HAWAII JOB CORPS CENTER
(Operated by Management & Training Corporation)

INDEPENDENT AUDITORS' REPORT ON

THE SCHEDULE OF JOB CORPS EXPENSES

FOR PROGRAM YEAR ENDED JUNE 30, 2001

This audit report was prepared by R. Navarro & Associates, Inc., under contract to the U.S. Department of Labor, Office of Inspector General, and, by acceptance, it becomes a report of the Office of Inspector General.

/S/

Acting Deputy Inspector General for Audit
U.S. Department of Labor

Report No.: 03-02-003-03-370

Date Issued: March 29, 2002

R. NAVARRO & ASSOCIATES, INC.
Certified Public Accountants

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ACRONYMS

CFR	Code of Federal Regulations
CRA	Construction and Rehabilitation Awards
DOL	U.S. Department of Labor
ETA	U.S. Department of Labor, Employment and Training Administration
GAAP	Generally Accepted Accounting Principles
HJCC	Hawaii Job Corps Center
MTC	Management & Training Corporation
OAP	Outreach, Admissions, and Placement
OIG	Office of Inspector General
PRH	Policy and Requirements Handbook
PY	Program Year

EXECUTIVE SUMMARY

Introduction

We were contracted by the U.S. Department of Labor (DOL), Office of Inspector General, to perform an audit of the Hawaii Job Corps Center's (HJCC) Schedule of Job Corps Expenses for the program year ended June 30, 2001, in order to render an opinion on that schedule and to report on internal control and compliance with laws and regulations in accordance with applicable audit standards.

The HJCC is 1 of over 100 Job Corps centers located throughout the country. These centers are funded and regulated by the DOL, Office of Job Corps, and are designed for purposes of operating the Job Corps program, a residential, educational, and training program which serves at-risk youth. The HJCC is operated by Management & Training Corporation (MTC), under contract with the DOL.

Our audit objective was to obtain reasonable assurance that the Schedule of Job Corps Expenses for program year ended June 30, 2001, was presented fairly in all material respects in accordance with the accounting principles prescribed by the DOL, Office of Job Corps, which is a comprehensive basis of accounting other than generally accepted accounting principles. In accordance with this objective, we also obtained an understanding of management's internal controls and assessed control risk, and performed tests of the HJCC's compliance with certain laws, regulations, and contracts. These procedures were performed as part of obtaining reasonable assurance on the Schedule of Job Corps Expenses, and our objective did not include expressing an opinion on the internal control structure or on overall compliance with laws and regulations.

Audit Results

While our opinion on the Schedule of Job Corps Expenses was unqualified, we noted the following matters that were required to be reported in accordance with the applicable audit standards.

Insurance Reserve Balances

We found that the reserves collected over the years to cover future uninsured losses far exceeded the actual amount paid to claimants and they were not deposited into an interest bearing account or set aside specifically to pay future claims. As of November 2000 the reserve balance was approximately $6.48 million. Additionally, it is our understanding that MTC has not obtained approval from the Office of Job Corps for their self-insurance program as required by the regulations.

Weak Controls Over Construction and Rehabilitation Projects

The HJCC is not exercising sufficient internal controls over its construction and rehabilitation (CRA) projects. Due to the restricted nature and purpose of CRA funding, it is essential that centers exercise controls which ensure that these Federal resources are used for their intended purposes and are properly tracked and documented. Specifically, we found the HJCC: (1) was unable to identify the specific projects approved by the Office of Job Corps for over $300,000 of $1.15 million of its CRA funding; (2) vouchered costs in excess of the approved amount for its Maui dorm project; (3) reported about $32,000 of CRA costs in error as operations expenses; and (4) processed 3 out of 10 CRA invoices for payment without written notations or other form of evidence that the goods or services were received and did not have a purchase requisition for 1 invoice.

Inadequate Accountability Over Inventories

The HJCC did not exercise adequate accountability over its inventories of expendable supplies which are Federal assets. Specifically, we found the inventory records did not include a report which provided the detail and composition of the center's ending inventory balances. Additionally, there were large and unusual fluctuations in 9 of the 12 months evaluated (defined as more than 20 percent variance from the preceding month). The HJCC was unable to explain why there were such large fluctuations throughout the audit period.

Journal Entries Not Reviewed

The HJCC did not ensure that journal entries were consistently approved by someone other than the preparer of the entry prior to being recorded in the general ledger. While the MTC policy requires such an approval, the approval line was left empty on all of the journal entries selected for testing. We discussed this finding with HJCC staff, and were told that while MTC policy required approval of journal entries, the finance manager was relatively new to the center and had not yet found the time to initiate this policy. If there are no review and approval procedures in place, there is a much higher risk that erroneous transactions will be recorded and will not be detected on a routine or timely basis.

Excessive Vacation and Sick Leave Balances

The HJCC was maintaining annual and sick leave balances in excess of allowable corporate limits. According to MTC corporate policy, the maximum amount of unused annual leave which employees can carry over to subsequent years ranges from 80 hours to 200 hours. The maximum unused sick leave which may be carried over is 240 hours. We noted many instances where the unused leave balances exceeded these limits. While the accrued balances noted during our audit are not charged to the contract until paid to employees, the payment of these balances to employees could result in unallowable charges to the Job Corps contract.

Recommendations

We recommend that:

- MTC prepare and submit a written plan to the Office of Job Corps which details the self-insurance policies and practices used in charging insurance costs to their government contracts. The plan should entail all of the required components of 48 CFR 28.308. We also recommend that MTC ensure that future charges for uninsured losses be based on the present value of future payments in accordance with the regulations. In addition, we recommend that MTC set aside the funds in an interest bearing account, whereby the interest will offset the cost of further insurance charges. Finally, MTC should ensure that the existing reserve represent only the present value of future payments and refund any excess balance (the proportionate share) to the Federal Government.

- HJCC implement improved controls over the CRA funding provided to ensure that there is: (1) adequate accountability over the CRA funds awarded; (2) adequate tracking and monitoring for timely completion; (3) advanced approval of redirected funds prior to expenditure of such funds for an alternative project; and (4) improved procedures for documenting receipt of goods or services prior to payment. In addition, we recommend that the HJCC adjust its ETA 2110 report to reflect accurate CRA and operations' costs. As of June 30, 2001, the necessary adjustment was $31,980.

- Complete perpetual inventory records are maintained which provide sufficient detail (description, quantity, and value) of the items held in inventory at the end of each reporting period. The balances reflected on the report should support the inventory balances reported on the Job Corps Contract Center Financial Report ETA 2110. We also recommend that HJCC take greater care in maintaining inventory records and in reporting these items on the ETA 2110 to ensure that the reports are accurate, complete, and up to date.

- HJCC initiates procedures which require that journal entries be reviewed and approved by someone other than the preparer. This process should be documented by initialing and dating the appropriate line on the journal entry form.

- MTC reviews the leave balances for HJCC staff and determine whether a portion of these balances should be forfeited by the respective employees. We also recommend that MTC ensures that the policies applicable to the HJCC are clarified and, if unique to the HJCC, put into writing and reissued to all HJCC staff.

Auditee's Response

In its response to our draft report, the auditee generally concurred with all of the recommendations described above, with the exception of those related to the insurance reserve accounts. They believe that the current self-insurance practices are in accordance with the cost accounting standards, and that the reserve balance is not excessive based on their estimate of future insurance losses.

We have incorporated the auditee's detailed comments at the end of each finding, as appropriate. In addition, a copy of the auditee's written response is included, in its entirety, as an appendix to this report.

Auditor's Conclusion

With the exception of the insurance reserve account, we agree with the corrective actions described in the auditee's response and consider all but one recommendation resolved.

As to the insurance reserves, we hold to our conclusion that the current reserve account balance significantly exceeds the actual payments made in any given year since inception of the reserves, and that the reserve funds should have been set aside for payment of insurance claims rather than consumed in the contractors operations. This recommendation is unresolved and will be addressed in ETA's formal resolution process.

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INDEPENDENT AUDITORS' REPORT ON THE SCHEDULE OF JOB CORPS EXPENSES

We have audited the accompanying Schedule of Job Corps Expenses of the Hawaii Job Corps Center (HJCC), for the program year ended June 30, 2001. This schedule is the responsibility of the Job Corps Center's management. Our responsibility is to express an opinion on this schedule based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards; and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance that the schedule of expenses is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the schedule of expenses. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the schedule of expenses. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the Schedule of Job Corps Expenses was prepared in conformity with the accounting practices prescribed by the DOL, Office of Job Corps, in the *Job Corps Policy and Requirements Handbook*, Chapter 9, "Financial Management," which is a comprehensive basis of accounting other than generally accepted accounting principles. Allowable costs are established by Federal regulations.

In our opinion, the Schedule of Job Corps Expenses presents fairly, in all material respects, the expenses of the HJCC for the program year ended June 30, 2001, in conformity with the accounting principles described in Note 1.

As described in Note 2, the Schedule of Job Corps Expenses includes indirect costs which have been charged to the Job Corps contract in accordance with provisional indirect cost rates negotiated with the DOL. The amount charged as indirect costs is subject to future adjustment when final rates are issued by DOL.

Our audit was conducted for the purpose of forming an opinion on the Schedule of Job Corps Expenses taken as a whole. The supplemental information presented on page 6 of this report is presented for the purposes of additional analysis and is not a required part of the schedule of expenses. Such information has not been subjected to the auditing procedures applied in the audit of the schedule of expenses, and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued reports dated October 25, 2001, on our consideration of HJCC's internal control structure and on our tests of its compliance with certain provisions of laws, regulations, and contracts. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

This report is intended solely for the information and use of the HJCC's management, and DOL, Office of Inspector General and Office of Job Corps, and is not intended to be and should not be used by anyone other than these specified parties.

San Diego, California
October 25, 2001

HAWAII JOB CORPS CENTER
Schedule of Job Corps Expenses

Program Year Ended June 30, 2001

Education personnel expense	$ 788,299
Other education expense	59,757
Vocational training personnel expense	642,746
Other vocational training expense	176,161
Social skills personnel expense	1,632,105
Other social skills expense	78,786
Food expense	506,498
Clothing expense	158,930
Support service personnel expense	513,241
Other support services expense	136,263
Medical & dental personnel expense	489,379
Other medical & dental expense	120,977
Administrative personnel expense	1,177,283
Other administrative expense	239,942
Indirect administrative expense (Note 2)	503,327
Facilities maintenance personnel expense	209,274
Other facilities maintenance expense	236,369
Security personnel expense	495,400
Other security expense	17,115
Communications expense	87,537
Utilities & fuel expense	276,645
Insurance expense	51,295
Motor vehicle expense	43,863
Travel & training expense	208,174
Construction & rehabilitation expense (Note 1g)	729,506
Equipment & furniture expense (Note 1g)	85,606
GSA vehicle rental expense	83,733
Vocational Skills Training expense (Note 1g)	26,853
Student transportation & meal allowance	1,386
Outreach, screening, & placement	511,556
Total expenses before Contractor's fee	**$10,288,006**
Contractor's fee (Note 3)	**$425,962**
Total Expenses	**$10,713,968**

See accompanying notes to the Schedule of Job Corps Expenses.

HAWAII JOB CORPS CENTER

Notes to the Schedule of Job Corps Expenses (Continued)
Program Year Ended June 30, 2001

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Nature of Operations

The HJCC is 1 of over 100 Job Corps centers located throughout the country. These centers are funded and regulated by the DOL, Office of Job Corps and are designed for purposes of operating the Job Corps program, a residential, educational and training program which serves at-risk youth. Job Corps offers GED or high school equivalency programs and training in various vocational offerings, as well as a variety of supportive services. The primary offerings at the HJCC are: business clerical, culinary arts, retail sales, auto repair technician, building and apartment maintenance, desktop publishing, word processing and horticulture. The HJCC is located in Waimanalo, Hawaii, and is operated by Management & Training Corporation (MTC), under contract with the DOL.

b. Basis of Accounting

This Schedule of Job Corps Expenses has been prepared in accordance with the accounting practices prescribed by the Office of Job Corps, as set forth in the *Policy and Requirements Handbook* (PRH), Chapter 9, "Financial Management." For the most part, the PRH prescribes the accrual basis of accounting, with certain exceptions which are further described in this report.

c. Cost Categories

The PRH has defined 33 separate cost categories which are used for accounting and reporting purposes. These include 29 categories for operating costs, and 4 for capital expenditures such as construction and equipment costs. Costs and other contract information are reported monthly to the Office of Job Corps on ETA 2110 Report.

d. Use of Estimates

In conformity with the accounting practices previously identified, the preparation of Schedule of Job Corps Expenses requires management to make estimates and assumptions that effect certain reported amounts and disclosures. Accordingly, actual amounts could differ from those estimates.

Notes to the Schedule of Job Corps Expenses (Continued)
Program Year Ended June 30, 2001

e. Accrued Leave

Earned but unpaid leave (vacation and sick leave) is recorded as an expense when paid, rather than at the time it is earned by HJCC employees. Therefore, the salaries and wages expenses included on the Schedule of Job Corps Expenses do not include an accrual for leave earned but not yet taken as of June 30, 2001.

f. Inventories

The HJCC maintains inventories of certain operating supplies, including clothing, food, medical and dental, fuel, and other supplies. Purchases of inventoried supplies are recorded to an inventory account when received, and are charged to expense at the time of issue. Inventories are accounted for using average unit pricing.

g. Property and Equipment

Property and equipment purchased with Job Corps funds is considered property of the DOL. Costs of such property are not capitalized for reporting purposes, but are charged to expense in the period when incurred. The property and equipment items reflected on the Schedule of Job Corps Expenses include costs classified as: construction and rehabilitation, equipment and furniture, and vocational skills training.

NOTE 2. INDIRECT ADMINISTRATIVE EXPENSE

The HJCC operator, MTC, negotiated and obtained provisional indirect cost rates of 6.29 percent and 6.02 percent for the years ended December 31, 2001, and 2000, respectively. These provisional rates were awarded by the DOL, the Federal cognizant agency, and are subject to adjustment in future periods when the final rates are determined. The total indirect costs reflected on the Schedule of Job Corps expenses for the program year ended June 30, 2001, was $503,327.

NOTE 3. CONTRACTOR'S FEE

The operating contract for the HJCC includes an annual fee (i.e., provision for contractor's profit) of $433,000 and $421,000 for the contract years ended January 31, 2002, and 2001, respectively. The annual fee is divided evenly over each respective 12-month contract period, and recorded as expense on a monthly basis. The total contractor's fee for the program year ended June 30, 2001, as reflected on the Schedule of Job Corps Expenses was $425,962.

HAWAII JOB CORPS CENTER
Supplemental Information

Reconciliation of Job Corps Contract Center Financial Report, ETA 2110 to the Schedule of Job Corps Expenses

Program Year Ended June 30, 2001
Unaudited

	Total Costs (Unaudited)
Total Contract Year-to-Date Costs Reported per ETA 2110 as of January 31, 2001	$10,237,636
Less: Contract Year-to-Date Costs Reported per ETA 2110 as of June 30, 2000	(4,224,317)
Reported Costs per ETA 2110, July 2000, to January 2001	$ 6,013,319
Add: Total Contract Year-to-Date Costs Reported per ETA 2110 as of June 30, 2001	4,700,649
Total Costs Reported per ETA 2110 July 1, 2000, to June 30, 2001	$10,713,968
Total Costs per Schedule of Job Corps Expenses, page 3	$10,713,968

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REPORT ON INTERNAL CONTROL STRUCTURE

We have audited the Schedule of Job Corps Expenses of the Hawaii Job Corps Center (HJCC), for the program year ended June 30, 2001, and have issued our report thereon dated October 25, 2001.

We conducted our audit in accordance with U.S. generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Schedule of Job Corps Expenses is free of material misstatement.

The management of HJCC is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of Schedule of Job Corps Expenses in accordance with the accounting practices prescribed by the U.S. Department of Labor, Office of Job Corps. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the Schedule of Job Corps Expenses of HJCC for the program year ended June 30, 2001, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the Schedule of Job Corps Expenses and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal controls structure that, in our judgement, could adversely affect the organization's ability to record, process, summarize, and report financial data in a manner that is consistent with the assertions of management in the Schedule of Job Corps Expenses. Reportable conditions are described in the Findings and Recommendations section of this report as items 2. through 5.

A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the Schedule of Job Corps Expenses being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe that none of the reportable conditions described above is a material weakness.

This report is intended for the information of the U.S. Department of Labor, Office of Inspector General and Office of Job Corps, and the HJCC's management.

San Diego, California
October 25, 2001

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REPORT ON COMPLIANCE WITH LAWS, REGULATIONS, AND CONTRACTS

We have audited the Schedule of Job Corps Expenses of the Hawaii Job Corps Center (HJCC) for the program year ended June 30, 2001, and have issued our report thereon dated October 25, 2001.

We conducted our audit in accordance with U.S. generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Schedule of Job Corps Expenses is free of material misstatement.

Compliance with laws, regulations, and contracts applicable to HJCC is the responsibility of HJCC's management. As part of obtaining reasonable assurance about whether the Schedule of Job Corps Expenses is free of material misstatement, we performed tests of HJCC's compliance with certain provisions of laws, regulations, and contracts. However, the objective of our audit of the Schedule of Job Corps Expenses was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed certain instances of noncompliance that are required to be reported under *Government Auditing Standards*. These instances of noncompliance are included in the Findings and Recommendations section of this report as items 1 and 2.

We considered these instances of noncompliance in forming our opinion on whether HJCC's Schedule of Job Corps Expenses are presented fairly, in all material respects, in conformity with the accounting principles described in Note 1. This report does not affect our report dated October 25, 2001, on that schedule.

This report is intended for the information of the U.S. Department of Labor, Office of Inspector General and Office of Job Corps, and the HJCC's management.

San Diego, California
October 25, 2001

FINDINGS AND RECOMMENDATIONS

1. Insurance Reserve Balances

MTC acquires various types of insurance for its Job Corps centers and other corporate operations in combined policies. The insurance policy for workers compensation and auto liability have self-insured deductibles of up to $100,000 per incident. According to MTC, this practice allows them to acquire insurance at a very reasonable price. Annual insurance charges to the individual Job Corps centers and other operations include actual charges for the policy premiums, as well as an estimated amount for potential losses arising from the self-insured deductibles. The projection of potential uninsured losses is provided by the insurance company, and according to MTC, is based on their actual loss experience and anticipated conditions in accordance with accepted actuarial principles described at 48 CFR 9904.416-50. MTC makes an annual addition to the reserve balance equal to the amount calculated by the insurance company plus a reserve of 10 percent.

The estimated portion of insurance charges collected from the various cost centers to cover future uninsured losses is retained by MTC as a reserve balance. The majority of the reserve balance is related to workers compensation losses. These reserves have accumulated over the past several years as follows:

Year	Reserves Collected	Actual Payments	Cumulative Ending Balances
Prior			$ 883,500
1993	$ 1,200,000	$ 406,357	1,677,143
1994	1,255,322	618,898	2,313,567
1995	1,912,474	846,270	3,379,771
1996	2,245,654	752,268	4,873,157
1997	1,973,829	1,319,316	5,527,670
1998	1,980,733	1,626,693	5,881,710
1999	1,859,000	2,013,858	5,726,852
2000*	2,568,500	1,815,648	6,479,704
Total	**$14,995,512**	**$9,399,308**	

*Data provided through November 2000.

With the exception of 1999, the data above reflects the reserves collected in a given year for projected uninsured losses far exceed the actual amount paid to claimants during that year. As a result, the reserve balance has increased by over $5.5 million since 1992. This increase is due to claims that occur in a particular year that may not be filed, settled and/or paid for many more years. MTC's methodology is to provide a reserve for the projected loss associated with actual claims filed and projected to be filed.

An analysis of the reserve balance as of November 2000 reflects $6.48 million which represents cash collected to date, from Job Corps and other operations, to pay uninsured losses (known and estimated) for the following years:

Year of Loss	**Balance Remaining in Reserves**
Prior	$ .31 million
1994	.55 million
1995	.37 million
1996	.50 million
1997	.45 million
1998	.66 million
1999	1.07 million
2000	2.57 million
Total	**$6.48 million**

We conclude that the $6.48 million collected for insurance reserves significantly exceeds the amount paid out annually since inception of the self insurance program. The most that the contractor has had to pay out in any one year is $2.0 million, or 31% of the current reserve balance. The cost accounting standards and cost principles allow contractors to charge Federal contracts for estimated self-insured losses, such as those charged by MTC. However, the regulations require that if the liability will not be paid within 1 year after the loss is incurred, the amount collected for the loss must be computed as the present value of future payments using a specified rate of interest. This practice ensures that the Federal government does not lose interest on cash transferred to a contractor for payment of future amounts, and prevents excessive accumulation of the reserve balance. The regulations state the following:

> If a loss has been incurred and the amount of the liability to a claimant is fixed or reasonably certain, but actual payment of the liability will not take place for more than 1 year after the loss is incurred, the amount of the loss to be recognized currently shall be the present value of the future payments, determined by using a discount rate equal to the interest rate as determined by the Secretary of the Treasury . . . in effect at the time the loss is recognized. Alternatively, where settlement will consist of a series of payments over an indefinite time period, as in workmen's compensation, the contractor may follow a consistent policy of recognizing only the actual amounts paid in the period of payment. 48 CFR 9904.416-50(a)(3)(ii)

It is not clear from the data provided by the contractor whether or not the annual addition to the insurance reserves is based on the present value of projected future losses. In addition, while the reserve was established for future payment of uninsured losses, the cash collected from Job Corps and other operations has not been designated or set aside for this specific purpose, and has not been deposited into interest bearing accounts. Rather, the cash was deposited into MTC's operating accounts and used by them to meet other obligations. We noted that the December 31, 2000, financial statements of MTC did not reflect a positive cash balance.

Finally, it is our understanding that MTC has not obtained approval from the Office of Job Corps for their self-insurance program, as required by the following regulations:

> When it is anticipated that 50 percent or more of the self-insurance costs to be incurred at a segment (see 31.001) of a contractor's business will be allocable to negotiated Government contracts, and the self-insurance costs at the segment for the contractor's fiscal year are expected to be $200,000 or more, the contractor shall submit, in writing, information on its proposed self-insurance program to the administrative contracting officer and obtain that official's approval of the program. The submission . . . shall include– (1) a complete description of the program . . . ,(5) any self-insurance feasibility studies or insurance market surveys . . . , (7) a formula for establishing reserves, including percentage variations between losses paid and losses reserved. . . . 48 CFR 28.308
>
> Self-insurance includes the deductible portion of purchased insurance. 48 CFR 9904.416-30(a)(4)

Recommendations

a. We recommend that MTC prepare and submit a written plan to the Office of Job Corps which details the self-insurance policies and practices used in charging insurance costs to its government contracts. The plan should entail all of the required components of 48 CFR 28.308.

b. We recommend that MTC ensure that future charges for uninsured losses be based on the present value of future payments, in accordance with the regulations. We recommend that MTC set aside the funds in an interest bearing account, whereby the interest will offset the cost of further insurance charges. In addition, MTC should ensure that the existing reserves present value of the future payments against the existing reserve and refund any excess balance (the proportionate share) to the Federal Government.

Auditee's Response

With respect to recommendation a., the contractor concurred with the recommendation but provided the following comments:

> In the early 1980's, after MTC was formed and started business, management at that time asked the Office of Job Corps how to handle several administrative matters which should have been reviewed and approved by a government

> Administrative Contracting Officer (ACO). Unfortunately, we cannot find any written correspondence on this matter that far back in time, but at least one individual who was involved remembers that MTC was concerned about governmental approval of fringe benefits, invoices, etc. At that time, we were told that Job Corps did not use ACO's and that we were to provide a brief description of these policies or plans in our Business Management Proposals in response to Job Corps Request for Proposals. If we were the selected bidder/contractor and awarded the contract, then our policies and plans were approved as described in our proposals. We have continued to use that practice ever since that time, and this is the first time that this practice has ever been questioned.

With respect to recommendation b., the contractor disagreed with the recommendation, stating that they believe current insurance reserve policies are in accordance with the regulations, and that the present value requirements do not apply to their reserves since the "amount of these claims is neither fixed nor reasonably certain". They made the following key points:

> Once a claim has been filed, it may take a number of years to determine the appropriate treatment, and then an additional number of years to ultimately make payment on said claim.
>
> Additionally, future payment of claims almost always includes a consideration for inflation, higher medical costs, increased attorney fees, and other miscellaneous expenses making a value calculated in today's dollars totally inaccurate for future payments.
>
> However, settlement does consist of a series of payments over an indefinite time period and MTC has consistently followed an established policy of having the insurance company estimate the yearly reserves based on MTC's experience, relevant industry experience, and anticipated conditions in accordance with accepted actuarial principles.
>
> Based on the above, we believe we are in accordance with the regulation. However, we are working with our insurance carrier and broker to determine if there is an acceptable way to determine a present value of such claims and will make any appropriate changes in our reserving practices.
>
> MTC's yearly estimated reserve amount booked is significantly lower that if insurance was purchased for the self-insured risk.

Auditor's Conclusion

With respect to recommendation a., we consider this issue to be resolved subject to MTC's submission of their self insurance plan, with all of the required information, to the Office of Job Corps. As to the contractors comments regarding their proposals, we wish to note that neither the Hawaii Job Corps Center proposal or the operating contract mentioned MTC's self insurance program.

With respect to our other recommendations, the contractor first contends that the liability for insurance claims is not fixed or reasonably certain, stating that it can take years for a claim to be filed, settled, and paid, and therefore, the present value requirements of the cost accounting standards do not apply. However, we do not concur that the entire reserve balance is related to claims for which the amount of the liability is not reasonably certain. This would assume that none of the claims have been settled (or the amount of the settlement can not be reasonably estimated) as of December 31, 2000. In addition, according to the contractor, the related liability was recorded on MTC's audited financial statements which were prepared in accordance with generally accepted accounting principles (GAAP). This being the case, the amount of the liability would have to be reasonably certain in order to be recorded in accordance with GAAP.

The contractor also claims that the costs paid for insurance is significantly lower that it would be if insurance was purchased. We were not provided with any information regarding the basis for this statement, however, feasibility studies or insurance market surveys are part of the required information when submitting the plan for approval. We encourage MTC to provide this data when the self insurance plan is submitted to DOL for approval (see recommendation a.).

As to the contractor's statement that "settlement does consist of a series of payments over an indefinite time period", the cost accounting standards (48 CFR 9904.416-50) provide for such cases by allowing contractors to recognize only the actual amounts paid in the period of payment.

We conclude that the contractor's response does not provide sufficient justification as to why the reserve of $6.5 million is reasonable or necessary, and does not address the fact that the entire reserve balance has been spent for other purposes. Our finding is based on the fact that the $6.5 million in the reserve account far exceeds the annual claims paid by the contractor since inception of the reserve in 1992. The most that the contractor has ever had to pay out in one year was $2 million or 30% of the reserve balance. The average reserve balance since 1996 has been over $5 million. In addition, we question the need for reserves of $6.5 million since the contractor has not in fact reserved the funds for payment of future insurance claims. Had the funds been truly reserved and held in interest bearing accounts, insurance charges to government contracts could have been offset by the amount of interest earned on the cash balances on hand. Using simple interest calculations, the contractor would have earned about $2 million in interest over the last eight years. Instead, the contractor spent the funds for other unrelated purposes. We do not believe that these practices are within the intent of the self-insurance regulations. The present value concepts (required by the regulations) assume that funds set aside in the current period will earn interest sufficient to fund the full liability when it becomes due in subsequent years. For this reason, it is not necessary to fund the full liability in the current period when payment will not be made until years later, or when the liability will be paid over many years in incremental payments.

For these reasons, we believe that our recommendations are valid and should be addressed through audit resolution. In this regard, the contractor should provide cost feasibility studies and actuarial data to support the amount charged to the government for insurance reserves, and should provide a plan as to how the insurance claims will be paid since the funds have been spent for other purposes.

2. Weak Controls Over Construction and Rehabilitation Projects

Our audit included tests of the HJCC's construction and rehabilitation (CRA) projects. In general, costs charged to this line item includes expenses incurred for construction of new facilities, expansion, or renovation of existing facilities. Center operators are required to submit lists of needed CRA projects to the Office of Job Corps, to incur costs only for those projects specifically funded and approved, and to track actual costs by approved project.

The current operating contract had a total CRA budget of $1.15 million of which $729,000 was incurred during our audit period. Our audit tests of these funds identified the following discrepancies:

- The center was unable to identify the specific projects approved by the Office of Job Corps for a portion of the center's CRA funding, as shown below.

Source of Funding	Budget Authorized	Actual Incurred	DOL Funds	Date of Contract Modification
Carryover from prior contract	$131,795	$45,707	PY 94&95	June 1997
Facility survey PY 98	145,020	26,980	PY 97	July 1998
PY 99 incremental funding	46,500	0	PY 99	November 1999
PY 99 incremental funding	33,500	0	PY 99	March 2000
	$356,815	$72,687		
Note: The difference between Budget Authorized and Actual Incurred is $284,128.				

  The center was unable to provide a list of the projects that had been requested and approved for each of these CRA awards. A partial list was provided for the PY 98 facility survey, but it appeared that pages were missing since the items listed only added up to about $27,000. Since these CRA funds were significantly underspent, we conclude that many projects originally approved by the Office of Job Corps were never completed. The center has requested that the $284,128 funds remaining be redirected to cover costs incurred for the Maui dorm project (requests were pending). However, the period of availability for the PY 94, 95, and 97 funds has expired. Thus, only $80 million may be redirected with approval by Job Corps.

- The ETA 2110 reflected CRA obligations on June 30, 2001, of $1,243,823, and actual costs incurred of $1,015,387. However, the actual amount obligated (i.e., purchase orders and/or contracts issued) according to supporting CRA schedules was $1,275,803, and the actual costs incurred was $1,047,367. The difference of $31,980 represented amounts reported in error as center operations.

- The primary project funded with CRA resources was the construction of a new dorm for the Maui site. The CRA schedule as of June 30, 2001, reflects that MTC incurred costs for this project totaling $707,279, of which over $500,000 was actually vouchered. However, the total funds approved as of that date was only about $265,000. In a letter to the Job Corps Regional Office dated August 20, 2001, MTC requested redirection of

$284,000 of unspent funds from other CRA projects as well as new CRA funding of $450,000 to cover the costs of the Maui project. Documentation attached to that letter indicates that the National Office authorized the Job Corps Regional Office to award new CRA funds of $450,000 (from PY 2000 appropriations). However, the center had already incurred the costs and vouchered a portion of the funds prior to final approval and modification of the operating contract.

- We tested 10 invoices totaling approximately $688,000 billed against the Maui Dorm project. Of these invoices, four were advance payments paid in accordance with the terms of the contract or agreement. Of the remaining six invoices, three were processed for payment without written notations or other form of evidence that the goods or services were received, and one was not supported by a purchase requisition.

Based on these findings, we conclude that the center was not exercising sufficient internal controls over their CRA projects. This was partially caused by the fact that the center has experienced turnover in key finance positions, and the current financial services manager was relatively new to the center. The records available for prior projects and funding were not readily available and had to be assembled for audit purposes.

Due to the restricted nature and purpose of CRA funding, it is essential that centers exercise controls which ensure that these Federal resources are used for their intended purposes and are properly tracked and documented. These projects are initially requested as a means to provide a safe and appealing environment at the Job Corps center, and an atmosphere compatible with the goals of Job Corps. If the projects are not tracked or monitored for completion, the resources may not be used for their intended purposes and renovations deemed necessary by the Office of Job Corps will never be performed.

Recommendations

a. We recommend that MTC implement improved controls over the CRA funding provided to the HJCC. These controls should ensure:

   (1) adequate accountability over the CRA funds awarded,
   (2) adequate tracking and monitoring for timely completion,
   (3) advance approval of re-directed funds prior to expenditure of such funds for an alternative project, and
   (4) improved procedures for documenting receipt of goods or services prior to payment.

b. In addition, we recommend that the HJCC adjust its ETA 2110 report to reflect accurate CRA and operations' costs. As of June 30, 2001, the necessary adjustment was $31,980.

Auditee's Response

The contractor generally concurred with these recommendations, stating certain actions that have been put into place to monitor future CRA funding. However, they indicated that $145,020 of the funding related to a specific facility survey which was not provided by the Regional Office, and that the CRA expenses currently reported for this funding was estimated. The actual amount of unspent funds has not yet been identified. They indicated that further work will be done to determine the actual amount of CRA incurred against these projects and that reports will be adjusted as necessary.

Auditor's Conclusion

We agree with the corrective actions described in the contractor's response, and consider these recommendations resolved.

3. Accountability Over Inventories

Job Corps centers are required to maintain perpetual inventories of consumable supplies for the following: clothing, food, educational and vocational materials, medical and dental supplies, fuel, and other inventory items. In general, purchases of inventory items are vouchered at the time of receipt and expensed as items are issued from inventory for use at the center. Centers are required to process all receipts and distributions through the inventory accounts in order to maintain a complete accounting of inventory items. Our audit of the HJCC's inventory system and records disclosed the following:

a. Standard perpetual inventory systems include reports which provide the detail of recorded inventory balances, i.e., a list of each item or class of items held in inventory, the number of units on hand, the unit price or value, the extended value, and the total inventory value. Our audit identified that the inventory records maintained by MTC did not include a report which provided the detail and composition of the center's ending inventory balances. We were told by HJCC staff that the computer system did not produce such a report. For example, the ending inventory of food reported on the ETA 2110 at June 30, 2001, was $19,225. The inventory records available at the center did not include a report which provided the detail of items held in inventory which made up the $19,225 balance. Manual perpetual reports were maintained for fuel inventories and medical and dental supplies; however, these items represent only $16,761 of the $82,741 ending inventory balance.

b. We prepared a schedule of changes in the inventory balances, by ETA 2110 category, from June 2000 through June 2001. In 9 of the 12 months evaluated, we noted large and unusual fluctuations (defined as more than 20 percent variance from the preceding month). For example, the following table shows large and unusual fluctuations for medical and dental inventories.

More than 20% Variance from Preceding Month

ETA 2110 Category	June	July	November	December	January
Medical & Dental Inventories	$55	$11,598	$8,388	– $2	$16,209

We also found that the entire month of December looked particularly unusual. The following table provides the percentage change in inventories for December.

Percentage Change in Inventories - December 2000

Clothing	Food	Educational & Vocational	Medical & Dental	Fuel	Other
– 65%	– 4%	– 100%	– 2%	– 2%	72%

In addition, inventories were discontinued in December for educational and vocational supplies and were not reinstated for the remainder of the year. Due to turnover, the center staff was unable to explain why there were such large fluctuations throughout the audit period.

Based on these facts, we conclude that the center did not exercise adequate accountability over center inventories. These inventories are Federal assets, and the lack of accountability increases the risk that such assets may not be used for their intended purpose.

The PRH requires center operators to safeguard and account for consumable inventories, as follows:

> All receipts which could be inventoried must be processed through the inventory accounts even if immediately issued for use. Adequate and accurate accounting for inventory, through perpetual inventory records, is essential for proper control of financial resources and reporting of costs and government assets. It is important to note that inventory is a government-owned asset and must be protected and accurately reported. All receipts and issues in the inventory accounts must be recorded. Abnormally high or low usage in a particular category may not be evident if records do not reflect total usage.
> PRH Chapter 9, Appendix 901, page 64.

Recommendations

a. We recommend that complete perpetual inventory records are maintained which provide sufficient detail (description, quantity, and value) of the items held in inventory at the end of each reporting period. The balances reflected on the report should support the inventory balances reported on the ETA 2110.

b. We also recommend that MTC take greater care in maintaining inventory records and in reporting these items on the ETA 2110 to ensure that the reports are accurate, complete, and up to date.

Auditee's Response

With respect to recommendation a. the contractor stated the following:

> We do not completely agree with the auditor's findings and recommendations. The computerized inventory system used by Hawaii Job Corps Center **does** generate a detailed listing of recorded inventory balances. The HJCC staff discussed with the auditor the process in which inventories are generated. During the month-end close process there is a report that provides detail including item, number on hand, unit price, extended value and total inventory. In the past, the reports were ran to include totals only, not detailed information. Effective immediately, this report will be generated to include details of inventory to document and support inventory balances on the ETA 2110 reports.

The contractor concurred with recommendation b., stating that medical and dental inventories have since been put on the computerized system, and that greater care will be taken to ensure inventories are accurate, complete and up-to-date.

Auditor's Response

As indicated in our finding, the inventory reports provided at the center did not include a detailed perpetual record of ending inventory balances. We requested this report and were told that it was not produced by the inventory system. Nevertheless, the contractor's response indicates that they will begin to generate perpetual inventory reports, and that additional care will be taken in accounting for center inventories. These recommendations are considered resolved.

4. Journal Entries Not Reviewed

Our audit procedures for payroll and non-personnel costs included tests of journal entries posted during the program year. This procedure identified that journal entries were not consistently approved by someone other than the preparer of the entry prior to being recorded in the general ledger. While the MTC standard journal entry form requires the name of the individual who prepared the entry as well as the name of the individual who approved the entry, the approval line was blank on all of the journal entries selected for testing. We scanned the volumes of journal entries (maintained by month), and noted that journal entries were very rarely approved by someone other than the preparer.

We discussed this finding with center staff, and were told that while MTC policy required approval of journal entries, the finance manager was relatively new to the center and had not yet found the time to initiate this policy.

The approval function is a well recognized internal control component designed to ensure that financial records are free from error or irregularities. It is based on the concept that even the most highly skilled employees with the best of intentions will sometimes make mistakes. If there are no review and approval procedures in place, there is a much higher risk that erroneous transactions will be recorded and will not be detected on a routine or timely basis.

The Job Corps PRH requires Job Corps contractors to maintain accurate and complete financial information, and to provide internal control procedures which encompass approval requirements. The PRH, Chapter 9, Financial Management, states the following:

> P1. Purpose . . . To establish and maintain a financial management system that provides accurate, complete, and current disclosures by each contractor and agency receiving Job Corps funds.
>
> R4. Internal Control . . . Center operators and OAP contractors shall: a. Establish internal controls to provide reasonable assurance that: . . . 2. The integrity of the funds provided by the government is protected. 3. Assets are properly safeguarded.
>
> Control procedures shall include: 1. Separation of duties, 2. Approval requirements, 3. Documentation requirements.

Recommendation

We recommend that the center initiate procedures which require that journal entries be reviewed and approved by someone other than the preparer. This process should be documented by initialing and dating the appropriate line on the journal entry form.

Auditee's Response

> *We agree with the auditor's finding and recommendation. All journal entries will be reviewed by an accounting position other than the staff entering the journal entry. These positions have been trained on what to review to ensure that financial records are free from errors or irregularities.*

Auditor's Conclusion

We agree with the planned actions described in the contractor's response, and consider this recommendation resolved.

5. Vacation and Sick Leave Balances Exceed Corporate Limits

Our audit procedures for payroll expense and related liabilities disclosed that the HJCC was maintaining annual and sick leave balances in excess of allowable corporate limits. According to MTC corporate policy, the maximum amount of unused annual leave which employees can carry over to subsequent years ranges from 80 hours to 200 hours, depending on the total years of service. The maximum unused sick leave which may be carried over is 240 hours. However, we noted many instances where the unused leave balances exceeded these limits. For example, we noted sick leave balances for employees well in excess of 240 hours, 1 as high as 1,139 hours. We also noted vacation balances for employees in excess of the 200 hour limit.

According to center personnel, there was some confusion as to whether the corporate policy is applicable to the HJCC. Center staff believed that the HJCC was not required to follow MTC policy and that the limits on annual and sick leave did not apply to center staff. For this reason, accrued leave was never adjusted down to the maximum carryover limits. However, the written policy on hand at the HJCC did not indicate an exception to these policies, nor was an exception indicated in the centers' Job Corps proposal or contract.

MTC policies and procedures state the following:

> The maximum sick leave an employee may have earned and not used at any one time is 240 hours (30 days). MTC Policy, Serial No. 310.54, 20 August 1990, paragraph B.7.b.
>
> Full-time and part-time employees will earn vacation time in accordance with the following eligibility table . . .1st year [of service]-Carryover Maximum 80 hours per year . . . 20 years -Carryover Maximum 200 hours per year. MTC Policy, Serial No. 310.52, 20 July 1989, paragraph B.1.b.
>
> Site Operations - Excess hours over maximum must be used by no later than the cut-off date covered by the second paycheck in January. If all excess hours are not used by that date, any excess hours remaining will be lost and the employee's vacation balance adjusted down to his/her maximum annual accrual allowed. MTC Policy, Serial No. 310.52, 20 July 1989, paragraph B.8.

In addition, the cost principles applicable to Job Corps contractors indicate that payment of annual and sick leave is an allowable contract cost, if paid in accordance with contractor policy. The cost principles state the following:

> The costs of fringe benefits are allowable to the extent that they are reasonable and are required by law, employer-employee agreement, or an established policy of the contractor. 48 CFR 31.205-6(m)(1).

Accordingly, while the accrued balances noted during our audit are not charged to the contract until paid to employees, the payment of these balances to employees could result in unallowable charges to the Job Corps contract.

Recommendation

We recommend that MTC review the leave balances for center staff and determine whether a portion of these balances should be forfeited by the respective employees. We also recommend that MTC ensure that the policies applicable to the HJCC are clarified and, if unique to the HJCC, put into writing and reissued to all center staff.

Auditee's Response

The contractor concurred with our recommendation as it pertained to sick leave balances. However, they indicated that vacation balances were adjusted down (each January) to the maximum carry over balance as required by MTC policy. The contractor indicated that the maximum carry over amount was not intended to mean that employees leave balances could not exceed this maximum during the year.

Auditor's Conclusion

We understand that vacation balances will often exceed the maximum carryover balance throughout the year, and that only at year end will balances be adjusted to the maximum carryover. Our finding was based on our observation of balances in excess of the maximum as well as conversations with center staff, whereby we were informed that balances were not adjusted because the center was not following MTC corporate policy. We discussed this finding with corporate staff as well, and were never provided with information to the contrary. Nevertheless, since the contractor has indicated that both sick leave and vacation leave will be accounted for in accordance with written policy, this recommendation is considered resolved.

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APPENDIX

AUDITEE'S RESPONSE

PACIFIC EDUCATIONAL FOUNDATION, INC.
Hawai'i Job Corps

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March 25, 2002

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

Dear Mr. Hill,

Enclosed is the response to the U.S. Department of Labor, Office of Inspector General Audit, draft report dated February 26, 2002.

If you have any questions about these responses please contact me at 808-259-6001.

Sincerely,

Tommy Troxell
Center Director
Hawaii Job Corps Center

CC: Sam Hunter, Executive Vice President
Lyle Perry, Senior VP &CFO
Ellie Lopez, Regional Vice President
Virleen Ferre, Director Corporate Finance
Dave Arnold, Director Corporate Finance
Allison Summers, Director Corporate Financial Services
Dan Williams, Director Internal Audit

Hawaii Job Corps Center
(Operated by Management & Training Corporation)

Responses addressing Draft Report's Findings and Recommendations

1. Excess Insurance Reserve Balances

In addressing the recommendations of this area we will address a. and then split b. into two different areas.

a. Recommendation:

We recommend that MTC prepare and submit a written plan to the Office of Job Corps which details the self-insurance policies and practices used in charging insurance costs to its government contracts. The plan should entail all of the required components of 48 CFR 28.308.

Response:

MTC concurs with the recommendation made by the auditors. However, for the record, the following historic perspective is provided.

In the early 1980's, after MTC was formed and started business, management at that time asked the Office of Job Corps how to handle several administrative matters which should have been reviewed and approved by a government Administrative Contracting Officer (ACO). Unfortunately, we cannot find any written correspondence on this matter that far back in time, but at least one individual who was involved remembers that MTC was concerned about governmental approval of fringe benefits, invoices, etc. At that time, we were told that Job Corps did not use ACO's and that we were to provide a brief description of these policies or plans in our Business Management Proposals in response to Job Corps Request for Proposals. If we were the selected bidder/contractor and awarded the contract, then our policies and plans were approved as described in our proposals. We have continued to use that practice ever since that time, and this is the first time that this practice has ever been questioned.

b. (1) Recommendation:

We recommend that the contractor modify its practices to ensure that future charges for uninsured losses be based on the present value of future payments, in accordance with the regulations.

Response:

The finding by the auditors state that "The cost accounting standards and cost principles allow contractors to charge federal contracts for the estimated self-insured losses, such as those charged by MTC". It goes on to indicate "the regulations require that if a liability will not be paid within 1 year after the loss is incurred, the amount collected for that loss must be computed as the present value of future payments ...". In this particular instance the CASB 9904.416-50(a)(3) is distinguishing the "measurement of actual losses".

CASB 9904.416-50 (a)(3)(ii) states the following:

If a loss has been incurred and the amount of the liability to a claimant is fixed or reasonably certain, but actual payment of the liability will not take place for more than 1 year after the loss is incurred, the amount of the loss to be recognized currently shall be the present value of the future payments, determined by using a discount rate equal to the interest rate as determined by the Secretary of the Treasury...in effect at the time the loss is recognized. Alternatively, where settlement will consist of a series of payments over an indefinite time period, as in workmen's compensation, the contractor may follow a consistent policy or recognizing only the actual amounts paid in the period of payment.

It appears that the auditors have ignored the direction in CASB 9904.416-50 (a)(3)(ii) paragraph (1) a loss must be incurred and the amount of the liability to a claimant must be fixed or reasonably certain. Although the losses are incurred in specific periods, the claimant has up to a statutory number of years as defined by each state to file a claim, or reopen a previous claim. Thus not making the liability to the claimant fixed or reasonably certain. Once a claim has been filed, it may take a number of years to determine the appropriate treatment, and then an additional number of years to ultimately make payment on said claim. In fact, for the older years prior to 1992 and 1992, the claims exceeded the initial reserve amount, thus MTC had to hold additional funds in subsequent years to cover the shortage. Additionally, future payment of claims almost always includes a consideration for inflation, higher medical costs, increased attorney fees, and other miscellaneous expenses making a value calculated in today's dollars totally inaccurate for future payments. The amount of these claims is neither fixed nor reasonably certain, thus, calculating the present value of the future payments against the existing reserve is not applicable. However, settlement does consist of a series of payments over an indefinite time period and MTC has consistently followed an established policy of having the insurance company estimate the yearly reserves based on MTC's experience, relevant industry experience, and anticipated conditions in accordance with accepted actuarial principles.

MTC along with its insurance broker meet with the insurance carrier semi-annually and reviews all claims and their status. Each claim is monitored accordingly. The bigger issue arises from the "incurred but not reported" claims. Again these claims are included in the reserve analysis based on MTC's experience, MTC's risk management program, relevant industry experience, and anticipated conditions in accordance with accepted actuarial principles.

Based on the above, we believe we are in accordance with the regulation. However, we are working with our insurance carrier and broker to determine if there is an acceptable way to determine a present value of such claims and will make any appropriate changes in our reserving practices.

b. (2) Recommendation:

Since the contractor has accumulated an excessive reserve balance, we recommend that the contractor set aside the funds in an interest bearing account, whereby the interest will offset the cost of further insurance charges. In addition, the contractor should determine the present value of the future payments against the existing reserve and refund any excess balance to the Federal government (the proportionate share).

Response:

The auditors came to the conclusion that the reserves were excessive and not in accordance with cost accounting standards. The insurance costs being charged and allocated are in accordance with CASB 9904.416-50 (a)(2)(i) states the following:

Except as provided in subdivisions (a)(2)(ii) and (iii) of this subsection, actual losses shall not become a part of insurance cost. Instead, the contractor shall make a self-insurance charge for each period for each type of self-insured risk which shall represent the projected average loss for that period. If insurance could be purchased against the self-insured risk, the cost of such insurance may be used as an estimate of the projected average loss; if this method is used, the self-insurance charge plus insurance administration expenses may be equal to, but shall not exceed, the cost of comparable purchased insurance plus the associated insurance administration expenses. However, the contractor's actual loss experience shall be evaluated regularly, and self-insurance charges for subsequent periods shall reflect such experience in the same manner as would purchased insurance. If insurance could not be purchased against the self-insured risk, the amount of the self-insurance charge for each period shall be based on the contractor's experience, relevant industry experience, and anticipated conditions in accordance with accepted actuarial principles.

MTC is in accordance with CASB 9904.416-50 (a)(2)(i), "if insurance can be purchased against the self-insured risk, the cost of such insurance may be used as an estimate of the projected average loss". MTC's yearly estimated reserve amount booked is significantly lower than if insurance was purchased for the self-insured risk.

CASB 9904.416-50 (a)(2)(i), also states that, if insurance could not be purchased against the self-insured risk, the amount of the self-insurance charge for each period should be based on the contractor's experience, relevant industry experience, and anticipated conditions in accordance with accepted actuarial principles. MTC's estimated reserve amount is calculated by the insurance company and is based on MTC's experience, relevant industry experience, and anticipated conditions in accordance with accepted actuarial principles.

It also appears that the determination of the reserve being excessive is due to its increase.

From 1992 to 2000 MTC's business has grown and revenues have increased from $175,046,845 to $321,773,864, respectively. This is an increase in business of $146,727,019 or 83.82%. Thus, it would be reasonable that MTC's reserve balance would also increase from 1992.

Due to the fact that claims which occur in a particular year may not be filed until subsequent periods, and most likely will not be settled and/or paid for many more years, 1992 is the only year that appears to have the majority of the applicable claims paid by 2000. Thus, using 1992 as a base year and estimating future claims based on 1992 actual claims paid ($1,455,529) to revenue ($175,046,845) the following reserve estimates were calculated:

Year	Revenue Per Audited F/S	Revenue % Increase From From 1992	Estimated Based on 1992 Revenue Increase	Total Reserve Collect by Year
1993	187,540,063	7.14%	1,559,454	1,200,000
1994	195,021,742	11.41%	1,621,605	1,337,740
1995	222,505,574	27.11%	1,850,123	1,796,304
1996	240,799,277	37.56%	2,002,226	1,821,358
1997	241,854,355	38.17%	2,011,104	1,874,530
1998	253,934,267	45.07%	2,111,536	1,950,733
1999	285,650,403	63.19%	2,375,278	1,859,000
2000	321,773,864	83.82%	2,675,553	2,568,500

The data above reflects the fact that the total reserve collected in any given year is less than the estimated reserve. Based on the above calculations, and the fact that MTC's yearly estimated reserve amount booked is significantly lower than if insurance was purchased for the self-insured risk, MTC believes its reserve account balance is reasonable, but we will continue to evaluate this with our insurance carriers and consultants to ensure we are meeting all of the applicable FAR and CAS requirements.

Another mitigating factor in the appearance of excessive reserves is that for the policy year 2000 (October 2000 through September 2001), the costs of the insurance had not been expensed to the contracts. Approximately one quarter of those costs would have been expensed as of December 31, 2000 when this was reviewed, and therefore both asset and liability are grossing up the balance sheet.

Additionally, MTC was required to pay a portion of the reserve to the insurance company upfront for claims. It was not until recent years that the insurance company has agreed to accept a Letter of

Credit (LOC) in lieu of the upfront reserve payments. The amount of the LOC as of 2000 was $4,300,000.

Overall, the insurance is very complicated and we do not believe that the conclusions reached are valid.

2. Weak Controls Over Construction and Rehabilitation Projects

a. Recommendation:

We recommend that MTC implement improved controls over the CRA funding provided to the HJCC. These controls should ensure:

1. Adequate accountability over the CRA funds awarded;
2. adequate tracking and monitoring for timely completion,
3. advance approval of re-directed funds prior to expenditure of such funds for an alternative project, and
4. improved procedure for documenting receipt of goods or services prior to payment.

Response:

We concur with the auditor's recommendation. The current Financial Services Manager is monitoring funding of CRA and tracking progress of projects. On a monthly basis, a construction/rehab report is completed, and on a quarterly basis it is submitted to the Regional Office and National Office for review. This report shows progress of all projects funded. In addition, the Financial Services Manager is working closely with the Regional Project Manager to ensure funding is received prior to expenditures of funds. Prior to payment to vendors, all invoices are reviewed by the Financial Services Manager to ensure authorization of payment is evident with signatures of individuals monitoring project.

b. Recommendation:

In addition, we recommend that the HJCC adjust its ETA 2110 report to reflect accurate CRA and operations' costs. As of June 30, 2001, the necessary adjustment was $31,980.

Response:

We do not completely concur with the auditors recommendation. Funding was received in the amount of $145,020 and was referenced to the May 1998 Maui Facility Survey. No supporting documentation was received or could be obtained from the Regional office regarding the required projects to be completed. The Financial Services Manager, Maui Site Manager and Maui Maintenance Supervisor reviewed every project in the survey to identify what projects had been completed. The cost of competing these projects was an estimate based on the cost in the facility survey. We are currently in the process of identifying the invoices to support the completion of the projects. Once we have identified the invoices to support the completion of the projects, and verify where recorded, the amount will be moved to construction/rehab. The Financial Services Manager has taken step to accurately track funds based on projects.

3. Accountability Over Inventories

1. Recommendation:

We recommend that complete perpetual inventory records are maintained which provide sufficient detail (description, quantity and value) of the items held in inventory at the end of each reporting period. The balances reflected on the report should support the inventory balances reported on the ETA 2110.

Response:

We do not completely agree with the auditor's findings and recommendations. The computerized inventory system used by Hawaii Job Corps Center does generate a detailed listing of recorded inventory balances. The HJCC staff discussed with the auditor the process in which inventories are generated. During the month-end close process there is a report that provides detail including item, number on hand, unit price, extended value and total inventory. In the past, the reports were ran to include totals only, not detailed information. Effective immediately, this report will be generated to include details of inventory to document and support inventory balances on the ETA 2110 reports.

2. Recommendation:

We also recommend that MTC take greater care in maintaining records and in reporting these items on the ETA 2110 to ensure that the reports are accurate, complete, and up to date.

Response:

We concur with the auditor's recommendation. Significant variances in medical inventories was due to the manual process of maintaining this inventory. On September 1, 2001, the medical and dental supplies were put on the Lawson inventory system (computerized). This computerized inventory system will allow management the opportunity monitor receipts and issues of inventory items.

The Financial Services Manager has taken greater care in ensuring inventories recorded on the ETA 2110 are accurate, complete and up to date.

4. Journal Entries Not Reviewed

Recommendation:

We recommend that the center initiate procedures which require that journal entries be reviewed and approved by someone other than the preparer. This process should be documented by initialing and dating the appropriate line on the journal entry form.

Response:

We agree with the auditor's finding and recommendation. All journal entries will be reviewed by an accounting position other than the staff entering the journal entry. These positions have been trained on what to review to ensure that financial records are free from errors or irregularities.

5. Vacation and Sick Leave Balances Exceed Corporate Limits.

Recommendation:

We recommend that MTC review the leave balances for center staff and determine whether a portion of these balances should be forfeited by the respective employees. We also recommend that MTC ensure that the policies applicable to the HJCC are clarified and, if unique to HJCC, put into writing and re-issued to all center staff.

Response:

We do not completely concur with the auditor's findings or recommendations. We will address the recommendation of this area by separating Vacation Balances and Sick Leave Balances as these are two separate policies.

<u>Vacation Balances</u>

MTC reviews vacation balances on an annual basis. Employees may carry over an amount of vacation that does not exceed the employee's annual allowed accrual maximum. This amount is a sliding scale based on tenure. Any excess hours must be used by no later than the cut-off date covered by the second paycheck in January. Any excess hours remaining after that date will be lost and the vacation balance is adjusted down to his/her maximum annual allowed accrual.

Per MTC policies (No. 310.52), the maximum vacation balance applies to what may be **carried over** from year to year, not to set a limit on the available balance of vacation. The maximum balance does **not** mean that employees cannot continue to accrue vacation hours over and above that carryover balance during the year. At any given time during the year, an employee's vacation balance might exceed the maximum carryover limit. Employees have the opportunity to use their vacation throughout the year. The policy is in place to ensure that any excess vacation (amount above carryover) remaining at the end of each year is lost.

Sick Leave Balances

MTC has a provision in the subcontract agreement dated February 6, 1986 with Pacific Educational Foundation, Inc. that allows for sick leave balances in excess of the corporate limit for employees who had been employed prior to MTC's acquisition of the contract. We have identified these grandfathered employees and will maintain their accruals separately from all other employees. No further accruals will occur for these employees until their sick leave balance drops below the corporate limit of 240 hours.

All other balances have been reviewed and any that are above the 240 limit will be adjusted accordingly. Measures have been developed to ensure that no accruals will occur beyond the 240 hour limit.