

September 12, 2000

MEMORANDUM FOR: RAYMOND L. BRAMUCCI
Assistant Secretary
for Employment and Training

FROM: / S /
JOHN J. GETEK
Assistant Inspector General
for Audit

SUBJECT: North Carolina Y2K Conversion Expenditures Audit
Final Letter Report No. 04-00-003-03-315

The Office of Inspector General has audited North Carolina's expenditures of Year 2000 (Y2K) grant funds that occurred during the period October 1, 1997 to December 31, 1999. The funds were awarded by the U.S. Department of Labor, Employment and Training Administration (ETA) to ensure North Carolina's automated employment security functions were Y2K compliant. The objective of our audit was to determine whether funds designated for Y2K compliance were spent for that purpose, and in accordance with ETA guidance.

Summary of Our Findings and Recommendations

Generally, the Commission's expenditures were in accordance with the Y2K grant requirements and ETA's guidance. However, the Commission improperly spent \$39,690 of the funds on service warranties for 270 laptop computers. The warranties were not required for Y2K compliance and are not allowable charges to the Y2K grant. We recommend \$39,690 be returned to the U.S. Department of Labor.

Background

The Departments' of Labor, Health and Human Services, and Education, and Related Agencies Appropriations Act, 1998 provided \$200 million solely for the purpose of assisting states in ensuring their automated State Employment Security Agencies' (SESA) systems would be Y2K compliant.

North Carolina Y2K Expenditures

ETA provided guidance for the funding process through Field Memorandum No. 50-97, dated August 4, 1997. Each SESA, including North Carolina, received an initial base grant of \$1 million, to be used exclusively for Y2K activities relating to Employment Security automated systems.

North Carolina received an additional \$180,000 to fund independent verification and validation (IV and V) of its Unemployment Insurance automated benefit and tax systems' Y2K compliance. Field Memorandum No. 44-98, dated August 17, 1998, provided guidance regarding IV and V activities. The Office of the State Auditor managed the IV and V function for State agencies in North Carolina.

Additional Y2K funding was made available to North Carolina through two Supplemental Budget Requests (SBRs), during Fiscal Year (FY) 1999. In the first FY 1999 SBR, North Carolina received \$1,911,686, and an additional \$275,900 was awarded in a second SBR. Field Memoranda 3-99 and 47-99 provided guidance regarding use of the funds awarded through the SBRs.

In total, North Carolina received \$3,367,586 for Y2K compliance activities. As of December 31, 1999 (the ending date of our audit period), the Commission had spent \$2,766,875. None of the \$275,900 awarded in the second FY 1999 SBR had been spent. The Commission spent \$2,766,875 on the following categories of goods and services:

- \$740,544 for program code conversion;
- \$1,572,968 for hardware;
- \$229,526 for hardware installation;
- \$179,768 for IV and V activities; and
- \$44,069 for miscellaneous items.

Objective, Scope and Methodology

The objective of our audit was to determine whether funds designated for Y2K compliance were spent for that purpose, and in accordance with applicable ETA guidance.

Our audit scope included \$2,766,875 of Y2K conversion expenditures reported by the Commission as of December 31, 1999.

We reviewed the Y2K grants and SBRs, as well as financial reports prepared by the Commission. We interviewed ETA and SESA officials, reviewed contracts, financial records and other documentation. We inventoried equipment purchased with Y2K grant funds and examined samples of expenditures and modifications to computer programs in order to determine their compliance with Y2K requirements.

Our audit was conducted in accordance with *Government Auditing Standards*, as issued by the Comptroller General of the United States. Fieldwork was conducted intermittently from February 8, 2000 to July 21, 2000. At the conclusion of fieldwork, we issued a "Statement of Facts" to the Commission and considered their response in preparation of this document.

Y2K Funds Should Not Have Been Spent on Computer Warranties

The Commission used Y2K funds to purchase 270 laptop computers. In a separate transaction, the Commission spent an additional \$39,690, from the initial Y2K grant, to purchase service warranties for the computers. The warranties provided 3-year next-day service, Monday through Friday, for the 270 computers.

The 270 new computers purchased by the Commission were Y2K compliant, and replaced older computers that were not. Hence, the service warranties were not necessary for the Commission to ensure its systems were Y2K compliant.

H.R. 2264 provided that the Y2K funds could only be used:

. . . solely for the purpose of assisting States to convert their automated State employment security agency systems to be year 2000 compliant.

ETA Field Memorandum No. 50-97 provided that Y2K funds were to be used for:

. . . activities relating to Year 2000 conversion efforts, the replacement or upgrading of systems, systems interfaces, and/or software products necessary to ensure Y2K compliance, or replacing or upgrading computer hardware that is not Y2K compliant and that will adversely impact system or program performance if not replaced or upgraded.

The purpose of the service warranties was to pay for future repair costs, should they be needed. Payments made to defray future repair costs are not allowable uses of Y2K funds.

Recommendation

We recommend the Assistant Secretary for Employment and Training recover \$39,690 of Y2K funds that North Carolina improperly spent on service warranties.

North Carolina's Response to Draft Report

North Carolina's complete response to our draft report is attached to this final report. North Carolina stated warranties are a prudent cost, but did not have a rebuttal to OIG's contention that the warranties were not required for Y2K compliance. The response indicates the \$39,690 charge would be removed from the Y2K grant.

OIG's Conclusion

If North Carolina removes the charge from the grant, the finding will be resolved. We recommend that the Assistant Secretary ensure that the charges are properly removed.

Action Requested of ETA

We would appreciate receiving your response to our audit finding and recommendation within 60 days.

If you have any questions regarding this audit, please contact Robert Wallace, Regional Inspector General for Audit, at (404) 562-2341.

Attachment

Employment Security Commission of North Carolina
Post Office Box 25903, Raleigh, North Carolina 27611 (919) 733-7546

James B. Hunt, Jr.
Governor

J. Parker Chesson, Jr.
Chairman

August 23, 2000

Robert R. Wallace
Regional Inspector General for Audit
U.S. Department of Labor - OIG
61 Forsyth Street, S. W., Room 6T20
Atlanta, Georgia 30303-3104

Dear Mr. Wallace:

This is in response to your draft Letter Report dated August 16, 2000. The issue raised by the audit concerns the purchase of 3-year warranties for the 270 laptop computers at a cost of \$39,690. We feel that the purchase of warranties is a normal and prudent cost of doing business when equipment is critical to daily operations. We also feel that the cost should be part of the total equipment purchase price. However, we have no rebuttal to your argument that the warranties were not required for Y2K compliance. Therefore, we will remove \$39,690 from the charges to the Y2K grants.

We appreciate the professionalism and courtesy of your auditors during the audit process. If you have any questions concerning our response, please call Mike McGuffey, Director, Finance and Budget at (919) 733-5207.

Sincerely,

/ S /

J. Parker Chesson, Jr.

Employment Service

Unemployment Insurance

Labor Market Information