DATE: September 30, 2004

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

Elliot P. Lewis

FROM: ELLIOT P. LEWIS
Assistant Inspector General
for Audit

SUBJECT: **ALERT REPORT**: Health Coverage
Tax Credit (HCTC)
Report Number: 02-04-204-03-330

We are in the process of conducting a performance audit of the Health Coverage Tax Credit (HCTC) bridge/gap[1] program. Our preliminary work has been on the HCTC bridge/gap program at the Maine Department of Labor (MDOL). During our preliminary analysis of data, we came across a time sensitive issue that requires the Employment and Training Administration's (ETA) immediate attention. Specifically, as of March 31, 2004, MDOL expended $298,000, or 4 percent of the $7.5 million awarded. The grant was to expire June 30, 2004, but has been recently extended to June 30, 2005. In addition, on a national scale[2], expenditures are at extremely low levels. We found that as of March 31, 2004, only 10 states have participated in the bridge/gap program and have expended $3 million, or less than 9 percent of the $35 million awarded. Over half of these grants have been in effect for at least one year.

ETA needs to immediately assess the need for outstanding funds at the 10 states and where necessary, redirect funds to other states that are able to participate in the program. This assessment and redirection of funds should be completed by ETA prior to September 30, 2004, which is the fund availability deadline. If ETA does not take immediate action, these funds may continue to be underutilized and individuals who are in need of interim health coverage assistance may not be able to receive them as authorized by the Trade Adjustment Assistance Reform Act of 2002.

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[1]Bridge funding was utilized to provide interim health insurance coverage cost assistance until the HCTC advance payment system was implemented on August 1, 2003. Gap funding is used to provide interim health insurance coverage cost assistance until the IRS completes the advance credit enrollment and first payment processes under the HCTC program.

[2] Information referred to as "national scale" refers to the states presented on page 4 of this report. All states except Maine have not been subjected to audit procedures.

The Assistant Secretary for Employment and Training responded to the draft report on September 30, 2004. ETA has taken constructive steps towards resolving our recommendations. We consider recommendations 1(a), 2 and 4 resolved and closed. (See recommendations on page 4.)

However, ETA still needs to proactively provide technical assistance to the participating states to enhance performance, reach out to nonparticipating states to assist in lifting barriers, and continue it's coordination efforts with partnering organizations to work towards seamless delivery and program enhancements that will increase the likelihood of individuals participating in the program. ETA's comments are incorporated on page 5 in the report and the response is included in its entirety as an attachment to this report.

Background

The Trade Adjustment Assistance Reform Act of 2002 (P.L. 107-210), was signed by the President on August 6, 2002. Among other things, the Act amended the Internal Revenue Code of 1986 and the Workforce Investment Act of 1998 (WIA) to establish new mechanisms by which certain Trade Adjustment Assistance (TAA) participants, as well as eligible Pension Benefit Guaranty Corporation (PBGC) pension recipients, can receive assistance in covering the cost of health insurance coverage. The primary mechanism for such assistance is a Federal tax credit administered by the Internal Revenue Service. The tax credit is equal to 65 percent of the amount paid by an eligible individual for coverage of the individual and certain family members under qualified health insurance coverage. The tax credit is applicable to qualified health insurance coverage costs paid by eligible individuals and the credit was made available on an advance payment basis on August 1, 2003.

The Act also established an additional mechanism, which is intended to be used as a bridge/gap until eligible individuals can receive the tax credit on an advance basis, by authorizing the use of National Emergency Grant (NEG) funds under WIA to assist in paying the cost of qualified health insurance coverage.

To carry this out, the Act authorized $50 million of Fiscal Year (FY) 2002 NEG funds for interim health insurance coverage and other assistance with a fund availability date until September 30, 2004. As we understand the Act, ETA must have the $50 million obligated by September 30, 2004. Further, based on correspondence received from ETA's Administrator of the Office of National Response, another $29.8 million has been authorized using FY 2003 funds. ETA is in the process of determining the availability period for FY 2003 funds.

Objective, Scope and Methodology

Interim audit work is being conducted as part of audit planning to determine the scope of an overall program performance audit. Our overall objective was designed to determine if the states have implemented systems and programs that will effectively reduce the number of uninsured eligible participants. We conducted interviews with ETA and MDOL personnel, performed an expenditure rate analysis of FY 2002 funding and tested for compliance with implementation guidance.

Our work was conducted in accordance with Government Auditing Standards, issued by the Comptroller General of the United States. We conducted fieldwork from June 8, 2004 through July 2, 2004. We held an exit conference with ETA officials on July 27, 2004. They indicated they are aware of the issues and are developing actions to remedy the situation.

Results

Our initial work concentrated on the Health Coverage Tax Credit bridge/gap program at the Maine Department of Labor. Based on the low expenditure level at MDOL, we expanded our analysis to include all 10 awarded bridge/gap grants to determine if the same pattern existed nationwide.

Maine Department of Labor

As of March 31, 2004, MDOL has expended $298,000, or 4 percent, of the $7.5 million FY 2002 funds awarded. The grant was to expire June 30, 2004, but has been recently extended to June 30, 2005. The original grant called for "reach-back" bridge payments for the period September 30, 2002 through June 30, 2003.

In MDOL's request for grant modification dated December 18, 2003, the grantee specifically recognized that its original proposal was overstated and that the participant level was lower than expected. We asked MDOL why participation was low. Although they could not provide conclusions based on factual information, they were of the opinion that the high cost of the participants' required contribution towards the medical insurance premium was a significant factor in the low participation level. MDOL further advised that its revised cost projection through June 30, 2004, would be $596,000 or a $6.9 million reduction from its original estimate. Further MDOL advised that the scope of the grant would be modified from a "bridge" payment to a "gap" payment basis. The grant extension to June 30, 2004, was granted. However, no action was taken on the request for grant reduction. By MDOL's own admission, HCTC funds will not be fully utilized. In fact, actual expenditures at June 30, 2004 only totaled $378,000 vs. the $596,000 originally projected.

National

A preliminary analysis of states around the country shows that less than 9 percent of the funds awarded had been expended even though over half of these grants have been in effect for at least one year.

Fiscal Year 2002 Funding

State[3]	Effective Date	Award Amount	Expenditures 3/31/2004	Percent to Award Amount
Maine	9/1/2002	$7,500,000	$297,576	4.0
Maryland	3/3/2003	5,632,000	15,934	0.3
Minnesota	1/1/2003	4,000,000	193,701	4.8
Montana	4/1/2003	266,923	114,548	42.9
New Jersey	1/1/2003	1,930,000	30,931	1.6
North Carolina	8/1/2003	7,614,684	1,214,839	16.0
Utah	4/1/2003	721,415	693,785	96.2
Virginia	8/1/2003	3,176,800	481,343	15.2
W. Virginia	6/1/2003	2,852,374	0	0.0
Washington	6/1/2003	1,512,000	0	0.0
Total		**$35,206,196**	**$3,042,657**	**8.6**

Based on the current spending trends, funds that have been authorized will be under-utilized. The underutilization of funds indicates that the program is not working as intended by the Act.

Recommendations

We recommend that the Assistant Secretary improve HCTC grant management and performance by:

1. Conducting an immediate assessment of awarded bridge/gap grants to determine (a) the need for outstanding funds, and (b) reasons for such underutilization.

2. Ensure Federal Project Officers (FPO) identify program deficiencies in a timely manner and institute corrective actions to address those deficiencies.

3. Reaching out to the 40 non-participating states and determining their bridge/gap payment needs.

4. Reallocating funds to the states as appropriate.

[3] With the exception of Maine, information presented was obtained from the Employment and Training Administration and has not been subjected to audit procedures.

Agency's Response

ETA stated that strategies are in place or are being planned to deal with the funding issues as well as to facilitate the participation of more states in the NEG HCTC program. In addition, ETA stated that other actions have taken place since the report issuance pertaining to OIG recommendations as summarized below:

- One additional state award and three pending applications will ensure that all FY 2002 funds will be obligated by September 30, 2004.

- FY 2002 funds will be available for expenditure at a minimum through September 30, 2007. Grantees have been informed.

- ETA issued a TEGL regarding refined policy guidance pertaining to the use of NEG HCTC funds to make "gap-filler" payments.

- ETA Regional offices canvassed grantees to identify any unneeded funds. With minor exception, ETA states that no funds are being returned by the grantees.

- ETA is advising states that additional resources are available for system building.

- On September 8, 2004 a working session with IRS HCTC was convened to examine the implementation of the HCTC program and to address program areas needing improvement.

Auditors Conclusion

ETA has taken constructive steps towards resolving our recommendations. We consider recommendations 1(a), 2 and 4 resolved and closed. ETA still needs to proactively provide technical assistance to the participating states to enhance performance, reach out to nonparticipating states to assist in lifting barriers, and continue it's coordination efforts with partnering organizations to work towards seamless delivery and program enhancements that will increase the likelihood of individuals participating in the program.

Recommendation 1(b)

ETA has not provided any specific actions or plans relative to determining the reasons behind the underutilization of funds. It is apparent that although ETA is extending grant periods, there continues to be underlying problems in the program. Nationally, state expenditure levels continue to be low. At June 30, 2004, only 14 percent of obligated funds have been expended. Five of the ten original states, accounting for $21 million, have only expended 3 percent of awarded funds.

To date, we have completed fieldwork at two states, Maine and Maryland. Both states have been running Gap programs and both have indicated that through June 30, 2005, awarded funds grossly exceed their needs. Maine projected needs of $725 thousand leaving excess funds of $6.8 million and Maryland projected needs of $436 thousand leaving excess funds of $5.2 million. Even if grant periods are ultimately extended to September 30, 2007, it seems unlikely that funds will be utilized unless significant performance improvements occur.

Recommendation 3

ETA has taken some general actions including additional TEGL guidance and announcing fund availability. However, it's response lacks specific actions that will identify reasons why so many states are not participating, identify barriers and plans to help lift identified barriers.

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We request a response to this report within 60 days. It is your responsibility to promptly transmit the attached report to program officials for resolution.

I would like to express our appreciation for the cooperation and courtesy that was extended to us by your staff during our audit. We are continuing work on our performance audit. An additional report will be issued upon completion. If you have any questions regarding this interim report, please contact Richard H. Brooks, Regional Inspector General for Audit, at (646) 264-3500.

Attachment