



U.S. Department of Agriculture
Office of Inspector General
Southwest Region
Audit Report

Food and Nutrition Service
Food Stamp Program
Administrative Costs
State of New Mexico



Report No.
27099-14-Te
FEBRUARY 2003



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Southwest Region

101 South Main Street, Suite 309

Temple, Texas 76501

TEL: 254-743-6500 FAX: 254-298-1358



DATE: February 7, 2003

REPLY TO

ATTN OF: 27099-14-Te

SUBJECT: Food Stamp Program Administrative Costs - New Mexico

TO:

Esther Phillips

Acting Regional Administrator

Food and Nutrition Service Southwest Region

Dallas, TX 75242

ATTN:

Albert M. McIlwain

Regional Director

Financial Management

This report presents the results of our audit of the Food Stamp Program Administrative Costs in New Mexico. Your written response to the official draft report is included in its entirety as exhibit B with excerpts and the Office of Inspector General's position incorporated into the Findings and Recommendations section of the report. Your written response contained sufficient justification to reach a management decision on Recommendation No. 1. Please follow Departmental and your internal agency procedures in forwarding final action correspondence to the Office of the Chief Financial Officer.

Based on the response, management decision has not been reached on Recommendations Nos. 2 and 3. The information needed to reach management decision is set forth in our position section after each recommendation.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective action taken or planned and the timeframes for implementation for those recommendations for which a management decision has not yet been reached. Please note that the regulation requires a management decision to be reached on all findings and recommendations within a maximum of 6 months from report issuance, and final action to be taken within 1 year of each management decision.

If you have any questions, please call me at 254-743-6565 or have a member of your staff contact Amy McCormack, Assistant Regional Inspector General, at 254-743-6566.

/s/

ROBERT E. GRAY

Regional Inspector General

for Audit

EXECUTIVE SUMMARY

FOOD AND NUTRITION SERVICE FOOD STAMP PROGRAM ADMINISTRATIVE COSTS STATE OF NEW MEXICO

REPORT NO. 27099-14-Te

RESULTS IN BRIEF

The objectives of our audit were to: (1) determine if the New Mexico Human Services Department (NMHSD) followed its cost allocation plan in claiming direct and indirect costs, and (2) review the accuracy and allowability of the administrative costs claimed on the quarterly Financial Status Reports (SF¹-269). Except for the following issues, we found no departure from the cost allocation plan or material instances of inaccurate or unallowable administrative costs.

The NMHSD did not follow established financial management procedures regarding funding of an information technology (IT) project because State officials thought that the method of obtaining funding was too cumbersome, burdensome, and added cost to the project. As a result, NMHSD incurred unauthorized project expenses in hopes of retroactive reimbursement, violated Food and Nutrition Service (FNS) procurement guidelines, and may have inappropriately claimed salaries and benefits to the Food Stamp Program (FSP).

NMHSD officials incurred costs without approval of their advance-planning document (APD) in spite of multiple warnings by the Food and Nutrition Service Regional Office (FNSRO) officials that they may be jeopardizing Federal funding by doing so. Invoices obtained from a vendor that provides system implementation services show total expenditures to date of over \$15 million, with FNS' potential share being 49 percent.

A portion of this amount was a result of NMHSD's awarding of a software development contract of about \$1.5 million via a contract amendment to a computer vendor already under contract despite FNS' policy that any contract amendment over \$1 million must be approved in advance by the agency.

¹ Standard Form.

We also found that NMHSD may have inappropriately allocated salary and benefit expenses to the FSP. This issue is included as a General Comment because of FNS' ongoing review, no recommendations are warranted at this time.

At the request of the FNS Administrator, an Office of Inspector General (OIG) representative met with and briefed the Administrator and other FNS officials on the issues outlined in this report. OIG later issued a briefing letter to the Administrator describing these issues.

KEY RECOMMENDATIONS

Determine what portion of the incurred IT project expense is unallowable and disallow any claim for reimbursement of unallowable project costs. Direct NMHSD to follow all aspects of the procurement guidelines in FNS Handbook 901.²

AGENCY RESPONSE

In a letter dated January 23, 2003, FNSRO generally agreed with the findings and recommendations (see exhibit B).

OIG POSITION

We need additional information to reach management decision for Recommendations Nos. 2, and 3. The information needed to reach management decision is set forth in the findings and recommendations section of the report.

² FNS Handbook 901, as amended December 12, 1997.

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INTRODUCTION

BACKGROUND

In 1977, Congress passed Public Law 95-113, the Food Stamp Act, which made the FSP a permanent Federal food assistance program that provides support to needy households.

Title 7, Code of Federal Regulations, part 277, dated January 1, 1999, established uniform requirements for the management of funds provided to the States for the administration of the FSP. Appendix A of this part, "Principles for Determining Costs Applicable to Administration of the Food Stamp Program by State Agencies," sets forth the principles for determining the allowable costs of administering the program.

States prepare a quarterly SF-269 of their FSP administrative costs and forward this report to FNS. FNS generally reimburses 50 percent of the States' direct and indirect administrative costs for certifying households, antifraud and investigations activities, automated data processing operations, fair hearings, outreach, nutrition education, and electronic benefits transfer issuance.

In fiscal year (FY) 2000, the FSP was funded at over \$21 billion, including over \$2 billion for administrative costs. State agencies administer the FSP at State and local levels, including determination of eligibility and distribution of benefits.

NMHSD is responsible for the FSP in the State of New Mexico. Total Federal outlay for the FSP administrative costs in the State increased from just over \$12 million in FY 1999 to almost \$12.5 million in FY 2000. This represented an increase of over 3 percent in 1 year. Monthly participation decreased from more than 178,000 recipients in FY 1999 to just over 169,000 in FY 2000, or a 5 percent decrease over 1 year. In 2000, New Mexico's administrative cost per FSP participant increased by \$6.14, compared to the region's average increase of \$5.93.

NMHSD officials reported to FNS that their computer system for administering assistance programs had exceeded its life expectancy and could no longer sufficiently perform business requirements due to the increasing needs of the Department. They proposed a new, fully integrated system with a life expectancy of 15 years and would include the FSP, Temporary Assistance to Needy Families, Work Programs, General Assistance, Claims, and Medicaid with a total cost of about \$36 million.

NMHSD bases its direct and indirect administrative costs on its cost allocation plan, approved by the cognizant Federal agency, the United States Department of Health and Human Services (HHS). Prior to approval, FNS has the opportunity to review the cost allocation plan and submit comments and recommendations to HHS. The FSP administrative costs are charged through direct and indirect costs. Direct costs are allocated according to case counts, direct charge, staff effort, and other approved methodologies. Departmentwide indirect costs (utilities, supplies, maintenance, accounting, administrative, etc.) and some direct costs (eligibility determinations, certification, etc.) are allocated according to the random moment time studies.

OBJECTIVES

The objectives of this audit were to determine: (1) if NMHSD followed their cost allocation plan in claiming direct and indirect costs, and (2) the accuracy and allowability of the administrative costs claimed on the SF-269s.

SCOPE

This audit was a part of a nationwide review of FSP administrative costs. We performed this audit at the FNSRO in Dallas, Texas, and at the NMHSD Office in Santa Fe, New Mexico, from March through September 2002. We selected the State of New Mexico because it had the second highest increase of administrative cost per FSP participant in the Southwest Region for FY 2000 and because of concerns of the FNS Southwest Regional Office.

In FY 2000, the FSP was funded at over \$21 billion, including over \$2 billion for administrative costs. State agencies administer the FSP at State and local levels, including determination of eligibility and distribution of benefits. Total Federal outlay for the FSP administrative costs in New Mexico was almost \$12.5 million in FY 2000.

We reviewed NMHSD's accounting records for all quarters in FY 2000. During the audit, we discovered circumstances regarding an ongoing IT project that caused us to expand our scope to include transactions through June 2002.

This audit was performed in accordance with Generally Accepted Government Auditing Standards.

METHODOLOGY

To accomplish our objectives and support our findings, we performed the following procedures:

- We reviewed regulations, policies, and procedures governing FSP administrative costs, including Office of Management and Budget (OMB) Circular A-87 (Circular), "Cost Principles for State, local, and Indian tribal governments."
- We interviewed FNS Southwest Regional Office and NMHSD officials to determine what controls are used to monitor FSP administrative costs.
- We obtained and reviewed a recent FNS financial management review of the State of New Mexico and NMHSD's cost allocation plan approved by HHS.
- We contacted an official at HHS' Division of Cost Allocation to identify any issues relating to NMHSD's cost allocation plan.
- We reviewed the results of State audits performed under the Single Audit Act to identify issues concerning the allocation of State administrative costs.
- We reviewed the cost allocation plan to determine if direct and indirect costs were properly allocated to the FSP.
- We reviewed the State's accounting records and analyzed its charges and claims for reimbursement to the FSP for all quarters in FY 2000. We performed a general comparison of all the State's SF-269s (quarters 1-4, end-of-year, and end-of-year revision) to the budget.
- We judgmentally selected the State's fourth quarter data and validated that the costs were supported and properly allocated to the FSP in accordance with the cost allocation plan. Additionally, we verified direct costs of the employment and training cost category. We selected this category based on the amount of costs and because it contained only direct costs.
- We gathered, reviewed, and analyzed documentation associated with NMHSD's ongoing IT project and interviewed officials involved with the project.

FINDINGS AND RECOMMENDATIONS

CHAPTER 1	NEW MEXICO HUMAN SERVICES DEPARTMENT DEVELOPED A NEW COMPUTER SYSTEM WITHOUT FNS' APPROVAL
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FINDING NO. 1

NMHSD DID NOT FOLLOW ESTABLISHED FINANCIAL MANAGEMENT PROCEDURES

NMHSD incurred costs in the development of a new computer system even though FNS has not yet approved their APD and NMHSD told them that Federal funds might be in jeopardy if they continued to incur or claim reimbursement for pre-award costs. NMHSD management did not follow established financial management guidelines because

they said the current procedures were “* * * cumbersome, burdensome, and added cost to IT projects” and believed that IT projects should have a separate method for approval. As a result, NMHSD incurred unauthorized project expenses of \$17,679,857 as of June 2002, of which 49 percent, or \$8,663,130 (\$17,679,857 x 49 percent), was allocated to the FSP. NMHSD also did not follow prescribed FNS procurement procedures regarding contract amendments.

NMHSD Incurred Unauthorized Project Expenses

NMHSD began incurring costs in August 2000 to develop a pilot project called CURAM,³ later known as the State System Applicant Links to Services for Assistance (SSALSA), for a technology refresh using forward-looking design and development techniques for use in administering Government programs (including the FSP). NMHSD did not submit the APD to FNSRO for review and approval until February 2002.

While reviewing the unauthorized expenses shown above, we found that NMHSD was over \$8.85 million in arrears to a vendor who provides system development services. According to the APD, the State intended to seek reimbursement from FNS for 40 percent of these expenses. However, FNSRO determined during a separate review that an allocation rate of 49 percent was more appropriate. They also determined that NMHSD incurred and charged State costs via the normal cost allocation plan prior to the approval of the APD. FNSRO recognized the potential need to recover a portion of those costs.

³ Per NMHSD officials, CURAM is a Gaelic word meaning “care and protection.”

FNSRO became aware of the project in November 2001 and verbally warned NMHSD that, until the APD was approved, NMHSD was potentially liable for all pre-award expenditures. FNSRO gave a second written warning in March 2002 of the State's potential liability.

The Circular⁴ establishes principles and standards for determining costs for Federal awards carried out through grants, cost reimbursement contracts, and other agreements with State and local governments and federally recognized Indian tribal governments (governmental units). The Circular defines pre-award costs as "those incurred prior to the effective date of the award directly pursuant to the negotiation and in anticipation of the award where such costs are necessary to comply with the proposed delivery schedule or period of performance. Such costs are allowable only to the extent that they would have been allowable if incurred after the date of the award and only with the written approval of the awarding agency."

Additionally, FNS Handbook 901 (Handbook) cites the Circular's requirement of " * * * prior approval of costs for automated data processing (ADP) equipment and services used for the administration of Federal grant programs." The Handbook also provides guidance to ensure successful approval and subsequent Federal funding of projects supporting FNS programs. This guidance applies to States preparing requests for Federal financial participation and FNSRO and Headquarters (HQ) organizations reviewing and approving these requests. The Handbook further emphasizes the communication and coordination within FNS State agencies, FNSRO, and HQ stakeholders to ensure successful oversight and management of system automation projects.

NMHSD officials acknowledged using the Handbook to prepare the APD. The Deputy Director of the Income Support Division (ISD) said the State was hopeful that FNSRO would retroactively reimburse their share of the expenses but admitted that there was no guarantee of this. When we pointed out the Circular's requirement that pre-award costs be approved in writing by the awarding agency, officials acknowledged that no official approval was given but repeated their hopes that the costs would be approved retroactively, even though FNSRO had given both verbal and written warnings of the State's potential liability for any reimbursements already received. When asked why they did not comply, the Secretary-Designate said the APD process was " * * * cumbersome, burdensome, time consuming and added cost to the project."

⁴ OMB Circular A-87, as amended August 29, 1997.

NMHSD Did Not Follow Procurement Guidelines

NMHSD also violated FNS procurement guidelines by amending their software development contract for the CURAM/SSALSA project. The amendment increased the amount of the contract by \$1.5 million (included in the total unauthorized amount).

The Handbook states, "Federal grant management policies require that for entitlement programs (e.g., FSP), prior approval for noncompetitive procurement of ADP services or equipment is required for acquisitions exceeding \$1 million in total costs. Cost charged to FNS programs that should have been submitted to and approved by FNS and have not been disclosed through an audit or review are subject to disallowance." The Handbook also requires prior FNS approval for contract amendments exceeding \$1 million.

NMHSD entered into a contract with Integrated Systems Solutions Corporation, later known as IBM Global, beginning January 1, 1997. The purpose of the contract was for maintenance and modification services for the ISD2 application system for NMHSD's ISD. The contract was amended (amendment 4) in August 2000 to include a pilot project called CURAM for a distributed data warehouse using leading-edge architecture, technologies, tools, and techniques. The cost assigned to this pilot project was \$1.5 million.

NMHSD officials stated that this amendment was for "technology enhancements" and, since the original request for proposal included technology enhancements, believed the amendment was competitively bid. The State acknowledged that it took this action without obtaining prior approval or consulting the Handbook. In addition, the New Mexico Office of the State Purchasing Agent stated that it did not approve or review the amendment for compliance with State procurement procedures, indicating that NMHSD also did not follow the State's procurement policy.

At the request of the FNS Administrator, an OIG representative met with and briefed the Administrator and other FNS officials on the issues outlined here. OIG later issued a briefing letter to the Administrator describing these issues.

RECOMMENDATION NO. 1

Determine what CURAM/SSALSA project costs are unauthorized and disallow any claim for reimbursement of those costs.

FNS Response

FNS has disallowed all contractor costs for the project and has disallowed all project costs prior to receipt of the official APD in February 2002.

OIG Position

We accept the FNS management decision. For final action, FNS needs to provide the Office of the Chief Financial Officer with copies of documentation showing unauthorized and disallowed costs.

RECOMMENDATION NO. 2

Recover from NMHSD any unauthorized amount determined to have been reimbursed.

FNS Response

FNS has asked the State to submit a revised budget and to provide additional information to support the cost allocation plan. FNS stated that once it receives this information, it will recover the appropriate funds.

OIG Position

We cannot accept the FNS management decision at this time. In order to reach management decision, we need proposed timeframes for recovery of funds.

RECOMMENDATION NO. 3

Direct NMHSD to follow all aspects of the procurement guidelines in FNS Handbook 901.

FNS Response

FNS agreed with this recommendation but did not provide its plan of action to be taken on this recommendation and proposed completion dates for implementation of the action.

OIG Position

We cannot accept the FNS management decision at this time. In order to reach management decision, we need a plan of action and proposed completion date for implementing the corrective action.

GENERAL COMMENTS

NMHSD May Have Allocated Administrative Expenses Inappropriately

NMHSD may have inappropriately allocated salary and benefit expenses to the FSP. The HHS Centers for Medicare and Medicaid Services performed a quarterly review of NMHSD's administrative expenses. They found that the State claimed reimbursement for salaries and benefits of ISD eligibility workers who were reportedly spending 100 percent of their time on a system implementation included in an APD that had not yet been approved. Since this is the same APD that FNS had not approved, this condition may also be occurring in the FSP.

HHS ultimately disapproved the APD, citing NMHSD's failure to obtain prior written approval, sole source acquisitions for contracting services, and failure to meet information requirements.

Because we notified them of these conditions, FNSRO conducted a separate review of the project. The review focused on establishing an acceptable methodology for allocating development costs and on determining project expenses (both paid and incurred) as of June 30, 2002. They determined that the State agency incurred total project costs of \$14.5 million (\$12.75 million in contractor costs and \$1.75 million in noncontractor costs) through June 2002. Of this amount, only \$3.8 million in contractor costs and \$0.5 million in noncontractor costs had been paid. In addition, about \$0.5 million in salaries and benefits had been paid. At the time of our review, FNSRO personnel were still conducting analyses to determine the extent that expenses may have been inappropriately charged to the FSP. Because of FNSRO's review, we did not expand our work to further identify unauthorized costs already charged by NMHSD.

EXHIBIT A – SUMMARY OF MONETARY RESULTS

FINDING NUMBER	RECOMMENDATION NUMBER	DESCRIPTION	AMOUNT	CATEGORY
1	1	Unauthorized Expenditure	\$8,663,130 ⁵	FTBPTBU ⁶ - Review of Contract or Grant Agreement
Total			\$8,663,130	

⁵ A portion of this amount may be recoverable based on FNSRO review (see Recommendation No. 2).

⁶ Funds to be put to better use.

EXHIBIT B – FNS' RESPONSE TO DRAFT REPORT



United States Department of Agriculture
Food and Nutrition Service
Southwest Region

JAN 23 2003

Reply to
Attn of: SWFS-203

Subject: Audit Findings

To: Robert E. Gray, Regional Inspector General for Audit

We have reviewed the draft audit report (27099-14-Te) dated December 18, 2002. Overall, we concur with your findings, recommendations, and general comments. However, the following edits should be made before the report is finalized.

- In Finding No. 1, page 4, the report reads "As a result, NMHSD incurred unauthorized project expenses of \$17,679,857 as of December 2002." The month of the year should be changed to "June 2002."
- In Finding No. 1, page 4, the report reads "NMHSD did not submit the APD to FNSRO for review and approval until April 2002." The month of the year should be changed to "February 2002."
- In Finding No. 1, page 5, the report reads "FNSSWRO became aware of the project in June 2001 and warned NMHSD in writing that, until the APD was approved, NMHSAD was potentially liable for all pre-award expenditures. The month of the year should be changed to "November 2001."

We have asked the State to revise the SF-269 (expenditure) reports for Fiscal Years 2000 and 2001. Also, we have asked the State to submit a revised budget and to provide additional information to support the cost allocation plan. Once we have reviewed this information, we will recover the appropriate funds. In addition, we have disallowed all contractor costs for the project and have disallowed all costs for the project prior to receipt of the official APD in February 2002.

If you have any questions, please contact Judy K. Barron, Food Stamp Program, Regional Director at (214) 290-9804.

A handwritten signature in cursive script, appearing to read "Esther Phillips".

ESTHER PHILLIPS
Acting Regional Administrator

cc: Albert M. McIlwain
Judy K. Barron

Informational copies of this report have been distributed to:

Regional Administrator FNS	(2)
Agency Liaison Officer	(3)
Office of the Chief Financial Officer	(1)
OCFO, Director, Planning and Accountability Division	(1)
General Accounting Office	(2)