

MEMORANDUM FOR: EMILY STOVER DeROCCO
Assistant Secretary for
Employment and Training



FROM: ELLIOT P. LEWIS
Assistant Inspector General
for Audit

SUBJECT: Audit of Kentucky Workforce Development Cabinet's
ADP/IT Central Services Costs Charged to U.S. DOL Grants
During the Period July 1, 1996 through June 30, 2000
Final Audit Report 03-04-005-03-315

DATE: July 16, 2004

The Office of Inspector General (OIG) has completed an audit of the automatic data processing and information technology (ADP/IT) central services costs charged to Department of Labor grants awarded to Kentucky's Workforce Development Cabinet, Department for Employment Services (WDC/DES). Our objective was to determine whether such costs were reasonable, allowable, and properly allocable under the Federal cost principles set forth in Office of Management and Budget (OMB) Circular A-87 for State Fiscal Years (SFYs) 1997 through 2000.

We initially determined that Kentucky's State-Wide Cost Allocation Plan (SWCAP) did not contain documents required by Federal cost principles for billing ADP/IT central services costs to Federal grants. However, following receipt of our draft audit report, officials from the Kentucky Office of the State Controller provided the required documents. We concluded that these additional documents complied with Federal cost principles requirements for charging ADP/IT central services costs to U.S. Department of Labor (DOL) grants. Therefore, our report does not contain any conditions that warrant corrective action.

Background

Kentucky's WDC/DES, procures its computer mainframe ADP/IT central services from the Governor's Office of Technology (GOT). GOT is a service bureau providing ADP/IT central services to all agencies and departments of the executive and legislative branches of the Kentucky State government. GOT uses a chargeback system to recover its operating costs. GOT periodically prepares reconciliations between its budgeted and actual costs, and refunds any over-billings to user agencies. During SFYs 1997 through 2000, GOT charged a total of \$12,447,021 in ADP/IT central services costs to WDC/DES, of which \$10,008,625

was charged to DOL grants. Tichenor & Associates, LLP, under contract to the DOL, OIG, performed an audit of these ADP/IT central services costs charged to DOL grants.

Scope and Methodology

We audited the ADP/IT central services costs charged to DOL grants administered by WDC/DES in SFYs 1997 through 2000.

During our fieldwork our data requests were not always responded to in a timely manner. Therefore, we utilized alternative auditing procedures to achieve our audit objectives. We interviewed GOT officials and reviewed and documented Kentucky's SWCAPs for SFYs 1997 through 2000. We did not test the process GOT uses to accumulate the cost, allocate indirect cost, and bill programs. We did interview GOT officials to determine how expenditures charged to the DOL grant programs were recorded in the accounting system. We reviewed the year-to-date Monthly Management Budget analysis by program, and verified that costs were properly charged to the correct programs. We analyzed and scheduled all charges posted by WDC/DES for SFYs 1997 through 2000 for direct sub-objective 270, Computer Services, and sub-objective 508, Indirect Operating Expense, to identify all ADP/IT central services costs. We selected a judgmental sample of salaries to verify that they were properly charged through the accounting system to the correct programs for June 1999 activity. We did not perform an analysis of over/under billings; we only determined the billings were adjusted to actual costs for the years we audited.

Also, we wanted to determine if there was an overall decrease in the utilization of the ADP/IT central services by State agencies for SFYs 1997 through 2000. Although GOT officials were not able to provide the usage and cost information by agency, we performed a utilization analysis by analyzing the actual units sold by function codes reported in the Cost Allocation Reconciliation for SFYs 1997 through 2000. We also examined GOT's ADP/IT central services costs using GOT's Over/Under Recovery Reports for SFYs 1997 through 2000. No further analysis was necessary since the costs appeared reasonable.

Our audit was performed in accordance with applicable standards established by the American Institute of Certified Public Accountants and *Government Auditing Standards* issued by the Comptroller General of the United States.

The audit fieldwork for this engagement was conducted at WDC/DES and GOT offices in Frankfort, Kentucky, during the period September 2001 through January 2002. We held an exit conference with GOT and WDC officials on January 29, 2002.

Audit Results

At the beginning of our fieldwork at GOT we requested the Central Services Cost Allocation Plans (CSCAPs) covering its ADP/IT central services costs for SFYs 1997 through 2000. We were provided a document entitled the “State and Local Governments Cost Allocation Agreement.” WDC/DES officials referred to this document as Kentucky’s SWCAP, another name for the CSCAP. Although we found that Kentucky’s SWCAP included ADP/IT central services costs, it did not provide the specific OMB Circular A-87 requirements for charging ADP/IT central services costs to federal grants. Accordingly, we concluded that GOT ADP/IT charges to DOL grants failed to meet the mandatory requirements set forth in OMB Circular A-87, and were therefore unallowable. We reported this in our July 2003 draft audit report to WDC/DES.

Auditee Response and Auditor's Conclusion

In response to our draft report, WDC/DES officials disagreed with our conclusion that GOT’s ADP/IT central services had not been included in the Kentucky SWCAP. The response stated that the Kentucky Finance and Administration Cabinet, Office of the State Controller prepares and submits the SWCAP each year for approval to the U.S. Department of Health and Human Services’ (DHHS).

As a result of WDC/DES’ response, we met with a DHHS Division of Cost Allocation official to discuss OMB Circular A-87 requirements for charging ADP/IT central services costs to Federal grants. This official stated he agreed with WDC/DES that GOT’s ADP/IT central services costs were included in the Kentucky SWCAP and this would be acceptable as long as there was evidence to support the specific requirements in OMB Circular A-87 and the implementing guidelines published by DHHS in ASMB C-10.

We reviewed documents submitted by the Office of the State Controller and then concluded that all the required documents were prepared and approved timely and that variances resulting from the differences between the approved billing rates and the actual expenditures were adjusted in accordance with the terms in the SWCAP.

If you have any questions concerning this report, please contact Michael T. Hill, Regional Inspector General for Audit, in Philadelphia at (215) 446-3710.

AUDITEE'S RESPONSE



**CABINET FOR WORKFORCE DEVELOPMENT
DEPARTMENT FOR EMPLOYMENT SERVICES**

275 EAST MAIN STREET, 2WB

FRANKFORT, KY 40621

PHONE (502) 564-5331 FAX (502) 564-7452

WEBSITE: www.des.ky.gov

W. H. LILE
SECRETARY

JAMES F. THOMPSON
COMMISSIONER

August 6, 2003

Mr. Michael T. Hill
Assistant Inspector General for Audit
Office of Inspector General
U.S. Department of Labor
Frances Perkins Building, Room S-5512
200 Constitution Avenue
Washington, DC 20210

Dear Mr. Hill:

This letter is in response to the draft report issued by your office on July 8, 2003 concerning an audit conducted by Tichenor & Associates, LLP.

Finding 1:

ADP/IT Central Services Costs Charged to DOL Grants Were Not Supported by CSCAPs as Required by Federal Cost Principles.

Response 1:

We disagree with the assertion that the Governor's Office of Technology (GOT) ADP/IT central services costs had not been included in the Kentucky SWCAP. The Kentucky Finance and Administration Cabinet, Office of the State Controller prepares and submits the SWCAP each year for approval to the U.S. Department of Health and Human Services (HHS), Financial Management Service, Division of Cost Allocation. The cost allocation plan is negotiated between the Finance and Administration Cabinet's Office of the State Controller and the federal cognizant agency, HHS. HHS negotiates and approves the SWCAP on behalf of all federal agencies. All information requested by HHS was provided to their satisfaction as evidenced by their signed agreement (Attachment A).



EQUAL EMPLOYMENT OPPORTUNITIES MFD (DES)

The face of the duly executed State and Local Governments Cost Allocation Agreement (Attachment B) clearly lists Computer Services under Section II: BILLED COSTS. According to the Finance and Administration Cabinet's Office of the State Controller, the billing and charge back methodology for GOT was developed in conjunction with DOL several years ago and is periodically reviewed by Otto Kent, a former DOL employee who was later employed by HHS, Division of Cost Allocation. Please find a memorandum from Mr. Kent (Attachment C) describing a 1996 site visit to review the GOT charge back methodology.

We believe that given this evidence, it cannot be construed that the Computer Services billing cost are not included in Kentucky's SWCAP.

Thank you for the opportunity to respond to the Tichenor & Associates audit. Please feel free to contact me should you wish to discuss any of the above.

Sincerely,


James F. Thompson
Commissioner

cc: Tichenor & Associates
Stuart Weatherford

STATE AND LOCAL GOVERNMENTS COST ALLOCATION AGREEMENT

EIN: 1610600439

September 30, 2002

ATTACHMENT
A

STATE/LOCALITY:

Commonwealth of Kentucky
702 Capital Avenue, Room 484
Frankfort, Kentucky 40601-3454

FILING REF.: The Preceding
Agreement was dated
September 18, 2001

SECTION I: ALLOCATED COSTS

The central service costs listed in Exhibit A, attached, are approved on a Fixed basis and may be included as part of the costs of the State/local departments and agencies during the fiscal year ended June 30, 2002 for further allocation to Federal grants, contracts, and other agreements performed at those departments and agencies. A copy of Exhibit A may also be obtained from the Division of Cost Allocation noted on page 2 of this agreement.

SECTION II: BILLED COSTS

In addition to Section I, which provides for services furnished but not billed, the services listed below are furnished and billed to departments and agencies:

1. Fleet Management
2. Central Printing
3. Property Management
4. Computer Services
5. Risk Management (Self-Insurance)
6. Prison Industries
7. Pension Trust (State Employees Retirement)
8. Central Stores
9. Workers Compensation

SECTION III: CONDITIONS

The amounts approved in Section I and the billings for the services listed in Section II are subject to the following conditions:

- A. **LIMITATIONS:** (1) Charges resulting from this Agreement are subject to any statutory or administrative limitations and apply to a given grant, contract, or other agreement only to the extent that funds are available. (2) Such charges represent costs incurred by the State/locality, which are legal obligations of the State/locality and are allowable under OMB Circular A-87. (3) The same costs that are treated as indirect costs are not claimed as direct costs. (4) Similar types of costs are accorded consistent accounting treatment. (5) The information provided by the State/locality that was used to establish this Agreement is not later found to be materially incomplete or inaccurate.
- B. **ACCOUNTING CHANGES:** This Agreement is based on the accounting system purported by the State/locality to be in effect during the Agreement period. Changes to the method of accounting for costs which affect the amount of reimbursement resulting from the use of this Agreement require prior approval of the authorized representative of the Cognizant Agency. Such changes include, but are not limited to, changes in the charging of a particular type of cost from an allocated cost to a billed cost. Failure to obtain such approval may result in cost disallowance.



DEPARTMENT OF HEALTH & HUMAN SERVICES

Program Support Co
Financial Management Ser
Division of Cost Allocat

Cohen Building-Room 1
330 Independence Avenue, S
Washington, DC 205
PHONE: (202)-401-3
FAX: (202)-619-3

September 30, 2002

Mr. Stuart Weatherford
Director, Office of the Controller
Commonwealth of Kentucky
702 Capitol Avenue, Room 484
Frankfort, Kentucky 40601-3454

Dear Mr. Weatherford:

The enclosed Cost Allocation Agreement approves the Commonwealth of Kentucky Statewide Cost Allocation plan for the fiscal year ending June 30, 2002. Any variances resulting from the difference between the amounts cited as fixed in the Agreement and the actual expenditure for the fiscal year ended June 30, 2002 will be adjusted in accordance with the terms of the Cost Allocation Agreement.

The approved Central Services Costs contained in the Agreement may be considered as part of the operating costs of your various State Departments and Agencies in which activities of federally supported programs are conducted for the fiscal year beginning July 1, 2001. The indirect cost rate proposals for those departments allocating costs to Federal programs should clearly identify the adjustments made to segregate costs between direct and indirect, and to properly reflect those costs normally billed and those included in the State-Wide Cost Allocation.

Enclosed are the original and one copy of the Cost Allocation Agreement. Please sign both copies and return the original to this office at your earliest convenience, retaining the copy for your file. ~~In addition, please sign the copy of this letter of transmittal in the space provided to indicate your concurrence with the understanding cited above.~~ *No citing's!*

A Statewide Cost Allocation Plan, together with required supporting information, must be submitted to this office each fiscal year in which your organization allocates or bills costs under grants and contracts awarded by the Federal Government. Therefore, the Plan, based on actual costs for the fiscal year ended June 30, 2002 is due December 31, 2002.

Sincerely,

Philip A. Simard
Director
Division of Cost Allocation

Enclosures:

Exhibit B

USER AGENCIES	Records Center B11	Motorpool B12	State Risk B13	Correction Indemnities B14	Facilities B15	Central Stores B16	Printing B17	Gov Serv Center B18	Physical Plant B20	Info Systems B21	Workforce Comp B22	TOTAL Section II	Pass-Thru Section II*												
KENTUCKY STATEWIDE COST ALLOCATION																									
FISCAL YEAR 2002																									
EXHIBIT B																									
(Amounts Rounded to the Nearest Dollar)																									
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Information Systems

The Department of Information Systems, an agency in the Finance and Administration Cabinet, is responsible for the formulation of the policies and procedures necessary for usage and for providing coordination and implementation of the data processing developmental requirements for all state agencies in an efficient, timely, and cost effective manner. These responsibilities are carried out through the seven divisions in the Department, which provide technical advice and machines to the various agencies of State Government, along with management of all data processing equipment contracts in State Government.

Information Systems
Allocation of Costs

B20

User Agencies	Billings	Percentage	Allocation	
Leg Research	48,670	0.104%	868	
Judicial	135,438	0.288%	2,416	
Agriculture	36,881	0.078%	658	
Attny General	36,907	0.079%	658	
Election Fin	276,067	0.587%	4,924	
Gov's Office	3,262	0.007%	58	
Lt. Gov's Off	0	0.000%	0	
Military	61,421	0.131%	1,096	
Revenue	6,712,851	14.278%	119,737	
Local Govm't	21,100	0.045%	376	
Sec of State	19,022	0.040%	339	
Boards	117,234	0.249%	2,091	
Counc Higher Ed	51,377	0.109%	916	
Justice	1,341,492	2.853%	23,928	
Corrections	494,028	1.051%	8,812	
Education	1,358,716	2.890%	24,235	
KET	8,768	0.019%	156	
Libraries	22,930	0.049%	409	
NREP	621,412	1.322%	11,084	
Transportation	6,492,350	13.808%	115,802	
Commerce	20,579	0.044%	367	
Public Protection	395,767	0.842%	7,059	
Insurance	55,490	0.118%	990	
Health Services	1,114,755	2.371%	19,884	
Families And Children	18,533,713	39.422%	330,580	
Tourism	310,672	0.661%	5,541	
Labor	281,322	0.556%	4,661	
Workforce Development	3,864,365	8.220%	68,927	
UK	0	0.000%	0	
Other	264,346	0.562%	4,715	
Total	42,681,031	90.784%	761,288	Exhibit B
Central Services	4,332,673	9.216%	77,280	
Total All Agencies	47,013,704	100.000%	\$838,568	Schedule 20
	Schedule A3	Schedule A4	Total	
	790,883	47,885	838,568	

136

079

	Info Systems (Fin-Info Sys)	
E314	593.60 maj obj group 1	35,446,332.07
E341	1,588.60 maj obj group 3	22,899,902.97
E368	1,800.48 maj obj group 4	706.96
	maj obj group 6	1,752,052.42
E370	631.48 maj obj group 7	54,192.40
	Total All Prog	60,153,186.82

Off-budget transfers in the amount of 14,366,808.88 not included in Exp. Analysis.
14,366,808.88

off-budget transfer	3,093,521.15
T113,T132	14,366,808.88
	17,460,330.03

ATTACHMENT PUL



DEPARTMENT OF HEALTH & HUMAN SERVICES

Program Support Center
Office of Financial Management Services
Division of ADP Review

Cohen Building Room 1067
225 Independence Avenue, S.W.
Washington, DC 20201
PHONE: (202) 401-3813
FAX: (202) 401-3810

June 6, 1996

Kimberly G. Goodwin
Department of Accounts
Capitol Annex Building
702 Capitol Avenue, Room 484
Frankfort, Kentucky 40601-3454

Subject: Computer Center and Telecommunication Network Systems Chargeback
Review

Dear Ms. Goodwin:

Per our telephone conversation please make arrangements for our On-site Cost Determination review of the Kentucky State Computer and Network systems cost allocation and chargeback methodologies. We expect to limit our on-site review work to one week or less, July 22 - 26, 1996.

The purpose of the review is to identify the cost accounting and chargeback methodologies used by grantee and contractor organizations, and evaluate their appropriateness as a basis for cost reimbursements from Federal Programs. Our primary interest is in the identification, allowability, and allocability of costs for statewide computer services, local area networks (LAN), wide area networks (WAN), and statewide telecommunication systems.

Please have the documents named in the attached list available for review on Monday June 22, 1996. To expedite the review please forward copies of your most recent computer services and network processing cost allocation plans and organization charts by June 20, 1996 to assist in our planning process.

We anticipate the need to interview network, telecommunication and data center officials responsible for accounting, billing and cost allocation methodology.

Please call me or William Logan on (202) 401-2812 if you should have any questions or you can contact me by fax at (202) 401-2820. Thank you for your cooperation.

Sincerely,

W. Otto Kent, Director
Division of ADP Review

Attachment

cc: John West, PSC, FMS
Charles Seed, FMS, DCA
Steve Garfinkel, USDOL, OCD
Mark Regan, HHS, ACF
Richard Friedman, HHS, HCFA
Dave Temoshuk, USDA