 70
Hao Q. Lam, MIC 78

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State of California
Employment Development Department (EDD)
Response to the Draft Audit Report of Direct Labor Costs Charged To
Employment and Training Administration (ETA) Grants
Awarded by the U.S. Department of Labor (DOL)
July 1, 2000 to June 30, 2002

DOL Results and Findings: $53.2 million of direct labor costs and $23.5 million in associated costs were not allocated in accordance with Federal cost principles.

DOL audited $462.7 million in direct labor costs that EDD charged to ETA grants for State Fiscal Years (SFYs) 2001 and 2002, and estimated that about $53.2 million of direct labor costs and $23.5 million in associated costs were not allocated in accordance with Federal cost principles. The DOL audit specified that EDD did not have support for the basis it used to allocate the direct labor costs. EDD allocated the costs on an estimated basis and did not adjust the estimated costs to actual costs. DOL found that 127 employees or 18 percent of its sample, used allocation codes based on predetermined percentages to allocate their time in ETA grants. Based on DOL's statistical projection of the sample results, an estimated $76.7 million of labor costs and associated costs charged to ETA grants for SFYs 2001 and 2002 were questioned.

EDD Response: Since the initial occurrence in which allocations were questioned by a California audit agency, the EDD revised our allocation methodologies to ensure compliance with acceptable Federal cost principles as provided in OMB Circular A-87. The EDD completed an Indirect Cost Rate Proposal (ICRP) for the period beginning July 1, 2005 that uses cost pools to allocate actual costs to shared programs in accordance with Federal cost principles. These cost pools eliminated the need for 151 allocation codes that were questioned by DOL as estimated rather than actual costs.

Based on the Office of Inspector General (OIG) recommendations in the draft audit report, EDD reviewed the sampled 127 employees' allocated time that was the basis for the questioned costs and made necessary corrections on the allocation basis to adjust estimated costs to actual costs for the employees' time. The following summary recaps our recalculation of the questioned costs after the allocation base using historical or estimated cost estimates were adjusted to actual costs. These adjustments reflect our current cost pool methodology that was presented to our U.S. Department of Labor Regional Cost Negotiator for the SFY 2005-06.

	DOL Questioned Federal Amounts	EDD Adjustments to Actual Cost Amounts	Difference
FY 2000-01	$43,462,056	$42,207,797	-$1,254,259
FY 2001-02	$33,233,948	$34,654,718	$1,420,770
Total	$76,696,004	$76,862,515	$166,511

- Amount over charged federal programs
+ amount under charged federal programs

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Based on our analysis of the DOL questioned costs, after making the necessary adjustments of estimated costs to actual costs using acceptable Federal allocation standards, EDD appropriately charged the Federal programs and actually shows a slight undercharge of the DOL ETA grants by $166,511 of the $462.7 million total included in the audit period of SFYs 2001 and 2002. During this period EDD also expended state funds to support Federal programs. The amount of state supplemental funding was $44.0 million in SFY 2001 and $39.4 million in SFY 2002, for a total of $83.4 million over the two-year period.

Per audit recommendation no. 1, documentation to support the adjustment from estimated to actual costs concerning the $53.2 million of direct labor costs and $23.5 million in associated costs for SFY 2001 and 2002 was submitted separately to the OIG auditors for review on August 28, 2006. Attachment I provides a summary recap of our analysis for the audit period as recommended by the OIG.

The following sections provide discussion of our analysis of the 127 sampled employees in which DOL stated the allocation codes did not meet Federal cost principles. The questioned Federal costs were compared to our recalculated labor costs for the specific cost pools as recommended by the OIG. The recalculated labor costs are allowable based on use of acceptable Federal allocation cost principles.

California Unemployment Insurance Appeals Board (CUIAB)

In SFY 2001 and 2002, the CUIAB labor costs were not allocated on an unsupported allocation code, but instead were allocated based on actual workload from the previous quarter. We computed what the actual costs would have been if we had utilized the workload for the actual month of the timesheet. The attachment provides the recalculation of costs for the 62 employees included in the DOL sample that represent labor costs associated with CUIAB. Based on the adjustment to the labor costs using actual month workload, the labor costs for the 62 employees for SFY 2001 decreases the Federal amount charged from $115,170 to $113,960 and increases the Federal amount charged for SFY 2002 from $102,705 to $104,740 for a net undercharge of $825. As such, the CUIAB expenditures are allowable based on acceptable Federal allocation standards.

Information Technology (IT) Branch

The questioned IT costs may be grouped into the following five categories from the employees sampled by DOL:

IT Tax Branch Support

Some of the sampled IT Branch personnel performed work that solely benefited the tax programs, and this type of work is defined as Tax Branch support. The IT personnel that performed this work charged a code which split costs in accordance with the EDD tax sharing ratio approved by DOL.

The tax sharing ratio is an equitable distribution of costs to the benefiting programs in EDD and is included in our last approved ICRP. The IT Tax Branch Support labor costs of $23,562 in SFY 2001 and $9,900 in SFY 2002 are allowable based on acceptable Federal allocation standards.

IT Operations Branch Support

The sample included IT Branch personnel whose work benefited the Operations Branch, and this type of work was defined as IT Operations Branch support. During the audit period, the Operations Branch was comprised of Unemployment Insurance (UI) Division and Job Services (JS) Division (since the audit period, the two Divisions have split into separate Branches).

The IT personnel that performed this work charged a code that split costs to the benefiting programs, which were the UI and JS programs, and to State and reimbursable programs. Such an allocation is equitable when compared to Operations Branch benefiting programs. The labor costs of $5,642 in SFY 2001 and $1,370 in SFY 2002 are allowable based on acceptable Federal allocation standards.

IT Projects

Some of the sampled IT Branch personnel worked on specific IT projects. Feasibility Study Reports (FSRs) were completed for these projects that identified the benefiting program. The codes used were set up so that the charges would be directed to the benefiting programs. IT Branch personnel time records identified the specific projects. Examples include: TEAMFS, which captured the charges for the Tax Engineering and Modernization project that benefited the Tax Programs; and PIN100, which captured the charges for the Personal Identification Number project and benefited UI and Disability Insurance (DI) programs.

The specific IT project codes are an appropriate distribution of actual costs to the benefiting programs in EDD. Using this methodology, the labor costs of $5,142 in SFY 2001 and $240 in SFY 2002 is allowable based on acceptable Federal allocation standards.

IT Enterprise

EDD charges costs (personal services, personnel benefits, and non-personal service) to Administrative Staff and Technical (AS&T) to allow distribution of EDD's administrative overhead costs on an enterprise basis to all programs sharing in these costs. AS&T costs are allocated to all programs based on an enterprise percentage of monthly position equivalents (PEs) for each program that reflects the actual benefits to the charging program. The ratio of project code direct PEs to total PEs is calculated automatically by the Cost Accounting System (CAS) and the resulting percentage is used to allocate the total AS&T cost pool. This is allowable based on acceptable Federal allocation standards and deemed an appropriate distribution of enterprise costs.

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Many of the sampled IT personnel performed work that benefited all EDD organizations and programs (e.g., IT policy or infrastructure). This type of work is defined as IT Enterprise. This cost pool follows the same methodology as the AS&T cost allocation. During the audit period, IT staff charged a code that allocated costs to five major EDD programs.

In the recently submitted ICRP for SFY 2005-06, the EDD defined an IT Enterprise Cost Pool to charge these expenditures to all benefiting programs. These costs are allocated to programs based on a statewide percentage of monthly PEs for each program. The ratio of project code direct PEs to total PEs is calculated automatically by the CAS each month. The resulting percentage is used to allocate the total IT Enterprise pool to the project codes.

The labor costs for IT Enterprise were recalculated based on the actual AS&T tables in effect during the audited time period. This resulted in an increase to the Federal program's share of the IT Enterprise costs. The labor costs in the amount of $40,481 for SFY 2001 and $32,920 in SFY 2002 were recalculated as recommended by the OIG and should be $43,035 and $37,520, respectively, as allowed costs using this acceptable Federal allocation standard. As such, Federal programs were undercharged by $7,154.

IT Abstracts

The EDD agrees with the findings for these charges and the labor costs of $3,620 in SFY 2001 should be disallowed.

Other Branches

Administration Branch – The sampled Administration Branch personnel included the following work functions:

- **Admin Mail** – The costs for Administrative Branch staff that worked in the mail facility were recalculated based on actual mail volume. The resulting charges were applied to the benefiting programs. The allocation used was equitable when compared to actual mail volume counts during the audit period (62% to UI, 26% to DI, 12% to overall departmental functions). The labor costs in the amount of $5,052 for SFY 2001 and $1,262 for SFY 2002 were recalculated and should be $4,125 in SFY 2001 and $1,570 in SFY 2002 and allowed as an acceptable Federal allocation standard. As such, Federal programs were overcharged by $205.

- **Admin Forms** – The costs for Administration Branch staff that worked on the production of forms were recalculated based on the AS&T methodology. Forms are seldom associated with a particular program, but rather benefit the entire department. It is appropriate to charge these costs to all programs similar to AS&T methodology. The labor costs of $3,258 for SFY 2001 and $3,173 for SFY 2002 were recalculated and should be $3,022 in SFY 2001 and $3,204 in SFY 2002 and allowed as an

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acceptable Federal allocation standard. As such, Federal programs were overcharged by $619.

Program Review Branch – Staff in the Program Review Branch (PRB) carry out functions that benefit the entire department. It is appropriate for PRB staff to charge these costs to all programs and the actual code used by PRB staff charged distributed costs in a manner similar to an AS&T allocation. The recalculated PRB labor charges of $7,619 in 2001 and $5,180 in 2002 should be allowed as an acceptable Federal allocation standard. As such, Federal programs were undercharged $5,709.

Miscellaneous – The EDD agrees with the findings for these charges and the labor costs of $6,286 in SFY 2001 and $2,369 in SFY 2002 should be disallowed.

Summary Response to DOL Audit Recommendations:

After making the adjustments of estimated costs to actual costs as recommended by the OIG and the clarification of our use of acceptable cost allocation pools to charge costs to all programs the questioned Federal costs are allowable. Based on these adjustments, the EDD internal control policies meet the accepted Federal allocation standards mandated by OMB Circular A-87.

EDD continued the analysis of sampled employees' timesheets for the subsequent year grants for SFYs 2003 through 2005 as recommended by the OIG. The DOL audit sample selected timesheets from 67 employees for SFY 2001 and 60 employees for SFY 2002 that used allocation codes that did not meet the Federal cost principles to allocate their time to ETA projects. EDD followed the 60 employees included in the latter sample to determine if their labor charges for the subsequent years continued to charge costs to an allocated code. There would have been a total of 180 employee records if the 60 employees continued to charge to the questioned allocation codes for the subsequent three year period. Of the original sample, 26 of the employee records were now identified as direct charging their labor costs during this period. An additional 13 employees representing 30 employee records were identified as having left the department. As such, the actual sample resulted in 124 employee records charged to the questioned allocation codes. During this period EDD also expended state funds to support Federal programs. The amount of state supplemental funding was $37.9 million in SFY 2003, $178.6 million in SFY 2004, and $55.3 million for SFY 2005 for a total of $271.8 million over the three-year period.

Per audit recommendation number 2, Attachment II provides our recap of adjustments of estimated costs to actual costs for this audit sample for the grant period. Based on the recalculation of the 124 employee records, EDD undercharged the DOL ETA grants by $68,088 for the SFYs of 2003 through 2005. This audit sample would represent recalculation of an estimated $61.2 million in questioned direct labor costs and $33.6 million in associated costs based on the projection method of labor and associated costs used in the

two year audit sample included in Attachment I. The documentation of the detail analysis was submitted to the OIG auditors for their review on August 31, 2006.

Audit recommendation number 3 requested that EDD submit for approval an allocation methodology for the costs that benefit more than one program or activity to assure its methodology for charging direct labor and associated costs to ETA grants fully complies with the allowability and allocability criteria mandated by OMB Circular A-87. A copy of our allocation methodology was provided to the OIG auditors as requested on August 15, 2006. This allocation methodology is currently under review for approval by our U.S. DOL Regional Cost Negotiator.

In accordance with the OIG recommendations, EDD adjusted five years of sampled employee timesheet data from estimated to actual costs. The comparison of questioned labor costs to the recalculated labor costs showed no net overcharging of the ETA grants for this five year period. Effective July 1, 2005, EDD implemented the use of revised cost pools and allocation procedures that were documented in an updated ICRP. Implementation of these procedures complies with the required OMB Circular A-87 Federal cost principles.

Comparison of Questioned Federal Costs to Recalculated Federal Costs

Attachment I

SAMPLED LABOR COSTS

Sample Type	Employees		Questioned Federal Costs			Recalculated Federal Costs			Federal Cost Difference[1]		
	2000-01	2001-02	2000-01	2001-02	Total	2000-01	2001-02	Total	2000-01	2001-02	Total
CUIAB	29	33	$115,170	$102,705	$217,875	$113,960	$104,740	$218,700	-$1,210	$2,035	$825
IT Tax Br	9	5	$23,562	$9,900	$33,462	$23,562	$9,900	$33,462	$0	$0	$0
IT Operations Br	2	1	$5,642	$1,370	$7,012	$5,642	$1,370	$7,012	$0	$0	$0
IT Projects	3	1	$5,142	$240	$5,382	$5,142	$240	$5,382	$0	$0	$0
IT Enterprise	13	14	$40,481	$32,920	$73,401	$43,035	$37,520	$80,555	$2,554	$4,600	$7,154
IT Abstracts	1	0	$3,620	$0	$3,620	$0	$0	$0	-$3,620	$0	-$3,620
Admin Forms	2	2	$3,258	$3,173	$6,431	$3,022	$3,204	$6,226	-$236	$31	-$205
Admin Mail	3	1	$5,052	$1,262	$6,314	$4,125	$1,570	$5,695	-$927	$308	-$619
Prog Review Br	2	2	$4,018	$3,072	$7,090	$7,619	$5,180	$12,799	$3,601	$2,108	$5,709
Misc (IT & Ops Br)	4	2	$6,286	$2,369	$8,655	$0	$0	$0	-$6,286	-$2,369	-$8,655
Grand Total	**68**[2]	**61**[2]	**$212,231**	**$157,011**	**$369,242**	**$206,107**	**$163,724**	**$369,831**	**-$6,124**	**$6,713**	**$589**

ESTIMATED PROJECTION OF LABOR AND ASSOCIATED COSTS

Type of Projected Costs	Questioned Federal Costs			Recalculated Federal Costs			Federal Cost Difference[1]		
	2000-01	2001-02	Total	2000-01	2001-02	Total	2000-01	2001-02	Total
Salary & Wages	$30,513,581	$22,704,134	$53,217,715	$29,634,064	$23,674,490	$53,308,554	-$879,517	$970,356	$90,839
Personal Benefits	$6,716,026	$5,639,726	$12,355,752	$6,522,457	$5,880,743	$12,403,200	-$193,569	$241,017	$47,448
Operating Expense & Equipment	$3,551,906	$2,832,892	$6,384,798	$3,449,405	$2,954,576	$6,403,981	-$102,501	$121,684	$19,183
Administrative Support & Technical	$2,680,543	$2,057,196	$4,737,739	$2,601,871	$2,144,909	$4,746,780	-$78,672	$87,713	$9,041
Grand Total	**$43,462,056**	**$33,233,948**	**$76,696,004**	**$42,207,797**	**$34,654,718**	**$76,862,515**	**-$1,254,259**	**$1,420,770**	**$166,511**

ESTIMATED CALCULATION RATES TABLE

Type of Projected Costs	2000-01	2001-02	Calculation Method
Salary & Wages	143.78	144.60	Projected Salary & Wages / Questioned Federal Costs
Personal Benefits	22.01%	24.84%	Personal Benefits rate based on average rate for all EDD EE's (pg 16 discuss. draft)
Operating Expense & Equipment	11.64%	12.48%	Projected Operating Expense & Equipment / Projected Salary & Wages
Administrative Support & Technical	8.78%	9.06%	Projected Administrative Support & Technical / Projected Salary & Wages

[1] A positive amount indicates that federal programs were undercharged. A negative amount indicates an overcharge.

[2] The audit sampled 127 employees. The employee total is 129 because OIG Employee #22 and #35 supported both IT Operations Branch and IT Projects.

Comparison of Questioned Federal Costs to Recalculated Federal Costs

Attachment II

SAMPLED LABOR COSTS

Sample Type	Employees			Questioned Federal Costs				Recalculated Federal Costs				Federal Cost Difference[1]			
	2002-03	2003-04	2004-05	2002-03	2003-04	2004-05	Total	2002-03	2003-04	2004-05	Total	2002-03	2003-04	2004-05	Total
CUIAB	28	27	25	$102,899	$104,963	$107,932	$315,794	$104,426	$104,728	$107,169	$316,323	$1,527	-$235	-$763	$529
IT Tax Br	4	3	2	$8,135	$6,043	$2,672	$16,850	$8,135	$6,043	$2,672	$16,850	$0	$0	$0	$0
IT Operations Br	1	0	0	$243	$0	$0	$243	$243	$0	$0	$243	$0	$0	$0	$0
IT Projects	0	0	0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
IT Enterprise	10	11	11	$28,065	$30,759	$29,462	$88,286	$30,026	$31,048	$28,311	$89,385	$1,961	$289	-$1,151	$1,099
IT Abstracts	1	1	1	$269	$344	$304	$917	$0	$0	$0	$0	-$269	-$344	-$304	-$917
Admin Forms	1	0	0	$2,009	$0	$0	$2,009	$1,828	$0	$0	$1,828	-$181	$0	$0	-$181
Admin Mail	0	0	0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Prog Review Br	0	0	0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Misc (IT & Ops Br)	0	0	0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Grand Total	**45**	**42[2]**	**39[2]**	**$141,620**	**$142,109**	**$140,370**	**$424,099**	**$144,658**	**$141,819**	**$138,152**	**$424,629**	**$3,038**	**-$290**	**-$2,218**	**$530**

ESTIMATED PROJECTION OF LABOR AND ASSOCIATED COSTS

Type of Projected Costs	Questioned Federal Costs				Recalculated Federal Costs				Federal Cost Difference[1]			
	2002-03	2003-04	2004-05	Total	2002-03	2003-04	2004-05	Total	2002-03	2003-04	2004-05	Total
Salary & Wages	$20,420,188	$20,490,697	$20,239,950	$61,150,835	$20,858,237	$20,448,882	$19,920,137	$61,227,256	$438,049	-$41,815	-$319,813	$76,421
Personal Benefits	$5,629,846	$6,819,304	$8,304,451	$20,753,601	$5,750,616	$6,805,388	$8,173,232	$20,729,236	$120,770	-$13,916	-$131,219	-$24,365
Operating Expense & Equipment	$2,462,675	$2,471,178	$2,440,938	$7,374,791	$2,515,503	$2,466,135	$2,402,369	$7,384,007	$52,828	-$5,043	-$38,569	$9,216
Administrative Support & Technical	$1,821,481	$1,827,770	$1,805,404	$5,454,655	$1,860,555	$1,824,040	$1,776,876	$5,461,471	$39,074	-$3,730	-$28,528	$6,816
Grand Total	**$30,334,190**	**$31,608,949**	**$32,790,743**	**$94,733,882**	**$30,984,911**	**$31,544,445**	**$32,272,614**	**$94,801,970**	**$650,721**	**-$64,504**	**-$518,129**	**$68,088**

ESTIMATED CALCULATION RATES TABLE

Type of Projected Costs	2002-03	2003-04	2004-05	Calculation Method
Salary & Wages	144.19	144.19	144.19	Average of 2000-01 and 2001-02
Personal Benefits	27.57%	33.28%	41.03%	Published Personnel Benefit Rate
Operating Expense & Equipment	12.06%	12.06%	12.06%	Average of 2000-01 and 2001-02
Administrative Support & Technical	8.92%	8.92%	8.92%	Average of 2000-01 and 2001-02

[1] A positive amount indicates that federal programs were undercharged. A negative amount indicates an overcharge.

[2] The audit sampled 124 employees. The employee total is 126 because Employee #76 and #114 supported both IT Enterprise and IT Abstracts.