

**STATE OF WISCONSIN
DEPARTMENT OF WORKFORCE DEVELOPMENT
201 E. WASHINGTON AVENUE
MADISON, WISCONSIN 53707**

**AUDIT OF INDIRECT COSTS CHARGED TO
DEPARTMENT OF LABOR GRANTS AWARDED TO THE
DEPARTMENT OF WORKFORCE DEVELOPMENT FOR
STATE FISCAL YEARS ENDING JUNE 30, 1998, 1999, AND 2000**

Report No: 03-03-001-03-315

Date Issued: October 17, 2002

**TICHENOR & ASSOCIATES, LLP
CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS**

**STATE OF WISCONSIN
DEPARTMENT OF WORKFORCE DEVELOPMENT
201 E. WASHINGTON AVENUE
MADISON, WISCONSIN 53707**

**AUDIT OF INDIRECT COSTS CHARGED TO
DEPARTMENT OF LABOR GRANTS AWARDED TO THE
DEPARTMENT OF WORKFORCE DEVELOPMENT FOR
STATE FISCAL YEARS ENDING JUNE 30, 1998, 1999, AND 2000**

**This audit report was prepared by Tichenor & Associates, LLP,
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.**

Elisat P. Lewis

**Deputy Inspector General For Audit
U.S. Department of Labor**

Report No: 03-03-001-03-315

Date Issued: October 17, 2002

TABLE OF CONTENTS

ACRONYMS	i
GLOSSARY	ii
EXECUTIVE SUMMARY	1
INTRODUCTION	4
Background.....	4
Objective, Scope and Methodology.....	6
FINDINGS	
1. General Administration Pool Costs Charged to DOL Grants Were Overstated.....	8
2. DUI Did Not Allocate Its Share of the DWD ASD-Finance Indirect Cost Pool to “All” DUI Cost Objectives on the Basis of “Relative Benefits Received”.....	19
3. DUI and DWE Did Not Allocate Their Share of the DWD Application/Database Servers Indirect Cost Pool to “All” DUI and DWE Cost Objectives on the Basis of “Relative Benefits Received”.....	21
4. DWD Used Manual Vouchers to Improperly Shift Costs from a Non-DOL Program to DOL Grants	25
CONCLUSIONS AND RECOMMENDATIONS	28
INDEPENDENT ACCOUNTANT’S REPORT ON AUDIT	30
APPENDIX 1: FEDERAL COST REIMBURSEMENT PRINCIPLES	33
APPENDIX 2: AUDITEE’S RESPONSE	38

ACRONYMS

AFDC	Aid to Families with Dependent Children
ASD	Administrative Service Division
CC	Child Care
CFR	Code of Federal Regulations
DWD	Wisconsin Department of Workforce Development
DOL	U.S. Department of Labor
DUI	Division of Unemployment Insurance
DWE	Division of Workforce Excellence
FS	Food Stamps
FTE	Full-time Equivalent
HHS	U.S. Department of Health and Human Services
MA	Medical Assistance
NPS	Non-Personnel Services
OCD	U.S. Department of Labor, Office of Cost Determination
OIG	U.S. Department of Labor, Office of Inspector General
OMB	U.S. Office of Management and Budget
PR-S	Program Revenue Service
SFY	State Fiscal Year
SWCAP	Statewide Cost Allocation Plan
TANF	Temporary Assistance to Needy Families
UI	Unemployment Insurance

GLOSSARY

- Direct Cost:** A cost that can be identified specifically with a particular cost objective, e.g., the DOL Unemployment Insurance Program.
- Indirect Cost:** A cost which cannot be identified with a single, final cost objective, but is identified with two or more final cost objectives, one or more of which benefits Federal programs. Such costs are combined into groupings or pools for distribution to benefiting final cost objectives. Indirect cost pools should be distributed to benefited cost objectives on bases that will produce an equitable result in consideration of relative benefits derived.
- Questioned Cost:** A cost that is questioned because of:
- (a) an alleged violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the expenditure of funds; or
 - (b) at the time of the audit, such cost is not supported by adequate documentation; or
 - (c) the expenditure of funds for the intended purpose is unnecessary or unreasonable.
- Allowable Cost:** To be allowable under Federal awards, costs must meet the following general criteria: (1) be reasonable and necessary for proper and efficient performance and administration of Federal awards; (2) be allocable to Federal awards in accordance with OMB Circular A-87; (3) be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit; (4) be accorded consistent treatment (e.g., a cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost); (5) except as otherwise provided for in OMB Circular A-87, be determined in accordance with generally accepted accounting principles; (6) be the net of all applicable credits; and finally (7) be adequately documented.
- Allocable Cost:** A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with “relative benefits received.”

EXECUTIVE SUMMARY

Tichenor & Associates, LLP, Certified Public Accountants and Management Consultants, under contract to the U.S. Department of Labor (DOL), Office of Inspector General (OIG), audited the indirect costs charged by the State of Wisconsin’s Department of Workforce Development (DWD) to DOL grants administered by the Division of Unemployment Insurance (DUI) and Division of Workforce Excellence (DWE).

Our audit objective was to conduct an audit of the direct and indirect costs charged to the UI grant award to DWD for the period July 1, 1999, through June 30, 2000 (SFY 2000), to determine whether such costs were reasonable, allocable, and otherwise allowable under the Federal cost principles set forth in OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, and the implementing guidelines set forth in ASMB C-10, *Cost Principles and Procedures for Establishing Cost Allocation Plans and Indirect Cost Rates for Agreements with the Federal Government*. Based on the results of our audit efforts of SFY 2000, the scope of the audit was expanded to include SFYs 1998 and 1999 and to cover other DOL grants administered by DWD.

Audit Results

Our audit found that DWD needs to adhere to OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, which requires that indirect costs be given “consistent treatment” and be allocated to cost objectives on the basis of “relative benefits received.” Our audit disclosed that for the SFYs ended June 30, 1998, 1999, and 2000, DWD charged \$75.3 million to DOL grants administered by DUI and DWE instead of the actual allowable indirect costs properly allocable to DOL grants within DUI and DWE of \$71.5 million. We are questioning a total of \$3,819,850 in indirect costs as follows.

(Dollars in Thousands)

Description	1998	1999	2000	Total
Indirect Costs Charged to DOL Grants Administered by DUI and DWE	\$25,714	\$24,059	\$25,542	\$75,315
Allowable Indirect Costs on DOL grants within DUI and DWE	24,305	23,235	23,956	71,496
Indirect Costs Overcharged on DOL Grants	\$ 1,409	\$ 824	\$ 1,586	\$ 3,819

Based on our audit, we questioned a total of \$3,819,850 in indirect costs charged by DWD to DOL grants administered by DUI and DWE during the 3-year period ended June 30, 2000, primarily because:

1. DWD's General Administration pool costs improperly included \$459,460 of Office of Legal Counsel costs that were allocated to DOL grants on a basis other than "relative benefits received;" and General Administration pool costs charged to DOL grants, on the basis that budget estimates were not periodically adjusted to and exceeded DWD's actual costs by \$2,147,099.
2. DUI did not allocate its share of the DWD Administrative Service Division (ASD)-Finance indirect cost pool to all DUI cost objectives on the basis of "relative benefits received;" instead, 100 percent of these indirect costs were charged to a single DOL grant award resulting in \$120,985 of questioned costs.
3. DUI and DWE did not allocate their share of the DWD Application/Database Servers indirect cost pool to all DUI and DWE cost objectives on the basis of "relative benefits received;" instead, they charged 100 percent of these indirect costs to a single DOL grant award within each of their respective divisions resulting in \$933,306 of questioned costs.
4. Manual vouchers totaling \$159,000 were improperly shifted from a non-DOL program to DOL grants because the State project had reached its budget.

Similar improper allocated charges of indirect costs to DOL grants may have occurred in SFYs 2001 and 2002, since the conditions discussed above have not changed since the completion of our fieldwork in December 2001.

Auditee's Response

In its written response dated June 25, 2002, DWD disagreed with virtually all our findings and recommendations. We have incorporated DWD's detailed comments at the end of each finding, as appropriate. In addition, a copy of DWD's written response is included in its entirety as an appendix to this report.

Auditor's Conclusion

DWD's written response did not provide any new or compelling evidence that would warrant any change in the findings, conclusions, and recommendations presented in our report. In summary, all recommendations are considered unresolved and will be addressed in the DOL's formal resolution process.

Recommendations

We recommend that the cognizant DOL grant officer(s) direct DWD to refund the \$3,819,850 million in indirect costs that it overcharged to DOL grants in SFYs 1998, 1999, and 2000, and to adjust its billings to DOL for SFYs 2001 and 2002 to preclude further overcharging of indirect costs attributable to the findings in this report.

Further, we recommend that the Assistant Secretary for Employment and Training direct DWD to develop written internal control policies and procedures to ensure that its methodology for charging indirect costs to DOL grants fully complies with the reasonableness, allocability, and allowability criteria mandated by OMB Circular A-87.

INTRODUCTION

BACKGROUND

The State of Wisconsin's Department of Workforce Development (DWD) is a State agency charged with building and strengthening Wisconsin's workforce in the twenty-first century and beyond. The Department's primary responsibilities include providing job services, training, and employment assistance to people looking for work. At the same time, it works with employers to find the necessary workers to fill job openings.

DWD consisted of seven divisions and three organizations. For the State fiscal years (SFYs) ended June 30, 1998, 1999, and 2000, DWD reported expenditures of more than \$.9, \$1.3, and \$1.9 billion, respectively, and employed more than 2,300 people. The Division of Unemployment Insurance (DUI) and Division of Workforce Excellence (DWE) administer nearly 97 percent of the U.S. Department of Labor (DOL) funds. DUI had expenditures of \$57.8, \$60.8, and \$66.0 million and employed more than 600 employees for SFYs June 30, 1998, 1999, and 2000, respectively. DWE had expenditures of \$71.9, \$65.5, and \$68.0 million and employed more than 400 employees for SFYs June 30, 1998, 1999, and 2000, respectively. A brief discussion of the two divisions covered in our audit follows:

Division of Unemployment Insurance

This division is responsible for:

- C providing temporary economic assistance to Wisconsin's unemployed workers;
- C collecting Unemployment Insurance (UI) taxes from employers in compliance with State and Federal UI laws;
- C estimating the accuracy of UI benefit payments, revenue operations, denied claims, and identifies individuals using the Telephone Initial Claims system;
- C collecting overpayments of UI, Aid to Families with Dependent Children (AFDC), Temporary Assistance to Needy Families (TANF), Medical Assistance (MA), Food Stamps (FS), and Child Care (CC);
- C conducting hearings when workers or employers disagree with DUI decisions regarding UI benefits or UI taxes; and
- C helping local agencies minimize fraud for AFDC, TANF, MA, FS, and CC.

Division of Workforce Excellence

This division is responsible for implementing the Partnership for Full Employment program. This program was developed for the delivery of three tiers of services: self-service, “lite” service, and case-managed service for both job seekers and employers. The key element of the program is the delivery of these multiple program services through integrated “one-stop” Job Centers.

* * * * *

DWD annually prepares and submits to the DOL’s Office of Cost Determination (OCD) an indirect cost rate and program revenue service (PR-S) rate proposals for the various DOL grants. The indirect cost rate is used to recover the costs associated with the Wisconsin Statewide Cost Allocation Plan (SWCAP) from all projects within DWD. The PR-S rates are used to recover the costs of the Administrative Service Division (ASD) and are based on budget estimates. ASD provides accounting, budgetary, electrical, facilities, information systems, mail processing, payroll, personnel, printing, purchasing, and training services for the other divisions within DWD. ASD costs are accumulated in individual cost pools and each cost pool has its own PR-S rate. The following are the ASD cost pools for SFYs 1998, 1999, and 2000:

- | | |
|--------------------------------|---|
| Ⓒ Analyst/Programmer | Ⓒ Mainframe Printing |
| Ⓒ Application/Database Servers | Ⓒ Network Support Fixed |
| Ⓒ DWD-ASD Finance | Ⓒ Network Support FTE (full time equivalents) |
| Ⓒ Electrician | Ⓒ Network Support Time |
| Ⓒ Facilities | Ⓒ Special Initiatives |
| Ⓒ General Administration | Ⓒ Wisconsin Conservation Corps Payroll |
| Ⓒ Mail Service | Ⓒ Y2K Client Server Test Environment |
| Ⓒ Mainframe Activities | Ⓒ Non-fee NPS (non-personnel services) |

In preparing its proposal for the indirect cost rate, DWD receives from the Wisconsin Department of Administration an estimate of DWD’s share of the SWCAP costs. DWD’s share of the estimated SWCAP cost is then divided by the total estimated DWD direct labor cost allocation base to determine the proposed indirect cost rate submitted to DOL/OCD for review and approval. The DOL’s OCD-approved rate is then applied to the actual labor cost of each project within DWD. This indirect cost rate was used to recover approximately \$500,000 of SWCAP costs; we did not audit these costs because the amounts allocable to DOL grants were not material in relation to other costs.

OBJECTIVE, SCOPE AND METHODOLOGY

Our audit objective was to conduct an audit of the direct and indirect costs charged to the UI grant award to DWD for the period July 1, 1999, through June 30, 2000 (SFY 2000), to determine whether such costs were reasonable, allocable, and otherwise allowable under the Federal cost principles set forth in OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, and the implementing guidelines set forth in ASMB C-10, *Cost Principles and Procedures for Establishing Cost Allocation Plans and Indirect Cost Rates for Agreements with the Federal Government*. Based on the results of our audit efforts of SFY 2000, the scope of the audit was expanded to include SFYs 1998 and 1999 and to cover other DOL grants administered by DWD.

Our phase one risk assessment of costs charged to the UI Program for SFY 2000 indicated that 97 percent of the costs charged to DOL grants were used for grants administered by DUI and DWE. We also determined that most of DWD's indirect costs involved the PR-S rates used to allocate the ASD costs to the other divisions within DWD. Our phase one risk assessment of the direct and indirect costs charged to DOL grants within DUI and DWE did not indicate any significant problems with the allowability of the costs. However, it did indicate problems with the methodology used to allocate ASD costs to the DOL grants. Accordingly, we focused our audit on the DUI and DWE grants and the indirect costs allocated to them using the PR-S rates. In addition, we expanded our audit to include SFYs 1998 and 1999 for the issues noted during our audit of the SFY 2000 costs.

The primary objective of phase two of our audit was to examine the DWD processes for claiming and recovering indirect costs to determine the allowability and allocability of:

(1) the costs of services provided by the DWD administrative support groups for the benefit of federally funded programs; (2) the expenses included in each center; (3) the methods used to allocate these indirect costs to the operating units; and (4) to develop and report our findings.

The extent of our work on internal controls and compliance was limited to that necessary to fully develop the specific problems/findings disclosed by our audit in accordance with *Government Auditing Standards*.

Under Federal cost reimbursement principles, only actual incurred costs are allowable; budget estimates are not allowable. However, when actual costs are not readily available, the Federal cost principles permit the use of budget estimates for billing purposes on the condition that the claimed costs are periodically adjusted to actual allowable costs. For example, the indirect cost rate and PR-S rates proposal submitted by DWD to DOL's OCD were based on budget estimates that provide a basis for negotiating "fixed" indirect cost rates and PR-S rates for billing purposes, and were purportedly adjusted to actual costs through the use of the "cash balance" of the cost pools from the preceding year. Further, the negotiated indirect cost rate agreements state that DWD's

recovery of indirect costs using these “fixed” indirect costs are subject to audit. See Appendix 1 for a detailed discussion of Federal cost principles.

This engagement was performed in accordance with the *Government Auditing Standards* issued by the Comptroller General of the United States. Our engagement did not include expressing a written opinion on the reasonableness and allowability of DWD’s total claimed costs, the adequacy of its overall system of internal controls, or its overall compliance with laws and regulations applicable to Federal grants.

Our audit fieldwork was performed at DWD offices in Madison, Wisconsin, during the period August 27, 2001, through December 19, 2001. An exit conference was held on December 19, 2001, with officials from the Secretary’s Office of DWD and various other DWD officials.

FINDINGS

FINDING 1. General Administration Pool Costs Charged to DOL Grants Were Overstated

Our audit of the General Administration pool costs charged to DOL grants administered by DUI and DWE disclosed overcharges totaling \$2,606,559 for SFYs 1998, 1999, and 2000. The General Administration cost pool includes the costs of various ASD support functions that are allocated to all divisions within DWD each month, using an approved PR-S rate, based on each division's actual FTEs for the month. Specifically, we found that:

- A. The General Administrative cost pool improperly included the costs of DWD's Office of Legal Counsel that were allocated to DOL grants administered by DUI and DWE on the basis of FTEs rather than "relative benefits received" as required by OMB Circular A-87. Our discussions with Office of Legal Counsel staff indicated that only about 5 percent of their time directly benefited DUI and DWE programs (including the DOL grants they administer), whereas about 45 percent of the costs of the Office of Legal Counsel costs was allocated to DUI and DWE. In turn, \$459,460 of these costs (38 percent of total Office of Legal Counsel costs) was improperly allocated to the DOL grants administered by DUI and DWE.

- B. DWD did not periodically adjust the General Administration pool costs charged to DOL grants (using PR-S rates based on budget estimates) once its actual costs became known, as required by Federal cost principles mandated by OMB Circular A-87. Our comparison of the total General Administration pool costs charged to the DOL grants (using PR-S rates that were based on budget estimates), with the actual incurred General Administration pool costs properly allocable to the DOL grants, disclosed that the DOL grants had been overcharged another \$2,147,099 (after deducting the \$459,460 in overcharges of Office of Legal Counsel costs noted above).

The following table summarizes by year: (1) the total actual incurred costs included in the General Administration cost pool; (2) the total actual costs incurred by the Office of Legal Counsel that should not have been included in the General Administration cost pool; (3) the total allowable incurred costs included in the General Administration cost pool; (4) General Administration pool costs allocated to DOL grants within DUI and DWE; (5) the amount of allowable General Administration pool costs allocable to DOL grants administered by DUI and DWE; and (6) the amount of General Administration pool costs overcharged to DOL grants administered by DUI and DWE during SFYs 1998, 1999, and 2000.

GENERAL ADMINISTRATION COST POOL

(dollars in thousands)

Description	1998	1999	2000	Total
Total General Administration Cost Pool (Actual Incurred Costs)	\$6,669	\$6,311	\$6,593	\$19,573
Less: Actual Office of Legal Counsel Costs	347	365	497	1,209
Total Allowable General Administration Cost Pool (Actual Incurred Costs)	\$6,322	\$5,946	\$6,096	\$18,364
Total General Administration Pool Costs Allocated to DOL Grants within DUI & DWE (PR-S Rate times Actual FTEs)	\$3,188	\$3,087	\$3,260	\$9,535
Total Allowable General Administration Cost Pool Allocable to DOL Grants within DUI & DWE (Actual Incurred Costs)	2,354	2,240	2,334	6,928
Total General Administration Pool Costs Overcharged to DOL Grants Administered by DUI & DWE	\$ 834	\$ 847	\$ 926	\$2,607

A. Office of Legal Counsel Costs Charged to DOL Grants

Our audit disclosed that \$459,460 in Office of Legal Counsel costs were improperly allocated to DOL grants administered by DUI and DWE during SFYs 1998, 1999, and 2000, on a basis other than “relative benefits received” in violation of Federal cost principles mandated by OMB Circular A-87. During the 3-year period covered by our audit, we found that about \$1.2 million in costs incurred by the Office of Legal Counsel, Office of the Secretary of DWD, were improperly included in the General Administration cost pool and allocated to all DWD operating divisions based on FTEs. DUI and DWE account for about 45 percent of total DWD FTEs. About 38 percent of the \$1.2 million in legal costs (or \$459,460) were allocated to DOL grants administered by DUI and DWE.

OMB Circular A-87 requires that indirect costs be allocated to cost objectives on the basis of “relative benefits received.” To help grantees comply with this requirement, the implementation guide for OMB Circular A-87 recommends specific bases for charging various types of administrative and support services costs to Federal grants. The implementation guide specifically recommends that legal services be charged/allocated to cost objectives on the basis of “direct hours,” (i.e., treated as a direct cost rather than being included in an indirect cost pool).

Based on our discussions with the employees of the Office of Legal Counsel, we learned that they performed very little legal work for DUI and DWE. Using data obtained in these interviews, we calculated that the employees of the Office of Legal Counsel only spend about 5 percent of their time on issues directly related to DUI and DWE programs.

We believe that the amount of legal work that the Office of Legal Counsel staff performs for DUI and DWE clearly demonstrates that FTEs are not an acceptable basis for allocating the Office of Legal Counsel costs to DOL grants on the basis of “relative benefits received,” as required by OMB Circular A-87.

We also learned from our discussions with Office of Legal Counsel officials that their primary responsibilities involved consulting with specific divisions on personnel or labor issues and assisting the State Department of Justice with gathering information related to personnel or labor issues that are going to court where it relates to a specific employee within a specific division.

In addition, we learned that DUI has its own staff of attorneys who “direct charge” their time to the grants on which they work. OMB Circular No. A-87, Attachment A, paragraph C.1.f. specifically states that costs must “Be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost if any cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.” Similarly, Attachment E, paragraph A.1. states, in part, that “A cost may not be allocated to a Federal award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to a Federal award as a direct cost.” [Emphasis added.]

Finally, assuming that the information obtained from Office of Legal Counsel staff was correct, about 5 percent of the Office of Legal Counsel costs could have been charged to DUI and DWE programs as direct costs had the staff maintained personnel activity reports or equivalent documentation that met the detailed documentation standards set forth in OMB Circular A-87, Attachment B, paragraph 11.h., subsection (5), which must be met in order to support claimed salaries and wages (and all directly associated non-personnel costs). However, because this was not done, the costs of any legal services they may have rendered to DUI and DWE are also unallowable as direct costs.

Accordingly, we are questioning all of the \$459,460 in Office of Legal Counsel costs charged as indirect costs to DOL grants during SFYs 1998, 1999, and 2000.

Auditee’s Response

In its written response to our draft report, DWD stated that it did not agree with this finding, and that its methodology for allocating the costs associated with the Office of Legal Counsel allocates costs on the basis of “relative benefits received” and provides for consistent treatment of like costs.

Among other things, DWD said that the auditors’ conclusion that the employees of the Office of

Legal Counsel only spend about 5 percent of their time on matters directly related to DUI and DWE programs appeared to be based on discussions the auditors had with Office of Legal Counsel legal staff. According to the head of the Office Legal Counsel, “this finding flatly contradicts my recollection of my discussion with the contract auditor hired by DOL, in which I stated that the cost allocation estimate was a very fair approximation of the amount of legal work performed by OLC for DWE and DUI during this period.”

DWD further stated that the head of the Office of Legal Counsel “verified his impression of the amount of work done for DUI and DWE by reviewing the OLC work logs for 1998-2000 that contained over 400 entries. Discarding duplicate entries and minor items, he identified 127 cases, mostly labor representation matters, in which a significant amount of legal work was done on behalf of a DWD program. Of these, 65 involved services for DWE or DUI. While work logs do not reflect all of the legal office staff effort, the data indicates that the overall effort was probably much closer to the 38% actually charged than to the 5% that is quoted in the audit report.”

DWD also took exception to our quotes from OMB Circular A-87, Attachment A, paragraph C.1.f, and Attachment E, paragraph A.1 regarding the requirement for consistent treatment of direct and indirect costs of a like nature on the grounds that the legal work performed by the DUI staff attorneys “do not serve the same purpose as the DWD Legal Counsel attorneys.” DWD contended that the UI attorneys deal with UI program matters, while the Office of Legal Counsel attorneys work in other legal areas.

Finally, DWD took exception to our recommendation that legal services should be charged to cost objectives on the basis of “direct hours” pursuant to the OMB Circular A-87 implementation guide (ASMB C-10). DWD points out that this was only a recommendation and the implementation guide also states that “any method of distribution can be used which will produce an equitable distribution of costs. In selecting one method over another, consideration should be given to the additional effort required to achieve a greater degree of accuracy.”

Auditor’s Conclusion

DWD’s written response did not provide any new or compelling evidence that would warrant any change in this finding, nor the related conclusions and recommendations.

First, although DWD is correct in its statement that our conclusion appeared to be based on discussions we had with Office of Legal Counsel legal staff, we had no choice but to interview each individual staff attorney about how much time he/she spent on DWD’s various cost objectives because there was no acceptable documentary evidence showing how their time was actually spent. For example, the Office of Legal Counsel attorneys generally worked on multiple activities or cost objectives (both direct and indirect); however, they failed to maintain personnel activity reports or other acceptable supporting documentation required by OMB Circular A-87. Attachment B, paragraph 11.h., of the Circular expressly states that where employees work on multiple activities or

cost objectives, “a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation . . .” and that the “Personnel activity reports or equivalent documentation must meet . . .” a number of mandatory criteria which are cited elsewhere in this report. [Emphasis added.]

Second, we do not agree with the statement made by the head of the Office of Legal Counsel that the 38 percent “cost allocation estimate was a very fair approximation of the amount of legal work performed by OLC for DWE and DUI during this period” because we were not provided acceptable documentation that would support his conclusion.

Third, the “work logs” reviewed by the head of DWD’s Office of Legal Counsel do not constitute acceptable documentary support for the level of effort that may have been devoted to DOL grant awards administered by DWE and DUI. Some work log entries may involve only 1 or 2 hours of legal work, while other log entries may involve hundreds of hours of effort. In addition, DWD acknowledged in its response that the “work logs do not reflect all of the legal office staff effort. . . .” Accordingly, the work logs are not an acceptable basis for concluding that Office of Legal Counsel costs are allocated on the basis of “relative benefits received.”

Fourth, we disagree with DWD’s argument that DUI attorneys who “direct charge” the UI program “do not serve the same purpose as the DWD Legal Counsel attorneys” whose costs are included in a departmental indirect cost pool for allocation out to all final cost objectives (including the UI grant program). We agree that the DUI attorneys specialize in, and provide legal support to, the UI program. However, the fact remains that all of DWD’s other programs and cost objectives obtain their legal program support from the Office of Legal Counsel. As a result, the UI grants pay for their own legal program support services as direct costs, and then absorb a portion of the legal program support costs (properly allocable to DWD’s other State and Federal programs) through DWD’s indirect cost pool in violation of the Federal cost principles set forth in OMB Circular A-87, Attachment A, paragraph C.1.f., and Attachment E, paragraph A.1.

Finally, it is true that the “suggested” cost distribution base of “direct hours” for legal services is presented in the OMB Circular A-87 implementation guide (ASMB C-10) in the form of a suggestion/recommendation. However, the reason the implementation guide recommends “direct hours” as the allocation base for legal services costs is that Federal experience has shown that it is the best base for ensuring that such costs are distributed on the basis of “relative benefits received.” Based on data obtained in our interviews of Office of Legal Counsel staff attorneys, only about 5 percent of their time is spent on legal services on behalf of DOL grant programs administered by DWE and DUI, whereas about 38 percent of Office of Legal Counsel costs were allocated to DOL grant awards using FTEs as the allocation base during the period covered by our audit.

Based on our audit results, DOL grant awards were clearly overcharged for Office of Legal Services costs. Moreover, as previously discussed, even if we assume that the information we obtained from the staff attorneys were correct and that 5 percent of their time had, in fact, been

spent on legal services for DOL grant awards, DWD failed to maintain the required personnel activity reports to support these costs. We believe DOL should disallow all Office of Legal Services costs charged directly or indirectly to DOL grant awards until such time as these costs are properly supported by personnel activity reports that meet the criteria set forth in OMB Circular A-87.

B. Estimated General Administration Pool Costs Were Not Adjusted to Actual Costs

Our audit disclosed that the amount of General Administration pool costs allocated to DOL grants administered by DUI and DWE exceeded DWD's actual incurred General Administration pool costs allocable to DOL grants by \$2,147,099 during SFYs 1998, 1999, and 2000 (after deleting the Office of Legal Counsel costs questioned above).

OMB Circular A-87, Attachment B, paragraph 11.h(5)(e) states — “Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to Federal awards, but may be used for interim accounting purposes, provided that . . . they are periodically adjusted to actual costs.” This Federal cost principle is further emphasized in Attachment E to both OMB Circular A-87, and the implementing guidelines set forth in ASMB C-10, with respect to indirect cost rate proposals. A *provisional* rate is a temporary rate, agreed to in advance, based on an estimate of the costs to be incurred; however, it is subject to retroactive adjustment at a future date after actual costs are known. A *fixed* rate is also agreed to in advance, based on an estimate of future costs, but it is not retroactively adjusted; instead, the difference between estimated and actual costs is carried forward to future years. A *final* rate is established only after actual allowable costs are known.

As previously discussed in this report, DWD's General Administration pool costs were charged to DUI and DWE using PR-S rates, based on budget estimates, which, in turn, were allocated to the DOL grants administered by DUI and DWE based on actual FTEs.

When we compared the total amounts allocated to DOL grants administered by DUI and DWE, using the PR-S rates based on budget estimates, with the total actual allowable General Administration pool costs allocable to the DOL grants, we noted that DWD had over-recovered its actual costs by a substantial amount in each of the 3 years covered by our review (\$702,500 in 1998; \$707,733 in 1999; and \$736,866 in 2000).

DWD officials contended that its over-recoveries had been carried forward and offset against its budget estimates for succeeding years through the two-step process used to calculate the PR-S rates in each succeeding year.

The fact that DWD had substantial over-recoveries on DOL grants in each of the three consecutive years, despite the fact that its total estimated General Administration pool costs had remained relatively constant over this same period, indicates that DWD either (1) did not periodically adjust

its General Administration pool charges to DOL grants to actual allowable costs, as required by Federal cost principles, or (2) the methodology used by DWD was flawed. For example, if we were to assume that DWD's SFY 1999 costs, allocation base, and all other variables had remained identical to those for SFY 1998 (resulting in the \$702,500 over-recovery), a proper carry-forward would have produced a \$702,500 under-recovery on the DOL grants in SFY 1999 to offset the \$702,500 over-recovery in SFY 1998. Instead, DWD had another significant over-recovery totaling \$707,733.

According to ASD officials, any over/under-recoveries of General Administration pool costs on DOL grants in a given year are automatically carried forward to the following year by adding a "Dollar Cash Balance Target" to its estimated expenditures for the coming year, and subtracting its "Current Cash Balance." They explained that the "Dollar Cash Balance Target" was a variable for a working capital reserve, and that the "Current Cash Balance" was the carry-forward balance of prior year actual expenditures less the amount recovered based on the PR-S rates of the previous year. Finally, ASD further adjusts for the costs of any services the General Administration pool may have received from, or provided to, any of the other ASD support functions. The resulting balance is then divided by the estimated billable units to arrive at the proposed PR-S rate.

We were unable to properly evaluate the effectiveness of the above methodology because DWD was unable to provide the audit team with the necessary supporting documentation for SFY 1999. In addition, the above methodology is unnecessarily complex, and introduces subjective elements, such as the "Dollar Cash Balance Target," which DWD has acknowledged is a variable for a "working capital reserve." DWD's working capital needs are not relevant to the point at issue in this finding. Further, the introduction of such subjective elements tends to confuse the issue of DWD's alleged carry-forward of the apparent over-recoveries of indirect costs on the DOL grants.

Accordingly, we are questioning all of the \$2,147,099 in General Administration pool costs over-recovered by DWD in SFYs 1998, 1999, and 2000.

Auditee's Response

DWD disagreed with the finding on the grounds that its General Administration was considered a "billed service" and DWD was in full compliance with the requirements for "billed services" that are contained in A-87. DWD also contended that the references from OMB Circular A-87 listed in the audit report did not apply to the methodology that DWD utilizes for its General Administration cost pool because it was a "billed service." In support of this position, DWD cited OMB Circular A-87, Attachment E, paragraph F.2. which states, in part:

In some cases, governmental units provide and bill for services similar to those covered by central services costs allocation plans (e.g., computer centers). Where this occurs, the governmental unit should be guided by the requirements in

Attachment C relating to the development of billing rates and documentation requirements, and should advise the cognizant agency of any billed services.

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

DWD also cited OMB Circular A-87, Attachment C, paragraph G.4., regarding adjustments to billed central services costs, as follows:

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

DWD stated that it adjusted for “cash surpluses/deficits” by adjusting the next year’s billing rates pursuant to Attachment C, paragraph G.4., cited above.

DWD also disagreed with the auditor’s statement that its rate-setting process was “unnecessarily complex.” DWD noted that its current procedures for setting the billing rates reflect the essential factor needed to accurately adjust the rates for the actual cash balances, the allowable working capital reserve, the estimated activity, and the extent to which each cost pool provides services to other cost pools, and, accordingly, was not “unnecessarily complex.”

DWD also took exception to the auditor’s statement that “DWD’s working capital needs are not relevant to the point at issue in this finding.” DWD noted that OMB Circular A-87, Attachment C, paragraph D.2., allows billed central services to include “working capital reserves” in addition to the full recovery of costs, as follows:

Internal service funds are dependent upon a reasonable level of working capital reserve to operate from one billing cycle to the next. Charges by an internal service activity to provide for the establishment and maintenance of a reasonable level of working capital reserve, in addition to the full recovery of costs, are allowable. A working capital reserve as part of retained earnings of up to 60 days cash expenses for normal operating purposes is considered reasonable. A working capital reserve

exceeding 60 days may be approved by the cognizant Federal agency in exceptional cases.

Auditor's Conclusion

DWD's written response did not provide any new or compelling evidence that would warrant any change in this finding, nor the related conclusions and recommendations. DWD's response is based entirely on the premise that its ASD's General Administration cost pool is a "billed central service" (as defined in Attachment C, OMB Circular A-87) and, accordingly, DWD is entitled to a "working capital reserve" of up to 60 days cash expenses for normal operating purposes.

DWD's response did not consider the Federal cost principles set forth in OMB Circular A-87, Attachment C, and the implementing guidelines contained in ASMB C-10. A closer reading of Attachment C and the implementing guidelines shows that they pertain only to Central Services Cost Allocation Plans (CSCAPs) – commonly referred to as the statewide cost allocation plan or SWCAP, and for local governments, LOCAP. The "allocated" costs of the CSCAP are commonly referred to as the "Section I" costs, while the internal service funds and other "billed" services included in the CSCAP (e.g., self-insurance funds, fringe benefits costs, and pension and postretirement health insurance plans) are commonly referred to as "Section II" costs. The Federal cost principles and the implementing guidelines require that the CSCAPs be submitted to and approved by the Department of Health and Human Services. In addition, the Federal cost principles require very specific and detailed documentation for all "billed" services including, among other things:

- a balance sheet for each fund based on individual accounts contained in the governmental unit's accounting system;
- a revenue/expenses statement with revenues broken out by source;
- a list of non-operating transfers into and out of the fund;
- a description of the methodology used to charge the costs of each service to users, including how billing rates are determined;
- a schedule of current rates;
- a schedule comparing total revenues (including imputed revenues) generated by the service to the allowable costs of the service under Circular A-87, with an explanation of how variances will be handled; and
- a "Reconciliation of Retained Earnings" for all billed central services. For funds which utilize multiple billing rates, a reconciliation schedule may be required for each billing rate because various users do not utilize each/all billed services to the same extent.

Further, while Attachment C, paragraph G.2. permits working capital reserves up to 60-day cash needs, the implementation guidelines in ASMB C-10 expressly state that:

Reserves are only allowable for enterprise funds and bona fide ISFs [internal service funds] recognized in the government's comprehensive annual financial report (CAFR). Reserves are not allowable for activities funded through general revenue appropriations.

Our audit disclosed that DWD failed to meet these various requirements for "billed" central services. First, the various DWD overhead cost pools (including General Administration) only benefited the operating divisions and programs within DWD – they did not routinely provide central services (such as a State motor pool or a State data processing center) to other State agencies.

Second, the "billed" costs were actually "allocated" out to the benefiting operating divisions according to DWD's annual indirect cost proposals. More specifically, DWD's annual indirect cost proposals specifically state that the PR-S rates are used for "allocating" PR-S charges to the benefiting fund sources. For example, the SFY 1999 General Administration overhead pool (including such departmental overhead units as the Office of the Secretary, Procurement Bureau, Human Resources Bureau, Payroll Section in the Finance Bureau, etc.) is "allocated" out to the benefiting programs at the PR-S rate of \$307 per FTE per month. The fact that DWD uses a dollar amount instead of a percentage factor to charge these costs to the benefiting cost objectives does not mean that this overhead pool is "billed" rather than "allocated."

Third, DWD submits its indirect cost rate proposals containing the PR-S rates to DOL for review and approval to the U.S. Department of Labor's Office of Cost Determination – not to the Department of Health and Human Services which has cognizance over CSCAPs.

Fourth, DWD's annual indirect cost proposals failed to include the various documentation discussed above that are required by Federal cost principles to support the billing rates for valid central services.

Fifth, we verified with the Wisconsin Legislative Audit Bureau that neither DWD nor its various departmental overhead pools were recognized in the State's comprehensive annual financial reports as enterprise funds or bona fide internal service funds. Accordingly, DWD is not entitled to include a factor for 60-day working capital reserves into the PR-S rates it uses to "allocate" its departmental overhead costs out to its operating divisions (and, in turn, to DOL grant awards). Further, DWD's need for a 60-day working capital reserve is also negated by the fact that DWD has letters-of-credit on its various DOL grant awards that permit it draw Federal funds overnight to cover any and all allowable costs properly allocable to its DOL grants.

In summary, DWD has incorrectly applied the provisions of Attachment C of Circular A-87 to its General Administration cost pool (and its various other departmental overhead pools), in order to maintain a 60-day working capital reserve. DWD needs to revise its indirect cost rate proposals to comply with the provisions of Attachment E to Circular A-87 (State and Local Indirect Cost Rate Proposals), and exclude all elements pertaining to its stated need for working capital reserves (e.g.,

“Current Cash Balance” and “Dollar Cash Balance Target”). In addition, pursuant to OMB Circular A-87, Attachment E, paragraph F.5, DWD should refund to DOL the excess amounts charged to DOL grant awards as discussed above.

Accordingly, the finding stands as written.

FINDING 2. DUI Did Not Allocate Its Share of the DWD ASD-Finance Indirect Cost Pool to “All” DUI Cost Objectives on the Basis of “Relative Benefits Received”

The DWD ASD-Finance indirect cost pool includes the costs associated with the Finance Bureau, excluding the payroll department, and is allocated to the different divisions of DWD based on the amount of expenditures for each division. Our audit disclosed that DUI charged 100 percent of its allocated share of the ASD-Finance cost pool to a single DOL grant, instead of all grants administered by DUI, in violation of Federal cost principles set forth in OMB Circular A-87. As a result, \$120,985 in indirect costs, properly allocable to non-DOL programs within DUI, were improperly shifted to DOL grant awards during SFYs 1998, 1999, and 2000.

The following table summarizes the total amounts overcharged to DOL grants within DUI. Our calculations were based on actual incurred costs, rather than the budget estimates used by DWD in its cost allocation plans.

DWD ASD-FINANCE INDIRECT COST POOL

(dollars in thousands)

Description	1998	1999	2000	Total
Total DWD ASD-Finance Cost Pool (actual costs)	\$3,161	\$3,449	\$3,079	\$9,689
Total DWD ASD-Finance Cost Pool Allocated to DOL Grants Administered by DUI	213	220	135	568
Total Allowable DWD ASD-Finance Cost Pool Costs Which Should have been Allocated to DOL Grants Administered by DUI	155	194	99	448
Total Amount Overcharged to DOL Grants	\$ 58	\$ 26	\$ 36	\$ 120

During our review of the cost allocation plans for the divisions of DWD, we noted that most of the divisions include their allocated DWD ASD-Finance cost pool costs in their division overhead pool, which is then allocated to all projects within their respective divisions on an equitable basis. However, for DUI we noted that a portion of the DWD ASD-Finance cost pool, which had been allocated to DUI by ASD, had been charged 100 percent to a single DOL grant award rather than being allocated to all programs and activities within the division. This is a clear violation of the Federal cost principles set forth in OMB Circular A-87.

DWD officials stated that allocating 100 percent of the DWD ASD-Finance cost pool to a single DOL grant was reasonable and complied with OMB Circular A-87 because the overall DUI

mission supported DOL objectives. However, under Federal cost principles, we believe that the State projects and other non-DOL Federal projects administered by DUI must bear their fair share of these costs.

We took the total amount of DWD ASD-Finance costs allocated to DUI and allocated them to all projects within DUI using the same method DUI used to allocate its division overhead. Based on this reallocation, we determined that DOL grants within DUI were overcharged a total of \$120,985 during SFYs 1998, 1999, and 2000.

Auditee's Response

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

Auditor's Conclusion

DWD's written response did not provide any new or compelling evidence that would warrant any change in this finding, nor the related conclusions and recommendations. Also, DWD's written response (to the effect that the allocation methodology was incorrectly stated in DWD's cost allocation plans) contradicts statements made by DUI officials to the audit team during our fieldwork that "allocating 100 percent of the DWD ASD-Finance pool to a single DOL grant was reasonable." Nevertheless, when we allocated the ASD-Finance pool costs charged to DUI out over all benefiting DUI cost objectives under Federal cost principles, the amount properly allocable to DOL grant awards dropped by a total of \$120,985.

Accordingly, the finding stands as written.

FINDING 3. DUI and DWE Did Not Allocate Their Share of the DWD Application/Database Servers Indirect Cost Pool to “All” DUI and DWE Cost Objectives on the Basis of “Relative Benefits Received”

The DWD Application/Database Servers indirect cost pool includes the costs associated with the Oracle database, Interactive Voice Response systems, Internet, Lotus Notes systems, and Data Warehouse, and is allocated to the different divisions of DWD based on the number of users. Our audit disclosed that both DUI and DWE charged 100 percent of their share of the Application/Database Servers indirect cost pool to a single DOL grant award in each of their respective divisions, instead of all grants and programs administered by them, in violation of Federal cost principles set forth in OMB Circular A-87. As a result, \$933,306 in indirect costs, properly allocable to non-DOL programs within these two divisions, were improperly shifted to DOL grant awards during SFYs 1998, 1999, and 2000.

The following table summarizes the total amounts over/undercharged to DOL grants within DUI and DWE. Our calculations were based on actual incurred costs, rather than the budget estimates used by DWD in its cost allocation plans.

APPLICATION/DATABASE SERVERS INDIRECT COST POOL

(dollars in thousands)

Description	1998	1999	2000	Total
Total Application/Database Servers Cost Pool (actual costs)	\$2,620	\$3,669	\$2,974	\$9,263
Total Application/Database Servers Cost Pool Allocated to DOL Grants Administered by DUI and DWE	3,052	1,541	2,465	7,058
Total Allowable Application/Database Servers Cost Pool Which Should Have Been Allocated to DOL Grants Administered by DUI and DWE	2,535	1,590	2,000	6,125
Total Amounts Over/(Under) Charged to DOL Grants	\$ 517	\$ (49)	\$ 465	\$ 933

During our review of the cost allocation plans for the divisions of DWD, we noted that most of the divisions include their allocated DWD Application/Database Servers pool costs in their division overhead pool, which is then allocated to all projects within their respective divisions on an equitable basis. However, we noted that both DUI and DWE had charged 100 percent of their share of the Application/Database Servers indirect cost pool to a single DOL grant award in each of their

respective divisions rather than allocating these costs to all programs and activities within these two division. This is a clear violation of the Federal cost principles in OMB Circular A-87.

DWD officials stated that allocating 100 percent of the Application/Database Servers cost pool to a single DOL grant within DUI and DWE was reasonable and complied with OMB Circular A-87 because the overall DUI and DWE missions support DOL's objectives. However, under Federal cost principles, we believe that the State projects and other non-DOL Federal projects administered by DUI and DWE must bear their fair share of these costs.

We took the total amount of DWD Application/Database Servers indirect cost pool allocated to DUI and DWE and reallocated them to all projects within DUI and DWE using the same method DUI and DWE used to allocate their division overhead. Based on this reallocation, we determined that DOL grants within DUI and DWE were overcharged a total of \$933,306 during SFYs 1998, 1999, and 2000.

Auditee's Response

DWD did not agree with this audit finding. In its written response, DWD stated that DUI and DWE fund applications through the Applications/Database Server cost pool. DWD said it disagreed that these applications should be allocated on an FTE basis through the division overhead allocation process because they only benefit DOL grants activities and are appropriately 100 percent funded by DOL grants. The specific applications directly managed by each division and funded from the Applications/Database cost pool are summarized in the following paragraphs.

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

- DUI staff accesses the Oracle database to inquire, update, and create initial and continued unemployment claim information.
- The Interactive Voice Response system is used by unemployment claimants to file initial or continued unemployment claims.
- The Lotus Notes application is used to track state legislation affecting the unemployment insurance program as well as the critical indicators of the unemployment insurance program.
- DUI's charges for the Internet were based on the number of hits made to the Unemployment Insurance website. The website contains general information about the program as well as on-line employer reporting.

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

- The majority of the application and database cost (96 percent of the cost in SFY 1999, for example) is associated with JobNet. JobNet is an Internet application that links employers and job seekers. Using the DOL grant to fund JobNet is consistent with section 7.a.3.D of the Wagner-Peyser Act that states that 90 percent of the sum allotted to each state pursuant to section 6 may be used for developing and providing labor market and occupational information.
- A small portion of the application and development cost is associated with the apprenticeship program. Using the DOL grant to fund the apprenticeship program is consistent with sections 7.a.1 and 7.a.2 of the Wagner-Peyser Act that state that 90 percent of the sum allotted to each state pursuant to section 6 may be used:
 1. For job search and placement services to job seekers including counseling, testing, occupational and labor market information, assessment and referral to employers.
 2. For appropriate recruitment services and special technical services for employers.”

Auditor’s Conclusion

DWD’s written response did not provide any new or compelling evidence that would warrant any change in this finding, nor the related conclusions and recommendations. As discussed in the body of this finding, the DWD Application/Database Servers indirect cost pool is allocated out to the various operating divisions within DWD based on the number of users. Most of the other operating divisions within DWD included the Application/Database Server pool costs in their division overhead pool which was then allocated out to all projects within their respective divisions based on FTEs.

DWD’s written response regarding the Application/Database Server costs allocated to DUI focused solely on how DUI used these various services to benefit the UI program. However, the fact that other DWD operating divisions also utilize the services of the Application/Database Server show that these services (e.g., the internet, Lotus Notes, etc.) are not unique to the UI program. While DWD’s response was silent about how and to what extent DUI’s State and other Federal programs also used these various services, it is reasonable to assume that if other DWD divisions (other than DUI and DWE) are using the services of the Application/Database Server, then the State and other Federal programs within DUI also use these services and should, therefore, be allocated a share of these costs. DWD’s response provided no evidence showing that the State and other Federal programs within DUI did not benefit from these services.

Regarding the Application/Database Server costs allocated to DWE, DWD has taken the position that, because certain State programs (i.e., JobNet and apprenticeship programs) may have certain objectives in common with the Wagner-Peyser DOL grant award, it is acceptable to shift the Application/Database Server costs incurred by these State programs over to the DOL grant. This position is contrary to the Federal cost principles set forth in OMB Circular A-87, and the implementing guidelines thereto, which state that all activities which benefit from the governmental unit's indirect costs (including unallowable activities and services donated to the governmental unit by third parties) must receive an allocation of indirect costs in accordance with "relative benefits received by each activity or program." Cost shifting is unallowable.

Accordingly, the finding stands as written.

FINDING 4. DWD Used Manual Vouchers to Improperly Shift Costs from a Non-DOL Program to DOL Grants

Our audit identified two manual vouchers, totaling \$159,000, which stated that the costs were being shifted from a State project (a non-DOL program) to DOL grants because the State project had reached its budget limit. DWD charged certain costs (e.g., master leases payments, etc.) to clearing accounts, and then uses manual vouchers to reallocate the clearing account costs to all of the projects that benefited from these costs.

OMB Circular A-87, Attachment A, provides general principles for determining allocable costs, both direct and indirect, including the following in section C.3:

- a. A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received.
- b. All activities which benefit from the governmental unit's indirect costs, including unallowable activities and services donated to the governmental unit by third parties, will receive an appropriate allocation of indirect costs.
- c. Any costs allocable to a particular Federal award or cost objective under the principles provided for in this Circular may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons. However, this prohibition would not preclude governmental units from shifting costs that are allowable under two or more awards in accordance with existing program agreements.

Similarly, section F.3b of Attachment A states that "Amounts not recoverable as indirect costs or administrative costs under one Federal award may not be shifted to another Federal award, unless specifically authorized by Federal legislation or regulation." Although both sections (C.3c and F.3b) expressly prohibit the shifting of costs from one Federal award to another Federal award, we believe that these general principles are even more applicable in this particular case that involves the shifting of costs from a State program to a Federal award.

DWD officials stated that moving these costs to the DOL grants were allowable and reasonable. However, they provided nothing documenting that this shift in costs from a State program to this particular Federal grant award was expressly authorized in a written program agreement or Federal legislation/regulation. Therefore, we believe that the shifting of costs constitutes a clear violation of the general cost principles cited above, and that the \$159,000 of costs shifted to the DOL grant award are unallowable.

Auditee's Response

DWD stated that it did not agree with this finding because the questioned costs were for information technology upgrades that enhanced the database used to track trainees, employers and training programs related to its State apprenticeship program. According to DWD, this activity is an allowable charge to Wagner-Peyser per Section 7.a.3.E of the Wagner-Peyser Act which states that:

Ninety percent of the sums allotted to each state pursuant to section 6 may be used for developing a management information system and compiling and analyzing reports therefrom.

DWD also stated that the State apprenticeship program was an allowable charge to Wagner-Peyser per Sections 7.a.1 and 7.a.2 which state that:

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

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

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

Finally, DWD stated that it believes that these general principles are applicable in this particular case even though it involves shifting of costs from a State program to a Federal award i.e., this shifting of costs is acceptable because the costs are also allowable under Wagner-Peyser.

Auditor's Conclusion

Again, DWD has argued that because its State apprenticeship program has certain objectives in common with the Federal Wagner-Peyser grant award, costs properly allocable to the State program may be shifted to the Federal grant. In addition, DWD cited a particular provision in OMB Circular A-87 that it believes permits the shifting of costs from State programs to Federal

grant awards. However, the position it has taken violates a number of basic Federal cost principles previously discussed in this report (e.g., costs must be charged/allocated on the basis of “relative benefits received;” all activities which benefit from the costs, including unallowable activities, must receive an appropriate allocation of such costs; costs may not be shifted to other cost objectives to overcome fund deficiencies or for other reasons; etc.).

The cost principle cited by DWD as justification for its shifting of costs for a State program to a Federal grant award (OMB Circular A-87, Attachment A, paragraph C.3.a.) expressly prohibits the shifting of costs from one Federal grant to another Federal grant to overcome fund deficiencies, or for other purposes. The possible exception cited in that paragraph also pertains to shifting costs from one Federal grant award to another Federal grant award – it does not permit shifting costs from State programs to Federal grant awards.

This possible exception is addressed in more detail in paragraphs 2-12, 2-13, 2-14, and 2-16 in the ASMB C-10 implementing guidelines to OMB Circular A-87. In summary, these paragraphs make very clear that the basic underlying cost principles (previously cited) must be followed, and that any shifting of “unallocable” costs, or the costs of “common activities,” would be permitted only with the express authorization of the head of the awarding agency. In the absence of such authorization, costs must be allocated to all benefiting programs on the basis of “relative benefits received.”

In summary, there is no express authority in the Federal cost principles to shift costs from a State program to which such costs are properly allocable, to a Federal grant award, simply because they may have some broad objectives in common. Even if there were such criteria in the Federal cost principles, DWD has not provided any evidence that the Secretary of the U.S. Department of Labor has authorized the shifting of State apprenticeship costs to the Wagner-Peyser grant award.

Accordingly, the finding stands as written.

CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

Based on the results of our audit, we have concluded that DWD has overcharged DOL grant awards a total of \$3,819,850 in indirect costs over the 3-year period ended June 30, 2000. This occurred because DWD has failed to implement adequate internal control policies and procedures to ensure compliance with Federal cost principles mandated by OMB Circular A-87, the “Common Rule” (as implemented by DOL at 29 CFR 97), and the terms and conditions of the various DOL grants.

As discussed in the body of this report, our audit disclosed that:

1. DWD’s General Administration pool costs improperly included Office of Legal Counsel costs which were allocated to DOL grants on a basis other than “relative benefits received,” and General Administration pool costs charged to DOL grants, on the basis of budget estimates, were not periodically adjusted to actual costs as required by Federal cost principles.
2. DUI did not allocate its share of the DWD ASD-Finance indirect cost pool to “all” DUI cost objectives on the basis of “relative benefits received.” Instead, DUI charged 100 percent of its allocated share of the ASD-Finance cost pool to a single DOL grant rather than all grants administered by DUI, in violation of the Federal cost principles set forth in OMB Circular A-87.
3. DUI and DWE did not allocate their respective shares of the DWD Application/Database Servers indirect cost pool to “all” DUI and DWE cost objectives on the basis of “relative benefits received.” Instead, they charged the costs associated with the Application/Database Servers cost pool to a single DOL grant award in each of their respective divisions rather than to all of the grants and programs administered by them, in violation of the Federal cost principles set forth in OMB Circular A-87.
4. DWD used manual vouchers to improperly shift costs from a State project to a DOL project because the State project had reached its budget limit.

DWD officials stated that they believed their methodology for allocating the above costs was reasonable and complied with OMB Circular A-87. However, they did not provide any documentation or other evidence to support this position. We believe that the facts presented in this report clearly demonstrate that the costs we questioned did not meet the allowability, allocability, and reasonableness criteria mandated by the Federal cost principles in OMB Circular A-87, and are, therefore, unallowable.

In summary, the findings discussed above resulted in an improper shifting of costs totaling about \$3,819,850 from DWD State and other non-DOL Federal programs to DOL grants in DUI and DWE. We expect that a similar overcharge of indirect costs on DOL grants will also occur in SFYs 2001 and 2002 because the conditions discussed above had not changed as of the completion of our fieldwork in December 2001.

RECOMMENDATIONS

We recommend that:

1. The cognizant DOL Grant Officer(s) direct DWD to refund the \$3,819,850 in unallowable costs questioned in this report, pursuant to OMB Circular A-87, Attachment E, paragraph E.4. (Findings 1, 2, 3, and 4.)
2. The cognizant DOL Grant Officer(s) direct DWD to adjust its billings to DOL grants for FYs 2001 and 2002 indirect costs to preclude further overcharges of indirect costs attributed to the findings in this report. (Findings 1, 2, 3, and 4.)
3. The Assistant Secretary for Employment and Training direct DWD to develop and implement written internal control policies and procedures to ensure that its methodology for charging indirect costs to DOL grants fully complies with the reasonableness, allocability, and allowability criteria mandated by OMB Circular A-87. (Findings 1, 2, 3, and 4.) These internal control policies and procedures should ensure that:
 - a. DWD Office of Legal Counsel costs are direct-charged to the benefiting cost objectives rather than being included in the General Administration cost pool and allocated to DOL grants on a basis other than relative benefits received. (Finding 1.)
 - b. DWD's General Administration pool costs are adjusted annually to actual costs in accordance with OMB Circular A-87, and the implementing guidelines set forth in ASMB C-10. (Finding 1.)
 - c. DWD ASD-Finance cost pool costs are allocated to all projects within DUI through the divisional overhead rate. (Finding 2.)
 - d. Application/Database Servers cost pool costs are allocated to all projects within DUI and DWE through the divisional overhead rate. (Finding 3.)
 - e. Costs are not shifted from one project to another to overcome fund deficiencies. (Finding 4.)

TICHENOR & ASSOCIATES, LLP
CERTIFIED PUBLIC ACCOUNTANTS AND MANAGEMENT CONSULTANTS
304 MIDDLETOWN PARK PLACE, SUITE C
LOUISVILLE, KY 40243

BUSINESS: (502) 245-0775
FAX: (502) 245-0725
EMAIL: TICHENORKY@AOL.COM

Mr. Elliot P. Lewis
Deputy Inspector General for Audit
Office of Inspector General
U.S. Department of Labor
Frances Perkins Building, Room S-5518
200 Constitution Ave. NW
Washington, DC 20210

INDEPENDENT ACCOUNTANT'S REPORT ON AUDIT

Tichenor & Associates, LLP, under contract to the U.S. Department of Labor (DOL), Office of Inspector General, conducted an audit of indirect costs charged to DOL grants administered by the State of Wisconsin's Department of Workforce Development (DWD) for State fiscal year 2000, to determine whether such costs were reasonable, allowable, and allocable under the Federal cost principles set forth in OMB Circular A-87. The audit objectives provided that, depending on the results of our initial audit efforts on DOL unemployment insurance grants, the scope of the audit could be expanded to include additional years and other DOL grant programs.

The preliminary results of our audit indicated several potential problems with the allocation of indirect costs to the various cost objectives. Accordingly, we focused the balance of our audit on the DWD allocation of the costs of Administration Support Division, an administrative and support division of DWD, to the Division of Unemployment Insurance (DUI) and Division of Workforce Excellence (DWE), both operating/program divisions of DWD, for State fiscal years (SFYs) ended June 30, 1998, 1999, and 2000.

We were not engaged to, and did not perform, an audit of DWD's total costs charged to DOL grants, the objective of which would have been the expression of an opinion on the total costs claimed by DWD, and, accordingly, we do not express such an opinion. In addition, the extent of our work on internal controls and compliance was limited to that necessary to fully develop the specific problems/findings disclosed by our audit in accordance with *Government Auditing Standards*.

Based on the results of our audit, we questioned a total of \$3,819,850 in indirect costs charged to DOL grants administered by DUI and DWE during SFYs ended June 30, 1998, 1999, and 2000 which were not in compliance with the Federal costs principles mandated by OMB Circular A-87.

Specifically, we found that:

- (1) DWD's General Administration pool costs improperly included Office of Legal Counsel costs which was allocated to DOL grants on a basis other than "relative benefits received;" and General Administration pool costs charged to DOL grants, on the basis of budget estimates, were not periodically adjusted to actual costs as required by Federal cost principles.
- (2) DUI did not allocate its share of the DWD ASD-Finance indirect cost pool to "all" DUI cost objectives on the basis of "relative benefits received." Instead, DUI charged 100 percent of its allocated share of the ASD-Finance cost pool to a single DOL grant rather than all grants administered by DUI, in violation of the Federal cost principles set forth in OMB Circular A-87.
- (3) DUI and DWE did not allocate their respective shares of the DWD Application/Database Servers indirect cost pool to "all" DUI and DWE cost objectives on the basis of "relative benefits received." Instead, they charged the costs associated with the Application/Database Servers cost pool to a single DOL grant award in each of their respective divisions rather than all of the grants and programs administered by them, in violation of the Federal cost principles set forth in OMB Circular A-87.
- (4) DWD used manual vouchers to improperly shift costs from a State project to a DOL project because the State project had reached its budget limit.

In summary, we questioned a total of \$3,819,850 in indirect costs charged to DOL grants administered by DUI and DWE during SFYs ended June 30, 1998, 1999, and 2000, because the costs did not meet Federal cost principles mandated by OMB Circular A-87.

This engagement was performed in accordance with applicable standards established by the American Institute of Certified Public Accountants and the *Government Auditing Standards* issued by the Comptroller General of the United States. Our engagement did not include expressing a written opinion on the reasonableness and allowability of DWD's total claimed costs, the adequacy of its overall system of internal controls, or its overall compliance with laws and regulations applicable to Federal grants. Our detailed findings, conclusions, and recommendations are contained in the accompanying report.

This report is intended solely for the use of the U.S. Department of Labor; however, the final report is a matter of public record and its distribution is not limited.

Tichenor & Associates, LLP

TICHENOR & ASSOCIATES, LLP
Louisville, KY
December 19, 2001

FEDERAL COST REIMBURSEMENT PRINCIPLES

FEDERAL COST REIMBURSEMENT PRINCIPLES

The DOL grants awarded to DWD provide for payment of allowable, reasonable, and allocable incurred costs as determined by OMB Circular A-87. In addition to OMB Circular A-87, the grant award and the “Common Rule,” governing the administration of grants to state and local governments, contain a number of compliance requirements that must be met in order for costs to be allowable. Among other things, the costs must be incurred in accordance with generally accepted accounting principles, and the grant accounting records must be supported by adequate source documentation such as canceled checks, paid bills, payroll records, time and attendance records, contract, and subcontract award documents.

General Principles for Determining Allowable Costs

Attachment A to OMB Circular A-87 establishes general principles for determining allowable costs, both direct and indirect, incurred by state, local, and Indian tribal governments under grants, cost-reimbursement contracts, and other agreements with Federal agencies. The principles are established for the purpose of determining the reasonableness, allowability, and allocability of costs claimed and are not intended to dictate the extent of Federal or contractor/grantee participation in the financing of a particular program or project. Accordingly, the principles describe what may be reimbursed or recovered under a Federal award. The principles are designed to ensure that the Federal Government bears its fair share of costs incurred, except where specifically restricted or prohibited by law.

Under OMB Circular A-87, costs charged to Federal programs must meet the tests of allowability, reasonableness, and allocability. To be **allowable**, costs must meet the following general criteria:

- a. Be necessary and reasonable for proper and efficient performance and administration of Federal awards.
- b. Be allocable to Federal awards under the Circular (e.g., on the basis of relative benefits received).
- c. Be authorized (or not prohibited) under state or local laws and regulations.
- d. Conform to any limitations or exclusions set forth in these principles, Federal laws, the terms and conditions of the Federal award, or any other governing regulations as to types and/or amounts of cost items.
- e. Be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities/programs of the governmental unit.
- f. Be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost. Similarly, a cost may not be allocated to a Federal award as an indirect cost if any other cost incurred for the same purpose in like circumstances has been charged to the award as a direct cost.

- g. Except as otherwise provided for in the Circular, costs must be determined in accordance with generally accepted accounting principles.
- h. Not be included as a cost or used to meet cost-sharing or matching requirements of any other Federal award in either the current or a prior period, except as specifically provided by Federal law or regulation.
- i. Be the net of all applicable credits.
- j. Be adequately documented.

A cost may be considered reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. The question of reasonableness is particularly important when governmental units or components are predominantly federally funded. In determining **reasonableness** of a given cost, consideration will be given to:

- a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the governmental unit or the performance of the Federal award.
- b. The restraints or requirements imposed by such factors as sound business practices; arms-length bargaining; Federal, state, and other laws and regulations; and terms and conditions of the Federal award.
- c. Market prices for comparable goods or services.
- d. Whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the governmental unit, its employees, the public at large, and the Federal Government.
- e. Significant deviations from the established practices of the governmental unit which may unjustifiably increase the Federal award's cost.

The following are the basic guidelines for costs to be **allocable**:

- a. A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with the "relative benefits received."
- b. All activities which benefit from the governmental unit's indirect costs, including unallowable activities and services donated to the governmental unit by third parties, will receive an appropriate allocation of the indirect costs.
- c. Any cost allocable to a particular Federal award or cost objective under the principles provided for in this Circular may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons. However, this prohibition would not preclude governmental units from shifting costs that are allowable under two or more awards in accordance with existing program agreements.

- e. Where an accumulation of indirect costs will ultimately result in charges to a Federal award, a [approved] cost allocation plan [and/or an approved indirect cost rate agreement] will be required as described in Attachments C, D, and E.

OMB Circular A-87 mandates that the HHS issue implementing guidelines for A-87 on behalf of the entire Federal Government. HHS has developed and issued these guidelines in ASMB C10, *Cost Principles and Procedures for Establishing Cost Allocation Plans and Indirect Cost Rates for Agreements with the Federal Government*. These additional guidelines include discussions of the requirements for preparing and submitting cost allocation plans, public assistance cost allocation plans, and state and local indirect cost rate proposals. In addition, these guidelines address types of indirect cost rates, acceptable methodologies for indirect cost rate determinations, allocation bases, special rates, the submission and documentation of indirect cost rate proposals, the review, negotiation, and approval of indirect cost rates, etc.

Specific Principles for Determining Allowability of Selected Items of Cost

Attachment B to OMB Circular A-87 provides specific principles to be applied in determining the allowability or unallowability of selected items of costs. These principles apply whether a cost is treated as direct or indirect. For the purposes of this audit, the single most important principle in this section of A-87 is Attachment B, paragraph 11.h., *Support for salaries and wages*, which states, among other things:

- (3) Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official having first-hand knowledge of the work performed by the employee.

- (4) Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation Such documentary support will be required where employees work on:
 - (a) More than one Federal award,
 - (b) A Federal award and a non-Federal award,
 - (c) An indirect cost activity and a direct cost activity,
 - (d) Two or more indirect activities which are allocated using different allocation bases,
or
 - (e) An unallowable activity and a direct or indirect cost activity.

(5) Personnel activity reports or equivalent documentation must meet the following standards:

- (a) They must reflect an after-the-fact distribution of the actual activity of each employee,
- (b) They must account for the total activity for which each employee is compensated,
- (c) They must be prepared at least monthly and must coincide with one or more pay periods, and
- (d) They must be signed by the employee.
- (e) Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to Federal awards.

AUDITEE'S RESPONSE

Scott McCallum
Governor

Jennifer Reinert
Secretary



State of Wisconsin

Department of Workforce Development

OFFICE OF THE SECRETARY
201 East Washington Avenue
P.O. Box 7946
Madison, WI 53707-7946
Telephone: (608) 266-7552
Fax: (608) 266-1784
http://www.dwd.state.wi.us/
e-mail: dwdsec@dwd.state.wi.us

June 25, 2002

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

RECEIVED
U.S. DEPT. OF LABOR
2002 JUL -1 AM 9:18
OFFICE OF THE
INSPECTOR GENERAL
PHILADELPHIA, PA

Dear Mr. Hill:

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

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

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

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

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

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

SEC-7792-E (R. 07/2001)

Wisconsin.gov

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

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

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

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

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

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

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

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

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

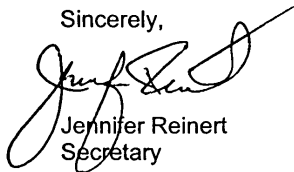
Mr. Michael T. Hill
June 25, 2002
Page 3

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

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

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

Sincerely,



Jennifer Reinert
Secretary

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

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

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

Part A – Office of Legal Counsel

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

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

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

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

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

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

Part B – Adjusting the General Administration Cost Pool to Actual

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

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

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

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

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

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

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

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

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

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

"Working Capital Reserves."

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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